

August 23, 2011

VIA ECFS

Marlene H. Dortch, Esq.
Secretary
Office of the Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Notice of Ex Parte Presentation: *In re Applications of AT&T Inc. and Deutsche Telekom AG for Consent To Assign or Transfer Control of Licenses and Authorizations*, WT Dkt No. 11-65

REDACTED - FOR PUBLIC INSPECTION

Dear Ms. Dortch:

On August 19, 2011, Professor Dennis Carlton of the University of Chicago and Compass Lexecon, Dr. Mark A. Israel and Bryan Keating of Compass Lexecon, along with William R. Drexel, Joan Marsh, James Meza III, and Gary Phillips of AT&T Inc. (“AT&T”); Richard L. Rosen, and Donna Patterson of Arnold & Porter LLP; and David Lawson of Sidley Austin LLP, on behalf of AT&T; and Steve Sharkey of T-Mobile USA; Nancy J. Victory and R. Michael Senkowski of Wiley Rein LLP; and George S. Cary and Alex Sistla of Cleary Gottlieb Steen & Hamilton LLP, representing Deutsche Telekom AG and T-Mobile USA, met with Renata Hesse, the FCC’s Senior Counsel to the Chairman for Transactions; Jim Bird and Michael Steffen of the FCC’s Office of the General Counsel; James Schlichting, Paul Murray, Susan Singer, Chris Helzer, Thuy Tran, Weiren Wang, and Pramesh Jobanputra of the FCC’s Wireless Telecommunications Bureau; Paul De Sa, Jack Erb, and Paul Lafontaine of the FCC’s Office of Strategic Planning and Policy Analysis; and Robert Majure, Kenneth Heyer, Wayne Dunham, Nathan Miller, and Claude Scott of the United States Department of Justice, Antitrust Division. Gregory Rosston and Jonathan Baker, the FCC’s Senior Economists for Transactions; Patrick DeGraba of the FCC’s Wireless Telecommunications Bureau; Fiona Scott-Morton, Lawrence Frankel, Shobitha Bhat and Nathan Kilbert of the United States Department of Justice, Antitrust Division; and Kenneth Dintzer of the United States Department of Justice, Civil Division, participated via teleconference.

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Professor Carlton and Dr. Israel discussed the updated results of their quantitative economic analysis, submitted to the Commission on August 19, 2011, which demonstrate that AT&T's acquisition of T-Mobile USA will lead to increased industry output and lower average quality-adjusted prices. As set forth in the attached presentation, they described the merger simulation technique that they used to analyze the potential competitive effects of the transaction. They explained that the simulation results for the 15 markets studied in the Engineering Analysis prepared by AT&T and submitted to the Commission, and in their analysis, represented a cross-section of larger and smaller markets and that the simulation results were consistent across this group of markets, which account for **[Begin Highly Confidential Information]** **[End Highly Confidential Information]** of T-Mobile USA's subscribers. They also discussed the fact that AT&T originally contemplated including four RSAs in the Engineering Analysis but, **[Begin Highly Confidential Information]**

[End Highly Confidential Information] meaningful data could not be obtained. In addition, it was pointed out that T-Mobile USA, whose customers tend to be concentrated in more densely populated areas, has few customers in those RSAs. Any T-Mobile USA customers in those RSAs nevertheless would benefit from the network efficiencies of the transaction and the resulting improvements in service quality.

As set forth at pages 18-26 of the attached presentation, Professor Carlton and Dr. Israel described how they accounted for certain aspects of quality improvement in the merger simulation, and how they quantified the monetary value of such improvements by **[Begin Highly Confidential Information]**

[End Highly Confidential Information] They noted that the only quality improvements measured for purposes of the merger simulation were those relating to increased signal strength and reduced use of the GSM network by UMTS customers due to expanded UMTS coverage. The merger simulation does not take account of other quality improvements that will result from the transaction, including reductions in blocked and dropped calls, increased throughput rates, and reduced latency and other benefits of expanded LTE service, **[Begin Highly Confidential Information]**

[End Highly Confidential Information] Professor Carlton and Dr. Israel explained that the quality improvements that were accounted for in the merger simulation were separate from and not subsumed within the marginal cost reductions derived from AT&T's Engineering Analysis.

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Professor Carlton noted that all customers are protected from price increases by their existing contracts, and that AT&T intends to allow T-Mobile USA customers to stay on their existing rate plans even after the expiration of their existing contracts, and even if they upgrade to a comparable device.

