

Sprint/T-Mobile: Despite Improved Regulatory Environment, DOJ, State AG Factors Render Full-Stop Challenge Antitrust Review's Most Likely Outcome

Deal Update

Given market, DOJ, and state AG dynamics, a merger of Sprint Corp. and T-Mobile US Inc. would face an uphill antitrust path to close.

Little has changed on the competitive merits since August 2014, when the companies abandoned merger talks in response to DOJ and FCC opposition. Fundamentally, then, a revived merger proposal amounts to a bet on the view that the regulatory environment has evolved to become substantially more receptive to their proposed tie-up.

In fact, primarily due to Ajit Pai's appointment as FCC Chairman, as well as the White House's potential willingness to intervene in enforcement matters, regulatory prospects for the deal have certainly improved over the past year.

However, important dynamics—including DOJ staff-level considerations—remain unchanged, according to interviewed attorneys familiar with DOJ telecom review. In addition, potential opposition from emboldened state AGs represents a nascent, underappreciated force. Given these factors, a Sprint/T-Mobile merger would face a difficult antitrust path, with—at least at first glance—a full-stop court challenge being the antitrust review's most likely outcome.

In-depth: DOJ, White House, and State AG Considerations

Cable entry marginally positive, but fundamental competitive issues remain. On the merits, the arguments for a Sprint/T-Mobile tie-up have improved marginally since 2014. The deal to reduce the number of national facilities-based wireless carriers from four to three, however, still raises significant, and—in DOJ staff's view—likely irresolvable, competitive issues.

The most substantial market development since 2014 involves cable's entry into the mobile wireless marketplace, where Comcast launched its Xfinity Mobile wireless product in May 2017, and Charter is expected to follow in the near-term. Even if insufficient to address competitive issues, cable entry may heighten prospects for a negotiated settlement, potentially through the combined Sprint/T-Mobile's commitment to provide Comcast and Charter a favorable, long-term, MVNO agreement.

The cable story, nonetheless, faces significant challenges. Comcast and Charter, at the moment, control a combined 0% share of the mobile wireless market. At least in the near-term, the companies will offer wireless service only as part of a bundle for broadband subscribers within their respective cable footprints, and there is no evidence that this bundle will constrain standalone wireless pricing. Comcast and Charter also rely on a competitor's network (Verizon) for their wireless product's voice component. And Comcast or Charter's entry, even if bolstered by an MVNO agreement with the merged entity, [provides](#) no real benefit to the millions of Americans residing outside of the cable companies' respective franchise areas.

With cable entry a plausible, but ultimately uphill, argument Sprint/T-Mobile faces the same fundamental structural problems as in 2014. From an effects perspective, T-Mobile continues to drive price and non-price competition industry-wide. And unlike 2014, when the company was the highest-priced national carrier and beset by ongoing

subscriber losses, Sprint has grown its subscriber count for two consecutive years, now offers the cheapest U.S. unlimited data plans, and competes aggressively on price and non-price factors.

More generally, wireless market dynamics show competition clearly on the upswing. Consumer wireless prices, for example, [fell](#) 13% in the past year. Industry average revenue per user—a proxy for consumer pricing—[declined](#) from \$45.63 in Q4 2013 to \$35.93 in Q4 2016. Although the parties will emphasize their deal’s substantial cost synergies, as well as the significant capital expenditure required for investment in 5G, these purported efficiencies are fundamentally the same arguments that enforcers rejected in 2014.

DOJ staff dynamics, litigation risk factors largely unchanged. Despite the fact that Sprint and T-Mobile never formally notified their proposed 2014 combination to DOJ, Antitrust Division staff nonetheless conducted an in-depth analysis of the deal, going so far as to prepare a draft complaint to enjoin the merger in court. Given broadly unchanged market and staff-level dynamics, the parties will face an uphill climb in reaching a different result for their revived transaction.

DOJ staff, including the Telecommunications and Media Enforcement (TEL) Section attorneys charged with reviewing mobile wireless consolidation, view blocking the AT&T/T-Mobile transaction as a move that subsequent developments have strongly vindicated, and may therefore harbor a strong bias against disturbing the status quo. “AT&T/T-Mobile was a real antitrust success story,” says one ex-DOJ attorney. “Everything that’s happened in the market confirmed the virtue of that decision,” a second former DOJ attorney adds.

