Hearing On "The AT&T/T-Mobile Merger: Is Humpty Dumpty Being Put Back Together Again?"
May 11, 2011

Follow-Up Questions

Responses of Daniel Hesse
CEO, Sprint Nextel Corporation

Follow-up Questions of Senator Patrick J. Leahy
Chairman, Senate Judiciary Committee

1. **Will consumers benefit from AT&T's acquisition of T-Mobile?**

No. Consumers will not benefit if AT&T is permitted to takeover T-Mobile. The transaction would eliminate T-Mobile, the fourth largest wireless provider, and create a Twin Bell duopoly that would control 82 percent of all U.S. contract subscribers, approximately 78 percent of all wireless industry revenues, and 88 percent of wireless industry operating profits. Essentially, the U.S. wireless marketplace would return to the structure we had almost two decades ago when each cellular market had two operators and before the PCS spectrum auctions allowed multiple facilities-based carriers to create the lower prices and industry growth we have enjoyed in recent times. If the government does not block the merger, the Twin Bell dominated wireless market will revert to higher prices, less choice, and less innovation.

2. **In what ways might AT&T's acquisition of T-Mobile benefit consumers?**

Consumers will not benefit if the government allows the takeover to proceed. AT&T and T-Mobile have made a variety of unsubstantiated claims that their takeover of T-Mobile will benefit consumers, for example by allegedly allowing AT&T to deploy LTE to 97 percent of the U.S. population. However, every one of AT&T's asserted benefits can be achieved by AT&T without creating a Bell duopoly. If AT&T invested only a portion of the $39 billion takeover price tag in improving its network and putting into service its substantial fallow spectrum holdings, it would be able to upgrade its current network, which already covers 97% of the population, to LTE. In any event, AT&T's takeover of T-Mobile would cause far more consumer harm than might be offset by any possible consumer benefits.

3. **In what ways might AT&T's acquisition of T-Mobile harm consumers?**

If the government allows the U.S. wireless market to be dominated by two vertically integrated Twin Bell companies, wireless consumers would face higher prices, less choice, and less innovation. Because of their market dominance and inherited control of the nation's wireline infrastructure, the Twin Bells would have the ability and incentive to (1) raise consumer prices, (2) raise the remaining competitors' costs by increasing the

prices on backhaul, roaming, and other inputs that competitors must purchase from AT&T and Verizon, and (3) lock-up exclusive arrangements with handset manufactures and applications innovators to ensure smaller rivals can't compete with quality or innovation. The remaining wireless competitors simply would not be able to discipline pricing or drive innovation, and consumers would pay the price.

Follow-up Questions of Senator Charles E. Grassley

At both the hearing and in your written testimony you stated the proposed merger is a bad idea and will lead to a "1980s-style duopoly." You claim that if the transaction is blocked, "wireless competition will thrive and competition . . . will continue to drive investment, innovation, consumer choice, and U.S. global leadership in wireless communications."

1. **How will the status quo lead to more innovation and competition given the concerns AT&T raise, such as spectrum challenges?**

The government should reject AT&T's bid to take over T-Mobile. Doing so would preserve and extend the nearly two decades of robust competition in the wireless industry – competition that has promoted economic growth and ensured U.S. global leadership in mobile communications. Currently, the relative shares and scale of industry players allow independent companies, like Sprint and T-Mobile, to drive down prices and compete with quality and innovation.

To be sure, meeting consumer data demands present a challenge, but all carriers face this issue. As long as the market remains competitive, carriers will have the incentive to innovate and overcome these challenges. For example, Sprint is currently investing heavily in "Network Vision" -- an innovative project where Sprint is upgrading our cell towers with state of the art multi-mode, multi-band equipment -- to squeeze even more out of Sprint's existing spectrum.

AT&T could better manage the growing traffic on its network, just as its competitors do. But AT&T has lagged the industry in network investment for years, nearly half of the spectrum it currently holds remains idle, and AT&T has avoided migrating its customers from last-generation technologies to more efficient next-generation technologies. By investing a fraction of the takeover's $39 billion price tag in innovation, network build out, and putting its warehoused spectrum to work, AT&T could overcome any network congestion challenges it may face.

2. **How will the proposed merger impact, if at all, the services Sprint provides to regional carriers as well as its agreements with regional carriers?**

Sprint will continue to provide roaming services to regional carriers that use CDMA technology. To the extent the merger further enables the Twin Bells to increase Sprint's costs of service, however, those costs will be passed along to regional carriers. Moreover, many regional carriers rely upon GSM technology Sprint does not offer.