As set forth at page 17 of the attached presentation, the marginal cost savings captured in AT&T's Engineering Analysis do not include other network synergies, and thus do not reflect the full extent of the network-related marginal cost savings resulting from the transaction. In addition, while AT&T has projected operational synergies that will generate annual savings equal to at least **[Begin Highly Confidential Information]** **[End Highly Confidential Information]** for purposes of the economic analysis it was conservatively assumed that such other marginal cost savings would be equal to **[Begin Highly Confidential Information]** **[End Highly Confidential Information]** of revenues.

Professor Carlton and Dr. Israel discussed the bases for the assumptions used in the merger simulation. A linear demand curve is assumed. Because it is simple to work with, this is one of the demand curves that is often used in merger simulations and, notably, it leads to conservative estimates of the pass-through to consumers of the proposed transaction's efficiencies. As described in greater detail in the accompanying White Paper, diversion ratios were based on data for shares of gross adds and margins were derived from T-Mobile USA documents.

Professor Carlton presented results of various sensitivity tests that varied key inputs substantially, as set forth at pages 35-39 of the presentation, all of which demonstrated the robustness of the analysis. He noted that the fact that the combined company's marginal cost of adding capacity will be lower than that for either company standing alone was especially noteworthy.

Dr. Israel noted that the analysis only provides results for 2014 and 2015 because those are the first full years after network integration will be complete. He noted that the one-time costs associated with accomplishing the integration will occur in the preceding years, and those costs are accounted for in AT&T's analysis of merger synergies as costs incurred in achieving synergies.

Professor Carlton also pointed out that the fact that the transaction will make the combined firm more efficient is beneficial from the standpoint of public policy. If the

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combined firm becomes more efficient relative to competitors, those competitors will be spurred to compete more vigorously. If competitors are concerned about the efficiency gains the Applicants will derive from the merger, their opposition should be viewed skeptically by regulators.

The attached White Paper contains additional information following up on the discussion with staff concerning the Economic Analysis.¹

Pursuant to the Protective Order and Second Protective Order in this proceeding,² enclosed please find an unredacted copy of the presentation and the White Paper on the CD-ROM that contains the unredacted copy of this letter. Redacted copies of the letter, the White Paper and the presentation are being submitted via the Electronic Comment Filing System. In addition, we are submitting two copies of the unredacted version of the letter and the presentation to Kathy Harris of the Wireless Telecommunications Bureau staff or her designee.

¹ Documents referenced in the attached White Paper will be separately submitted.

² *In re Applications of AT&T Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Dkt No. 11-65, Protective Order, DA 11-674 (WTB rel. Apr. 14, 2011) (“Protective Order”); *In re Applications of AT&T Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of Licenses and Authorizations*, WT Dkt No. 11-65, Second Protective Order (Revised), DA 11-1100 (WTB rel June 22, 2011), *modified*, DA 11-1214 (WTB rel. July 19, 2011) (“Second Protective Order”).

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If you have any questions or require further information, please feel free to contact Richard Rosen at 202-942-5499 or richard.rosen@aporter.com, or Nancy Victory at 202-719-7344 or nvictory@wileyrein.com. Thank you for your assistance.

Sincerely,

/s/

Richard L. Rosen
Counsel for AT&T Inc.

/s/

Nancy J. Victory
Counsel for Deutsche Telekom AG

Enclosure

cc: Kathy Harris, Esq. (redacted and unredacted versions)
Ms. Kate Matraves (redacted version)
Jim Bird, Esq. (redacted version)
Best Copy & Printing, Inc. (redacted version)



Competitive Effects of the AT&T – T-Mobile Transaction

**Washington DC
August 19, 2011**

Introduction

- We have analyzed the proposed transaction's competitive effects in fifteen metro areas.
 - New York, Los Angeles, Washington DC, San Francisco, Miami, San Diego, Buffalo, Portland, OR, Charleston, SC, San Juan, Shreveport, Portland, ME, Boise, Gainesville, Waco.
 - We use available estimates of diversion and margins.
 - We incorporate estimates of cost efficiencies and a subset of the transaction's quality benefits.
- With these parameter values, merger simulation indicate that the transaction is pro-competitive.
 - UPP analysis also supports this conclusion.

