

Sen. Kohl's Follow-Up Questions for the Record for Hearing on

"The Verizon/Cable Deals: Harmless Collaboration or A Threat to Competition and Consumers?"

For Joel Kelsey

1. One thing that competitive wireless companies require is what is known as "special access" or "backhaul" – access over wired phone lines from cell phone towers to long distance phone and Internet networks. For years, the competitive wireless companies have complained about what they see as very high prices for special access from incumbent phone companies such as Verizon and AT&T. One way around the incumbents is to contract with the cable companies for special access. Do you have any concerns that this deal will change the incentives of cable companies to provide special access?

Yes. There are only two wired ecosystems in the United States – cable companies and telephone companies. Access to the Internet backbone, which is necessary to provide consumers with Internet service, is wholly dependent upon relationships with the companies that own these "on ramps".

The "special access" rulemaking proceeding at the Federal Communications Commission is full of evidence demonstrating the severe lack of competition in this market for special access or other dedicated high-capacity connections. This has allowed Verizon and AT&T, the two dominant incumbent local exchange carriers, to favor their own wireless affiliates, charge supra-competitive rates and impose onerous contracts on their smaller wireless competitors who have no alternatives for special access lines. Cable companies have demonstrated some interest in competing more aggressively in this space (albeit in a geographically limited fashion); however that interest is now dampened as a result of this proposed transaction.

In the proposed transaction, cable providers serving 75 percent of the U.S. market have partnered with Verizon, creating considerable risk that the small amount of competition that exists in the market for backhaul transit will be significantly weakened.

2. In his March 8 Politico interview, David Cohen said that one of the reasons Comcast decided not to enter the wireless business was the presence of insurmountable hurdles like roaming – which he described as "next to impossible" to secure. If roaming is next to impossible for a company like Comcast to secure, what does that say about the ability of smaller carriers to effectively compete with Verizon?

Terrestrial based cable companies are in the best position to enter the wireless market. They have expertise in providing a retail product, they have a broad consumer base that already subscribes to their monthly services, they have their own fiber infrastructure to provide backhaul within their footprint, and established business relationships with telecom transit providers outside of their footprint.

The inability of these companies to offer facilities based competition in the wireless market illustrates significant barriers to entry, and underscores a deep structural problem with competition in this marketplace. This is very troubling given the trend towards a duopoly market

that the Department of Justice and the Federal Communications Commission identified in their rejection of the AT&T / T-Mobile merger.

What is most interesting in this transaction is that the cable companies involved have signaled that their entry into the wireless market is inevitable. Even if the costs of building out their own infrastructure are prohibitive, cable companies could still enter the wireless market in other ways that strengthen, rather than lessen, competition. For example, they could have leveraged SpectrumCo's licenses to partner with a non-dominant wireless carrier like Clearwire or T-Mobile, buying wholesale access to their network and offering cable subscribers wireless service at rates, terms and conditions that are competitive to Verizon or AT&T.

However, under these agreements, the companies are not re-selling access to wireless services under competitive rates, terms and conditions. They are merely acting as sales agents, signing their own customers into Verizon Wireless' two-year contracts in exchange for an assurance they won't face competition from Verizon FiOS in the monthly video and broadband at-home market.

3. One very interesting facet of this deal is its timing. Verizon's deals with the cable companies were announced last December, just days before AT&T and T-Mobile announced that they abandoned their proposed merger. Some industry observers suspect that these deals were deliberately reached at a time when T-Mobile was not free to bid on this spectrum. T-Mobile's FCC filing states "it is likely no coincidence that Verizon Wireless signed this deal while the AT&T/T-Mobile transaction was still pending, so that T-Mobile was unable to compete to purchase this spectrum." What is your view? Do you believe that the timing of the deal had anything to do with Verizon Wireless's desire to keep this spectrum out of the hands of competitors such as T-Mobile?

While it's hard to know all the drivers behind the decisions of the various companies that have entered into this multi-faceted transaction, the timing suggests Verizon Wireless was motivated at least in part due to the foreclosure value of keeping this spectrum from its competitors.

The DoJ has pointed out that because of the important role spectrum plays in the investment strategies of wireless carriers, the value of that spectrum to incumbent providers is increased. The private value of spectrum for an incumbent in a given market includes not only the revenue from use of the spectrum but also foreclosure value -- the benefits gained by preventing rivals from using that spectrum to erode the incumbents' existing businesses. Therefore, even though a carrier may not need spectrum to meet an immediate demand, it has significant incentives to keep that resource away from its would-be rivals. This represents the private value of the spectrum to an individual company, and not the public value of spectrum to the public or the US economy.

Indeed, that appears to be the case in this transaction. The companies seeking approval for this transaction freely admit that "Verizon Wireless has sufficient spectrum to meet its immediate needs, and generally to meet increased demand in many areas until 2015," and the record in the FCC proceeding is replete with evidence that Verizon is well positioned even after this time period.

Purchasing this spectrum is not the only way Verizon can meet increasing consumer demand for data, but it is the only way it can foreclose its competitors from providing a serious competitive threat by offering lower-cost high-speed mobile services.