Allowing the merger would create a nationwide GSM monopoly in AT&T that would severely restrict roaming options for regional GSM carriers. These regional carriers are likely to face significantly increased roaming expenses with the elimination of T-Mobile as an alternative roaming partner.

Likewise, CDMA based regional carriers would be affected negatively if the merger is approved. The resulting vertically integrated Twin Bell duopoly would control more than 88 percent of wireless industry operating profits and control the nation's wireline infrastructure. Sprint is heavily dependent on the Twin Bells for special access backhaul and other inputs to Sprint's services. The Twin Bells would have both the incentive and ability to raise Sprint's costs, which in turn will mean increased costs for regional carriers that rely on Sprint for CDMA roaming coverage.

These regional carriers likely would face direct cost increases as well. Sprint and T-Mobile together provide a nascent market for alternative backhaul providers. By simultaneously gaining scale and eliminating T-Mobile as a potential purchaser of alternative backhaul, however, AT&T would increase its ability and incentive (and Verizon's ability and incentive) to raise the prices they charge the local and regional carriers for backhaul.

Finally, the impact to the handset market likely would be substantial on regional carriers. The Twin Bell duopoly would have dramatic advantages in scale and the ability to lock up handsets or maintain a "first to market" advantage over all smaller carriers, including regional carriers.

Follow-up Questions of Senator Herbert H. Kohl

1. **Is T-Mobile generally viewed as the price leader among the four largest national cell phone companies? Does Sprint often respond to T-Mobile's offers when deciding how to price and market its services? What do you think the absence of T-Mobile would mean for price competition in the cell phone industry?**

T-Mobile is unquestionably a price leader among the four national carriers, and Sprint and T-Mobile compete vigorously. Not only does Sprint respond to T-Mobile's offers, but the FCC found in their 14th Mobile Wireless Competition Report that T-Mobile's decision to lower the prices on its unlimited calling plans "appear[s] to have prompted Verizon and AT&T to narrow the price premium on unlimited service offerings."

The current industry structure permits T-Mobile to exert significant downward price pressure on the entire national market. By simultaneously gaining enormous scale and eliminating T-Mobile as a competitor, AT&T's takeover would dramatically restructure the wireless industry in a way that would undermine price competition. The Twin Bell duopoly, with control 82% of contract customers and control over the nation's wireline

network, would be free to raise consumer prices, increase the remaining competitors' costs, and freeze competition through innovation.

2. **In its FCC filings regarding this merger, AT&T argues that T-Mobile is not a "close competitor." What's your view of this claim? From your perspective as the CEO of one the four national cell phone companies, do you think AT&T competes with T-Mobile? Why or why not?**

AT&T and T-Mobile, as the only two national carriers using GSM technology, are close competitors. T-Mobile consistently out-performs AT&T on customer service, it offers lower pricing for handsets and services, it claims to have upgraded more of its network for high speed data services than AT&T, it has helped develop and launch new innovative handsets such as the first android phone sold in the US, the T-Mobile G1, and it engages in aggressive advertising against AT&T. AT&T's proposed takeover would eliminate its sole national GSM rival and silence its biggest advertising critic.

3. **Sprint has argued that access to spectrum is a problem after this merger, and that AT&T and Verizon will have the lion's share of available spectrum. However, AT&T argues in its FCC filing that Sprint has an "exceptional spectrum position [in 4G], which is far stronger than AT&T's today." In fact AT&T quotes you as saying that "when you combine Sprint's spectrum position with Clearwire's spectrum position it puts us in the strongest place for the future." How do you reconcile this statement with your concerns about the merger?**

Sprint has a strong spectrum position, and our investment in Clearwire has allowed Sprint to be the first carrier to roll out true 4G service. Sprint expects to continue to squeeze the most out of its spectrum. But comparing Sprint's spectrum holdings with the unprecedented aggregation of choice spectrum AT&T is proposing to accumulate is like comparing prime rib to hamburger.

If AT&T were to add T-Mobile's spectrum on top of its already-pending acquisition of Qualcomm's spectrum assets, AT&T would hold a nationwide, population-weighted average of 165 MHz of spectrum – an amount nearly *double* Verizon's spectrum position and more than *triple* Sprint's spectrum position.