Basics of Competitive Analysis

- Under standard unilateral effects analysis, a merger has multiple effects:
 - The merging parties internalize the ability to recapture some of the customers lost due to higher prices in the form of profit margins earned by the acquired firm.
 - Marginal cost efficiencies lead to downward pressure on price.
 - Product quality improvements create direct consumer benefits, lowering quality-adjusted price.
- Our analysis indicates that the cost and quality benefits are more than sufficient to counteract any upward pricing pressure, leading to pro-competitive output expansion.
- In addition, consumers are protected by their existing contracts and T-Mobile USA consumers can keep their rate plans when they expire, even when upgrading to a comparable device.

Merger Simulation

- Merger simulation permits assessment of consumer welfare effects and has the following attributes:
 - Takes into account how changes in marginal cost affect pricing incentives
 - Takes into account how changes in quality affect the incentives to set prices
 - Takes into account how changes in one price affect the incentives to set other prices
 - Permits overall industry output and average quality-adjusted prices as summary statistics for merger's effects.

- Merger simulation results indicate that the merger will generate a pro-competitive expansion in output. We use a linear demand model, which yields a conservative estimate of the pass-through of efficiencies to consumers.

Merger Simulation Results: Effect on Output

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Merger Simulation Results: Effect on Weighted Average Quality Adjusted Prices

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Agenda for Remainder of Presentation

- Parameter values used in our analysis:
 - Marginal cost savings based on AT&T engineering model of network costs—for stand-alone and merged networks—as well as AT&T synergy models
 - Analysis of value of network quality improvements based on AT&T and TMUS data
 - Margins based on ordinary course of business TMUS documents.
 - Diversion ratios based on share of gross adds
- Details of merger simulation

COST EFFICIENCIES

Wireless Carriers Face Upward-Sloping Marginal Cost Curves

- Holding spectrum fixed, a wireless carrier faces an upward-sloping marginal cost curve.
 - As the volume of traffic per MHz rises, the firm must use increasingly expensive technologies: **[Begin AT&T Highly Confidential Information]**

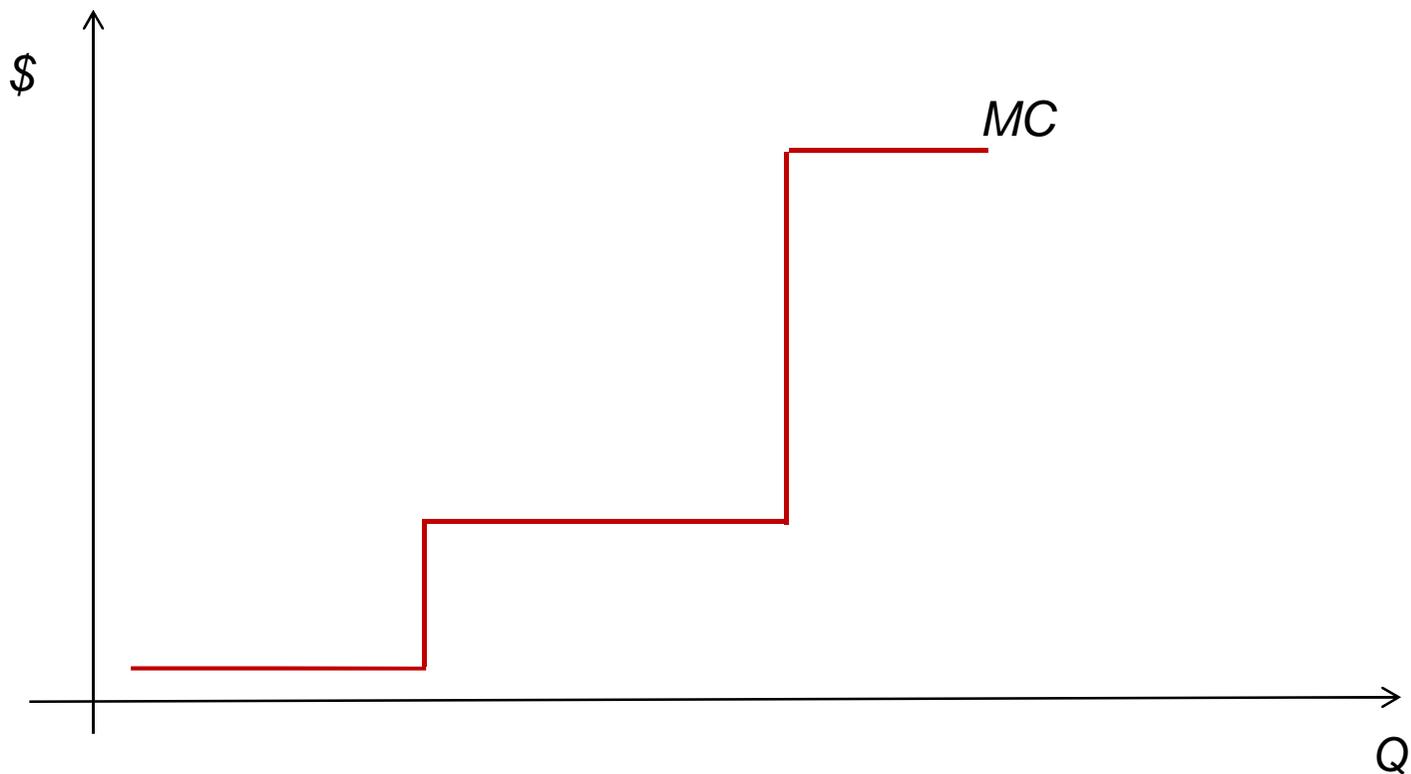
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[End AT&T Highly Confidential