Importantly, DOJ’s 2011 AT&T/T-Mobile complaint focused primarily on coordinated effects. Put differently, the Division’s objection to the deal rested largely on the four to three dynamic, rather than unilateral effects flowing from the combination of AT&T and T-Mobile specifically. In fact, due to convergence in handset offerings and network coverage, mobile wireless carriers’ offerings are arguably even less differentiated—and therefore the market more vulnerable to coordination—today than in 2011. Theory aside, the fact that AT&T and Verizon shares [spiked](#) on the September 19 news that Sprint/T-Mobile had re-engaged in merger talks will do little to dissuade DOJ staff that a deal to combine the two low-price national carriers will do anything but diminish post-merger price competition.

Importantly, despite some turnover at the trial attorney level, TEL Section management is unchanged since the 2014 Sprint/T-Mobile review. Scott Scheele continues to serve as the Section’s chief. And Larry Frankel and Jared Hughes, who were each with the Section for the AT&T/T-Mobile and Sprint/T-Mobile reviews, likewise remain the Section’s Assistant Chiefs.

Another dynamic that has not changed over the past three years is a DOJ lawsuit’s litigation prospects. Now, as was the case in 2014, DOJ would be a favorite to prevail in court on a suit to block the merger. Mobile wireless—in both national and local geographic markets—is almost certainly a valid product market. And the deal would significantly increase concentration in the already highly concentrated national wireless market, with even stronger structural case in many local markets.

Although this does not end the analysis, when the agencies establish this type of *prima facie* case, they almost always win in court. Such an outcome may be especially likely here, given that the cable entry story faces significant, potentially irresolvable, weaknesses, and that the efficiencies arguments on which Sprint and T-Mobile will rely have an extremely poor track record in court.

Adding to this dynamic, DOJ staff is notably litigation-ready, as the Division's substantial number of litigated merger challenges over the past 24 months have provided the agency with an unusually strong and deep litigation bench. And given these personnel, litigation, and merits factors, a staff recommendation for a full-stop injunction to the tie-up represents, at least at first glance, DOJ review's most likely outcome. "It's a real uphill slog, at least on the staff level," notes the ex-DOJ attorney.

DOJ front office turnover marginally positive, but impact may be overstated. To overcome staff-level opposition, Sprint and T-Mobile would rely on the Antitrust Division's front office to reject a staff recommendation, as well as the Ajit Pai-chaired FCC to approve the merger, or, at the very least, delay a decision until a court decision on a DOJ lawsuit.

As it relates to the FCC, this appears a plausible scenario. To be clear, FCC staff, like DOJ staff, believes in a four-firm mobile wireless marketplace and strongly supported then-FCC Chairman Tom Wheeler's opposition to the 2014 Sprint/T-Mobile proposal. However, sources view current FCC Chairman Pai as extremely favorable to the business community, and consolidation, more generally, "a 180 degree difference in terms of what Wheeler had," says the second former DOJ attorney.

In practice, DOJ is the expert agency in competition policy, and the Pai Commission may avoid front-running a DOJ decision by approving the merger during the pendency of the Division's antitrust review. Instead, the more likely outcome is that the FCC simply pauses its review in response to any DOJ lawsuit, rather than pursuing a follow-on designation for hearing that would effectively kill the deal.

Given these FCC dynamics, the ultimate enforcement call will reside with Antitrust Division AAG Makan Delrahim, who the Senate confirmed on September 27. At least on the margins, Delrahim is a better draw for the parties than former AAG Bill Baer, who opposed the 2014 Sprint/T-Mobile tie-up.

In that same respect, however, the likelihood that Delrahim will adopt a substantially different approach than his predecessor is likely overstated. The case against the deal rests on a straightforward horizontal theory of harm, of the type both Democratic and Republican antitrust enforcers have historically embraced. And litigation risk, typically a paramount front office concern, is relatively limited here, given the strong *prima facie* structural case against the merger.

Ultimately, Delrahim is likely to adopt a relatively mainstream approach to antitrust enforcement. In addition, by virtue of his tenure as a Deputy AAG from 2003 to 2005, Delrahim harbors institutional loyalty to the Division and experience working with staff. "You're dealing with someone that likes the institution," says the first ex-DOJ attorney. "If he thinks there's a good case, he'll bring it," the attorney adds.

To be clear, for the front office to reject a staff recommendation—especially in a Republican administration—is not unheard of. That said, internal DOJ dynamics may also play a role in Delrahim's decision process. As Sprint/T-Mobile would be the first high-profile merger review Delrahim would oversee from start to finish, rejecting a recommendation involving staff's years-long support of a four-firm marketplace could drive internal tension, and staff morale issues, right off the bat. Delrahim, a savvy political operator, will work to avoid such an outcome and, instead, may view endorsing a staff recommendation as a way to build up his front office's credibility at his tenure's outset.

Political factors may limit prospect of White House interference. At least implicitly, some optimism around the Sprint/T-Mobile deal's clearance odds rests not on internal DOJ factors, but rather on the prospect of White House intervention.