AT&T would also have a qualitative spectrum advantage. Virtually all the spectrum AT&T holds and plans to acquire is below 2 GHz, which makes a sound choice for providing wireless broadband; moreover, a significant portion of the spectrum AT&T already holds is prized spectrum below 1 GHz -- the prime cut.

By comparison, Clearwire's 2.5 GHz spectrum, which Sprint currently resells to provide 4G services, suffers from a multitude of technical, licensing, and regulatory issues that make it far more challenging to use for wireless broadband. In addition, a majority of Clearwire's spectrum is not licensed to Clearwire at all. Roughly 60% of Clearwire's average nationwide spectrum is licensed to schools and universities in the Educational

Broadband Services (EBS). Clearwire leases this spectrum for limited terms from the educators, who must retain capacity to meet certain educational service requirements, among other mandates.

Perhaps the best way to understand the differences both in propagation and regulatory environment between the "beachfront" 700 MHz band that AT&T holds and Clearwire's 2.5 GHz spectrum is to look at the market price for these different spectrum bands. In its 2007 transaction with Clearwire, Sprint received only $0.17 per MHz Pop in return for its 2.5 GHz holdings. By contrast, AT&T paid more than six times as much ($1.06 per MHz-POP) for Aloha Partners' 700 MHz spectrum in 2007, paid more than thirteen times as much ($3.15 per MHz-POP) during the 2008 700 MHz band auction, and is set to pay more than five times as much ($0.87 per MHz-POP) for Qualcomm's 700 MHz spectrum.

4. **I understand that you oppose the merger and believe that it should be blocked. However, if the Justice Department and FCC do not decide to block it, are there any conditions that you think they should impose in order to approve the merger?**

There are no conditions that would fix this merger. AT&T may offer up an assortment of voluntary concessions and conditions to try to make its takeover more palatable to the government. For AT&T, the chance to gobble up its only national GSM competitor while silencing its most vocal advertising critic is far too tempting to pass. But any conditions that DoJ and the FCC might impose would simply be tinkering at the edges.

AT&T's takeover of T-Mobile will precipitate a fundamental shift in the structure of the wireless market. The post-merger market would be dominated by two vertically integrated Twin Bell companies with the power and incentive to raise consumer prices, raise the remaining competitors' costs by increasing the prices on backhaul, roaming, and other inputs, and block competitors from competing with quality or innovation. Government tinkering cannot right the structural flaws inherent in such a lopsided market.

Follow-up Questions of Senator Michael S. Lee

1. **Some of the public comments you have made in recent weeks seem to suggest that Sprint would not survive this merger. Is this your position?**

Sprint would continue to compete aggressively in any environment. However, the relative size of Verizon and AT&T, along with their control over inputs like backhaul and roaming, as well as their ability to dominate the handset market, would limit severely Sprint's ability to discipline pricing and innovate in the wireless market.

2. **Sprint is currently the third-largest mobile wireless service provider, has recently increased its subscriber base, scores well in customer satisfaction surveys, offers a wide array of popular handsets that use Google software,**

was the first to market with a 4G product, and offers aggressively priced unlimited data plans. What obstacles stand in the way of Sprint continuing as a robust and effective competitor in a post-merger market?

Sprint has made tremendous strides in improving customer service, network performance, and device line-up, and the current competitive market has begun to reward us as consumers have started switching back to Sprint. Even in today's market, however, Sprint faces significant challenges, in part because Sprint is required to pay AT&T and Verizon for backhaul and termination on the wireline networks they inherited from Ma Bell. Sprint will continue to compete vigorously in the market even if the takeover gets government approval. In a market dominated by the Twin Bells and without T-Mobile, however, the Twin Bells would be able to simultaneously increase Sprint's costs by increasing the prices on backhaul, roaming, and other inputs and discourage handset manufactures and application innovators from partnering with Sprint. Sprint would find it increasingly difficult to discipline the Twin Bell pricing and develop industry leading handsets as it gets squeezed by the Twin Bells.

3. **Some analysts argue that, especially in light of the relationship Sprint has with Clearwire, your spectrum position and potential is the best of the major carriers. Is there anything about your spectrum holdings and opportunities that would limit Sprint's ability to continue to compete as a major nationwide wireless carrier?**

In partnership with Clearwire, Sprint became the first nationwide carrier to introduce 4G services and with the introduction of our iconic EVO 4G and Epic smartphones, Sprint has gained an edge on our competitors in attracting 4G customers. In a balanced, competitive wireless market, Sprint expects to continue to be able to compete as a major nationwide carrier. That is not to suggest that Sprint will not be required to overcome challenges to continue to be competitive.