Information]

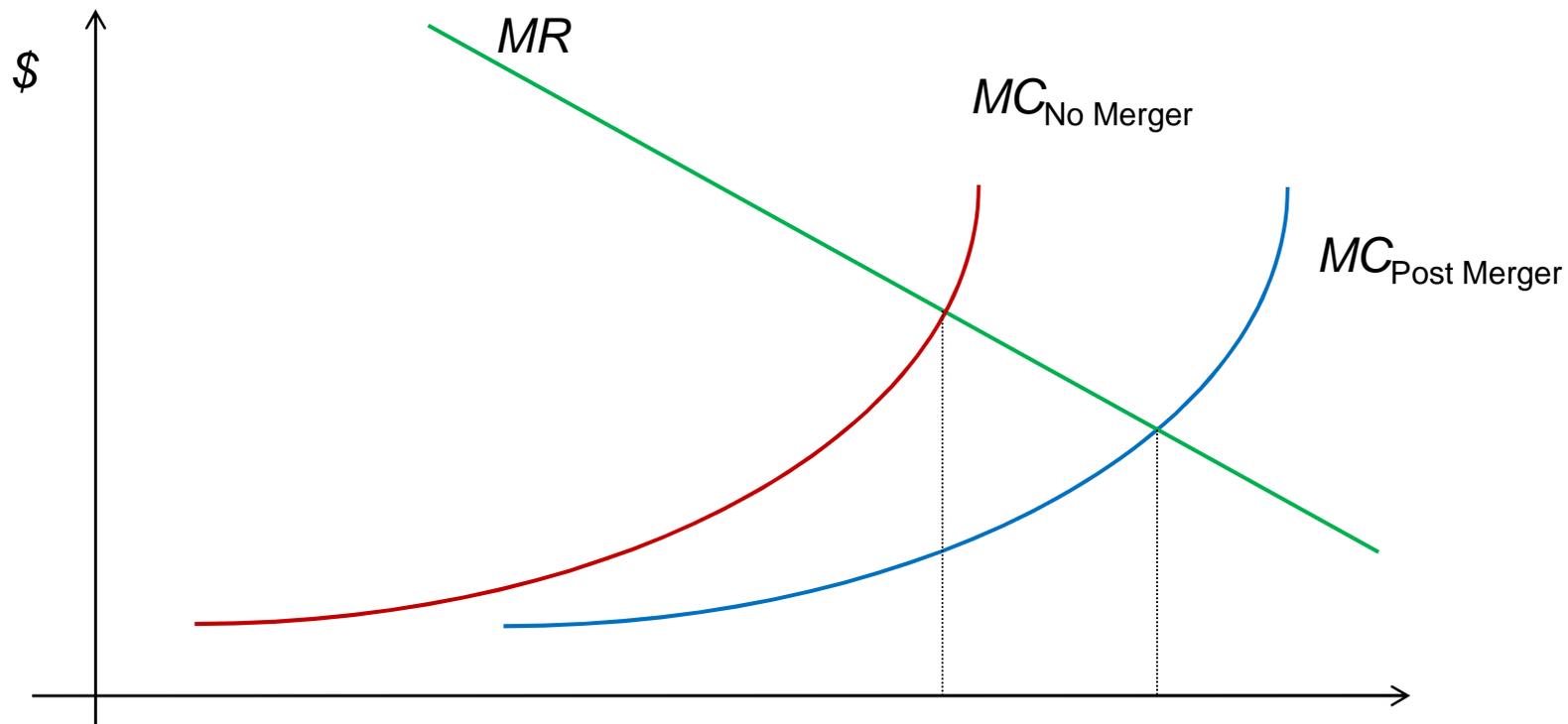
- Hence, marginal cost rises.
- Contrary to what merger opponents claim, efficiencies arise precisely because there is an array of technologies, with more expensive options required as less expensive options are exhausted.
- Proposed transaction will allow combined firm to operate with lower marginal costs for any given level of output/quality by avoiding the more expensive alternatives. Hence, those options *do not* imply that the cost saving are not merger specific.
- These points can be illustrated graphically.