President Trump is clearly [more](#) willing than his predecessors to interfere in individual law enforcement matters and, at least from outward appearances, open to a transactional approach to merger reviews. Given this context, Softbank CEO Masayoshi Son's December 2016 visit to Trump Tower, and subsequent promise to invest \$50 billion in the U.S. to create 50,000 jobs, may be viewed as a move to clear government roadblocks to wireless industry consolidation. The fact that Delrahim is the first AAG in recent memory to enter the Antitrust Division directly from the White House lends further support to the idea that if the President attempts to muscle the deal through, Delrahim may accede to such a request.

This view, however, assumes that not only would Delrahim—already under close scrutiny from Senate Democrats around White House interference in enforcement matters—accept such an outcome, but also that the White House would actually intervene to move a deal across the finish line. Given the overarching political dynamics at play, however, the likelihood of such an outcome appears somewhat overstated.

At the outset, a Sprint/T-Mobile merger could lead to substantial U.S. job cuts. The parties, of course, will almost certainly pair any deal announcement with optimistic employment projections tied to ostensibly deal-specific capital investment or repatriated call centers. Intuitively, however, the transaction—even if accompanied by unenforceable jobs commitments—would in all likelihood reduce aggregate employment in the medium-term.

More broadly, the deal to endorse an entity controlled by Japan's SoftBank Group Corp and Germany's Deutsche Telekom appears at some tension with the White House's nationalist rhetoric. Fundamentally, the prospect of a German-Japanese concern consolidating a mobile wireless market in which the average American household spends about \$1,074 per year faces uncertain political prospects.

Given increasing skepticism of corporate consolidation on both the right and left, consumer and public interest opposition to the deal could prove substantial. The merger also faces the threat of labor union pushback, where the CWA's historically antagonistic relationship with T-Mobile could create unwelcome dynamics of U.S. labor going to war with Japanese and German conglomerates. "If you're a foreign multinational, you really don't want CWA to gear up against you," a public interest source notes.

Finally, the deal comes in an environment in which the Democratic Party has positioned heightened antitrust enforcement as an increasingly high-profile issue. The deal will attract loud Democratic opposition and is perhaps sufficiently visible that it could—at least on the margins—turn into a legitimate campaign talking point in 2018. Given these factors, it is not clear that the White House will ultimately take the extraordinary step of interfering in the DOJ process on the merger's behalf.

Emboldened state AGs an underappreciated risk. Although the possibility that the White House will actually intervene in DOJ's Sprint/T-Mobile investigation is likely overstated, a second outside force—newly emboldened state AGs—are poised to play an underappreciated role in DOJ's review.

State AGs have expressed a post-election willingness and intent to step up antitrust enforcement to fill in potential gaps at the federal level. At a December 16, 2016 *Capitol Forum* [conference](#), for example, New York AG Antitrust

Bureau Chief Beau Buffier said that state AGs stood ready and willing to litigate problematic mergers the Trump administration had cleared.

California's recent lawsuit to enjoin the Valero/Plains All American Pipeline transaction, which the FTC cleared over some staff opposition, is an indication that this is more than just empty rhetoric. And the litigation's [outcome](#)—the parties abandoned their deal after the court's preliminary injunction decision—will heighten state AGs' conviction in their ability to litigate effectively, and credibility in threatening to do so.

Especially in more active and better-resourced blue state AGs' offices, the Sprint/T-Mobile deal will face substantial headwinds. This is partly due to political factors: with the hawkish approach to corporate consolidation articulated in leadership's "Better Deal" plan, politically ambitious Democratic state AGs will view anti-consolidation as winning political positioning. And from a merits perspective, Sprint and T-Mobile are typically strongest in urban centers, meaning that deal-driven concentration increases and competitive effects will be most pronounced in Democratic-skewing metropolitan areas.

Given these factors, a consortium of state AGs may have the resources and political will to not only advocate aggressively for a DOJ lawsuit, but even to threaten an independent challenge if DOJ front office clears the deal over staff objections. The highly public Trump/Son relationship could amplify these dynamics—even if the White House places no pressure on Antitrust Division leadership whatsoever, the perception of political interference in the investigation will linger.

A state AG consortium's move to independently file a lawsuit against such a highly visible deal would create embarrassment for both the Antitrust Division, and AAG Delrahim specifically, especially if the states were to prevail in court. And fundamentally, given this dynamic, potential state AG pressure is yet another factor that could ultimately lessen the front office's willingness to overrule DOJ staff.

Sprint and T-Mobile declined to comment on potential antitrust issues around their transaction.