4. The FCC has a test for evaluating acquisitions of spectrum, what they call the “spectrum screen.” Verizon Wireless points out that this deal falls under the FCC’s thresholds in 121 of the 136 markets in the transaction. Should that settle the question for those markets? Do you believe the spectrum screen – first developed in 2001 – is adequate to evaluate spectrum acquisitions today? Why or why not?

First, it’s important to keep in mind that the spectrum screen is not a bright line test that pre-determines the reaction of the Commission in any given transaction. Rather, like the Herfindahl-Herschman Index in the anti-trust context, the spectrum screen acts as a guide post to instruct the Commission when a transaction has the potential of significantly lessening competition.

In fact, in several instances the Commission has actually *changed the screen* during a transaction. In the past, it has always raised the screen to permit license transfers that have driven a dis-proportional amount of valuable spectrum to the two companies with the largest market share.

However, the screen is inadequate to measure the advantage that valuable spectrum gives to the nation’s largest wireless carriers.

Each band of spectrum in each local market has unique characteristics that result in no two identically sized blocks holding identical value. These differences are due in part to the propagation characteristics of the spectrum — how far they can carry a signal and how well that signal can penetrate buildings and terrain.

As with property, the location of broadband spectrum is the main driving force of its value. Unfortunately, the screens that the FCC uses to measure spectrum holdings don’t measure this dynamic. These antiquated screens are out of date — they measure only for the square footage of holdings (the amount of Mega-Hertz, or MHz) and fail to acknowledge whether the spectrum holdings are beachfront, beach adjacent, or have only a beach view.

Without access to a sufficient amount of high-quality spectrum, a wireless company cannot offer first-class wireless services. It cannot scale its business in a cost-efficient way, or keep up with growing consumer demand for wireless data. Spectrum, particularly highly valuable spectrum, is the input market on which the entire wireless industry is built.

When policymakers weigh whether or not this transaction will harm competition or benefit the public interest, they must look across the wireless marketplace and ask questions about the future prospects for competition and how they will be impacted by this deal.

Any analysis of this transaction must take into account the value of the spectrum being sold in order to adequately examine the concentration of market power that results from this deal. Simply counting the total MHz of available spectrum held by any one carrier provides an inaccurate and distorted portrait of market power.

An analysis of the spectrum holdings most valued for providing mobile data services reveals a significant imbalance in ownership. Currently two companies — AT&T and Verizon Wireless — hold a disproportionate percentage of beachfront spectrum, with Verizon alone controlling one-third of the spectrum best suited for nationwide mobile broadband.

Free Press attempted to provide a perspective of spectrum market share at the national level, based on value by constructing a weighting scheme based on the book value of spectrum holdings reported to the SEC, recent auction prices, and recent prices reported on the secondary markets. The result can be seen in the table on page 8 of my written testimony.

Using this approach, we observe that if these applications are approved, Verizon will control fully 35 percent of all value-weighted mobile broadband spectrum. If a more finely tuned valuation methodology is used by the expert federal agency to assess market shares, this level of control over the spectrum input market would clearly be considered “moderately concentrated” by DoJ standards, and should raise red flags at the Department and the FCC. Given the highly concentrated nature of the overall wireless market, the FCC and the DoJ must conclude that this transaction would significantly weaken future prospects for meaningful wireless competition.

5. Verizon and its cable partners have agreed to establish a joint venture to develop technologies to integrate wireless and wireline services – creating seamless Internet connections between consumers’ TVs and their cell phones or iPads. This has raised concerns because this means that top executives from the companies to these deals – competitors for pay TV customers – will meet regularly and work very closely together and in ways that could compromise their current or future competition. Investment in technology is generally good for consumers, but the concern here is that the joint venture will develop proprietary technology, and limit its content to platforms meeting standards set to that proprietary technology. Or, it might eliminate the parties incentives to compete against each other for future products and services. What’s your view? Are you worried about the joint venture being used to disadvantage competitors?

Yes. The joint-operating entity agreements have been described as collaborations to develop integration technology.

The entities involved in this transaction possess significant aggregate market power, so engaging in cross-licensing schemes should trigger anti-trust concerns because the likelihood these companies will exclusively deal with one another to exclude potential competitors is heightened.

We view the JOE’s as an attempt by the companies involved to control the pace of innovation. Consumers have some experience in past regimes like these that have dampened incentives for innovation and held back transformative technology from becoming more ubiquitous. The cartel-like agreement between cable companies to create “Cable Labs”, for example, prevents new devices from being more readily available to consumers. Acting as a gatekeeper to the broader marketplace, Cable Labs has prevented electronics manufacturers from designing universal devices that would allow consumers to navigate through video through both cable platforms, IP-enabled platforms like Netflix, or DVDs.

Much of the transformative nature the Internet is derived from the fact that it represents a universal language. Every Internet-enabled device can read TCP/IP and every network is designed to transmit data in this format. This “integration technology” to hand traffic off from

various wired and wireless networks is being designed by only a few of the largest broadband providers in the country. There is no guarantee that providers on the outside of this club will have access.