A Marginal Cost Step Function



- Different steps may correspond to different technologies (*e.g.*, [Begin AT&T Highly Confidential Information] [End AT&T Highly Confidential Information]).

Marginal Cost Efficiencies

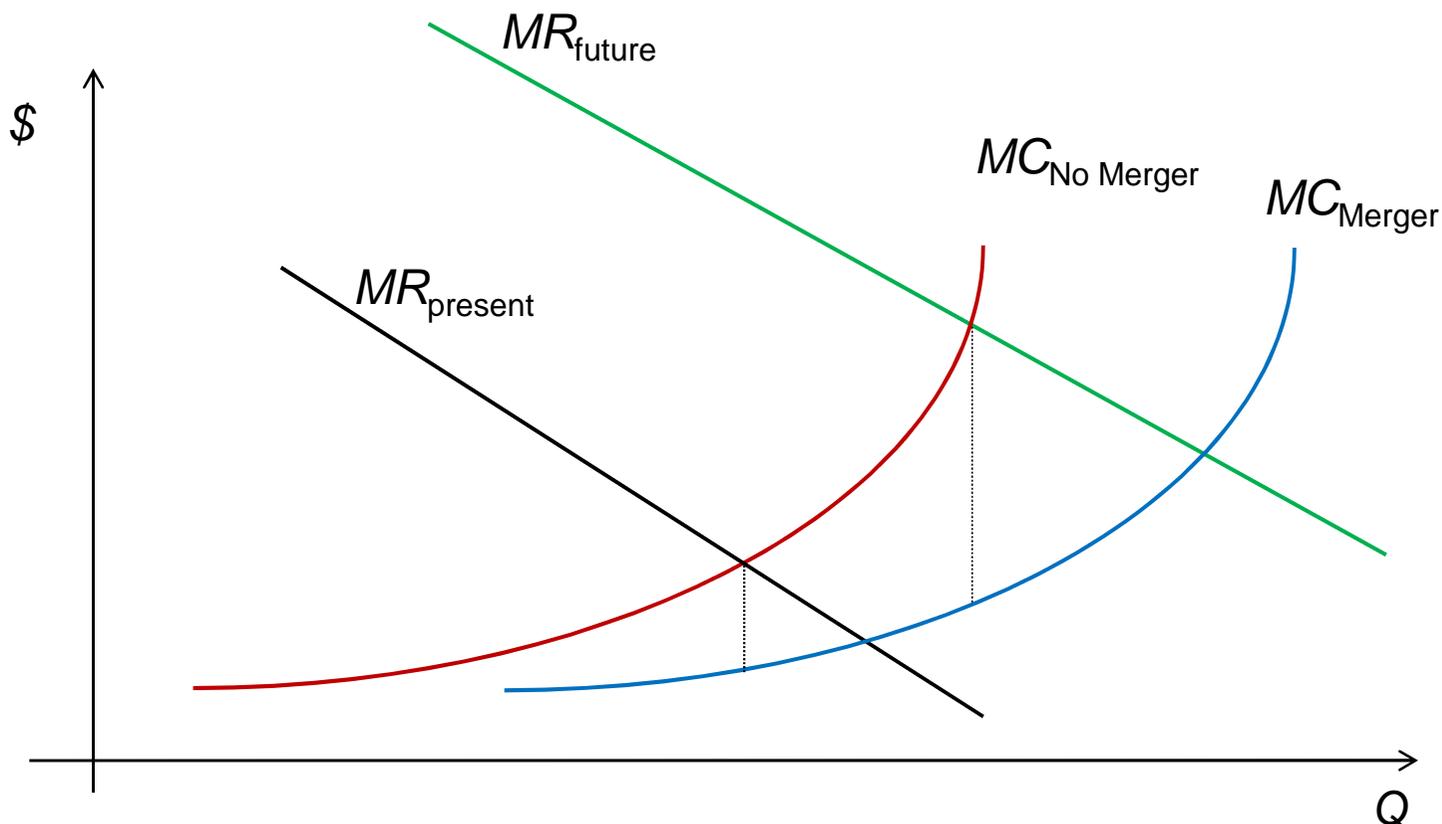


The marginal cost curve shifts out horizontally and allows the combined firm to operate at a lower marginal cost level and expand output.

Implications of Demand Growth

- By any measure, demand is growing extremely rapidly and the only reasonable projection is that demand will continue to grow rapidly.
- Failure to account for demand growth and spectrum scarcity will lead to an underestimate of cost efficiencies.

Implications of Growing Demand and Increasing Marginal Costs



Carrier will be operating on a very steep portion of the marginal cost curve, which [Begin AT&T
Highly Confidential Information] [End AT&T Highly
Confidential Information]

Projected Marginal Network Cost Reduction Based on AT&T Modeling

- AT&T prepared model of incremental network CapEx and associated OpEx required to serve growth in usage in the fifteen metro areas
- Model estimates marginal network costs for:
 - AT&T stand-alone
 - T-Mobile stand-alone
 - Combined AT&T/TM post-merger
- Costs for combined AT&T/TM post-merger reflect network synergies
- Merger-related savings are based on incremental network CapEx and associated OpEx for combined versus stand-alone entities

Model Calculations (for each metro area)

- Engineering model determines number of **[Begin AT&T Highly Confidential Information]**
[End AT&T Highly Confidential Information] required to serve load
 for a given quality and quantity (total data traffic)
- Incorporates cost of above facilities:
 - Unit capital and operating costs for each type of facility
 - Annual cost calculated as operating cost plus levelized (over **[Begin AT&T Highly Confidential Information]**
[End AT&T Highly Confidential Information])