Clearwire's 2.5 GHz spectrum, which Sprint uses to provide 4G services, suffers from a variety of technical, licensing, and regulatory problems and is far more troublesome than the prime 700 MHz spectrum Verizon uses and AT&T plans to use for 4G. If the government permits AT&T to acquire Qualcomm's 700 MHz spectrum and takeover T-Mobile's attractive PCS and AWS spectrum, which is also choice spectrum, Sprint would be at a serious spectrum disadvantage as compared to the Twin Bells. Excluding the local and regional players, the Twin Bells would have 85% of the spectrum below 1 GHz; Sprint would have 15%. The picture is not much better above 1 GHz. Again, excluding the local and regional players, the Twin Bells would have 79% of the spectrum; Sprint would have 21%, excluding spectrum held or leased by Clearwire. The competitive challenges in achieving scope and scale sufficient to compete in a market dominated by the Twin Bells would, of course, only exacerbate the spectrum disadvantage Sprint would face.

4. **Sprint is one of the primary voices opposing the merger regardless of restrictions or conditions the DOJ or FCC may require. In your view, why**

would spectrum divestitures, data roaming requirements, or other potential conditions fail to make the merger workable and keep the wireless market competitive?

The problem with trying to address the anticompetitive effects AT&T's proposed takeover of T-Mobile would create with conditions like spectrum divestitures and roaming requirements is that conditions are not effective tools when the overall market structure is incapable of supporting competition. Divestitures can be an excellent tool for government when a merger that might otherwise enhance competition would raise competitive concerns in only a handful of locales. Other conditions can sometimes temporarily address failures in a particular product market or address other concerns in the context of a transaction that is otherwise good for competition.

AT&T's takeover of T-Mobile, however, is not good for competition. The takeover would fundamentally change the U.S. wireless market by creating a vertically integrated Twin Bell duopoly. The competitive harms this market structure would cause are enormous, pervasive, and not limited to particular communities or isolated product markets. There are no genuine enhancements to competition that might be brought about by this merger. Any conditions the government might impose on AT&T would do little more than delay the inevitable decline in competition, increase in prices, and stifling of innovation that would result from a market structure dominated by a Twin Bell duopoly.

5. **In your mind, what are the benefits of having T-Mobile as a separate competitor**?

T-Mobile and Sprint are independent competitors that bring balance and competition to the wireless market. T-Mobile, as AT&T's sole nationwide GSM competitor and a price leader and innovator, puts significant downward pressure on nationwide prices and forces its competitors to innovate to compete. As a GSM carrier, T-Mobile competes with AT&T on handsets and international roaming. T-Mobile sports highly regarded customer service, low prices for handsets and services, an upgraded HSPA+ network and aggressive advertizing. Together, as two large independent nationwide carriers, Sprint and T-Mobile provide a market for alternative backhaul providers that helps place at least some price pressure on the Twin Bells for these services. Simply put, the U.S. wireless market is more competitive with independent competitors pressing the vertically integrated Twin Bells than it would be if AT&T absorbs T-Mobile.

6. **If the outcomes that you suggest will come about as a result of this merger—relating to higher prices and diminished service offerings—are unappealing to consumers, why wouldn't that increase the likelihood that Sprint would be able to increase its market share and attract new customers?**

In the short run, Sprint might gain some customers from the ranks of the dissatisfied. But in a market dominated by vertically integrated Twin Bells, Sprint's advantages would swiftly be eliminated by the Bells. If approved, the takeover would create a vertically integrated Twin Bell duopoly that would control more than 88 percent of wireless

industry operating profits and control the nation's wireline infrastructure. In an industry in which economies of scale are critical, the Bell companies would hold a significant advantage over Sprint.

In addition, because of their market dominance and inherited control of the nation's wireline infrastructure, the Twin Bells would have the ability and incentive to raise their own prices, and simultaneously prevent Sprint from competing on price by raising Sprint's costs. The Bells would have the ability to achieve this by increasing the prices on backhaul, roaming, and other inputs Sprint and the remaining competitors must purchase from AT&T and Verizon.

Finally, because of their enormous scale, AT&T and Verizon would have the ability to lock-up exclusive arrangements with handset manufactures and applications innovators to prevent Sprint from competing on quality or innovation. At the end of the day, disenfranchised customers might like to vote with their feet, but would have nowhere to go.