- Determine incremental cost based on year-over-year changes in costs and usage:
 - $\text{Incremental Cost}(t) = (\text{Cost}(t) - \text{Cost}(t-1)) / (\text{Usage}(t) - \text{Usage}(t-1))$
 - Usage is measured in equivalent MOUs (eMOUs)
 - Incremental cost is measured in \$/eMOU
- Determine incremental cost per additional sub:
 - Convert incremental cost per eMOU to incremental cost per sub based on usage per sub for year in question
 - **[Begin AT&T Highly Confidential Information]**

[End AT&T Highly Confidential Information]

Estimates of Marginal Network Cost Reductions (as % of estimated standalone marginal cost)

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Additional Marginal Cost Savings

- AT&T has identified additional network synergies not captured in the engineering marginal cost analysis.
- In addition to the cost savings from relaxation of capacity constraints, AT&T has also identified cost savings via its merger synergy modeling.
 - AT&T also has identified operational synergies in its merger synergy modeling and projects that these synergies will generate annual savings equal to at least **[Begin AT&T Confidential Information] [End AT&T Confidential Information]** % of revenue.
 - **[Begin AT&T Confidential Information]**
[End AT&T Confidential Information]
 - For simplicity, we conservatively assume marginal cost savings are equal to approximately **[Begin AT&T Confidential Information] [End AT&T Confidential Information]** % of revenues.

QUALITY IMPROVEMENTS

Quantifying Value of Quality Improvements

- We provide a highly *conservative* measurement of the value of improved quality in three steps:
 1. Estimate effect of the merger on two quality metrics:
 - Signal strength gains
 - Reduced need for customers with 3G Phones to spend time on 2G network
 2. Determine the extent to which churn decreases as these quality metrics improve.
 3. Convert changes in churn into “price equivalents” reflecting the dollar value of quality improvements.

- We have not yet included many other elements of quality improvement likely to flow from the merger including:
 - Lower dropped/blocked call rates
 - Throughput increases
 - Reduced latency and other advantages of LTE

Quality Improvement: Improved Signal Strength

- One source of quality improvements is the increase in signal strength, including from greater cell site density.
 - AT&T estimates that it will add approximately **[Begin AT&T Confidential Information]** **[End AT&T Confidential Information]** incremental TMUS cell sites to its existing network of **[Begin AT&T Confidential Information]** **[End AT&T Confidential Information]** cell sites (Hogg Reply Declaration, ¶ 34).
 - The increase in cell site density will result in increased signal strength (“more bars”).
- On a market-by-market basis, AT&T quantifies improvements in signal strength as follows:
 - **[Begin AT&T Confidential Information]**

[End AT&T Confidential

Information]

- Note that signal strength improvements may be particularly valuable in uncongested areas because the post-merger firm will have the ability to make 850 MHz spectrum available to TMUS subscribers.
 - The building penetration benefits of 850 MHz spectrum (for TMUS customers) are not incorporated in this analysis.

Quality Improvement: Relating Signal Strength to Churn

[Begin AT&T Highly Confidential Information]

Source: AT&T

[End AT&T Highly Confidential Information]

Quality Improvement: Reduced “3G on 2G”

- A second source of quality improvement is the reduction in number of calls for which 3G-capable handsets must operate on a 2G network.
- Model conservatively assumes this benefit accrues only to TMUS subscribers.
- We quantify this benefit as follows:
 - On market-by-market basis, compare estimates of average percent of calls on 3G handsets conducted on 2G network for both AT&T and TMUS
 - **[Begin AT&T and T-Mobile USA Highly Confidential Information]**

[End AT&T and T-Mobile USA Highly Confidential Information]
 - **[Begin AT&T and T-Mobile USA Confidential Information]**

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[End AT&T and T-Mobile USA Confidential Information] **[Begin AT&T and T-Mobile USA Highly Confidential Information]**

[End AT&T and T-Mobile Highly Confidential Information]

Quality Improvement: Relating % 3G on 2G to Churn

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Converting Changes in Churn into “Price Equivalents”

- Improvements in network quality shift the demand curve facing the merged network outward, reducing the quality adjusted price for any given nominal price.
- **[Begin AT&T and T-Mobile USA Highly Confidential Information]**

**[End AT&T
and T-Mobile USA Highly Confidential Information]**

Converting Changes in Churn into “Price Equivalents” (cont.)

- [Begin T-Mobile USA Highly Confidential Information]

[End T-

Mobile USA Highly Confidential Information]

- We conservatively base the analysis below on an assumed elasticity of [Begin T-Mobile USA Highly Confidential Information] [End T-Mobile USA Highly Confidential Information] .
 - This is conservative because a larger price elasticity (in absolute value) implies smaller price equivalents for quality improvements.
- Elasticity of [Begin T-Mobile USA Highly Confidential Information]

[End T-Mobile USA Highly Confidential Information]

Results on Quality Improvement

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

MARGINS AND DIVERSION RATIOS

Diversion Ratios Based on Share of Gross Adds

[Begin AT&T Highly Confidential Information]

- Absent clean natural experiments in which one company raises or lowers its quality-adjusted price while all rival carriers hold theirs constant, one should be cautious in interpreting these data based on SOGA, shares or porting data.
- Results are not sensitive to diversion ratios in range of these data.

[End AT&T Highly Confidential Information]

Merger Simulation Details

- Assume linear demand and static Bertrand-Nash competition, with an industry elasticity of **[Begin T-Mobile USA Highly Confidential Information]** **[End T-Mobile USA Highly Confidential Information]** .
- Five firms: AT&T; TMUS; Verizon; Sprint-Nextel; Other
- Calibrate model parameters assuming each firm has a margin of **[Begin AT&T Highly Confidential Information]** **[End AT&T Highly Confidential Information]** % and diversion is proportional to share of gross adds.
 - It is difficult to determine true economic margins from accounting data.
 - Results are not sensitive within reasonable range.
- Compute baseline AT&T and TMUS marginal costs using firm-specific ARPU and assumed margins.
- Add incremental network cost, derived from AT&T engineering model. Recompute optimal prices given change from baseline marginal costs
- Simulate merger to account for:
 - Change in ownership structure
 - Cost efficiencies (network costs and other synergies).
 - Quality efficiencies

Merger Simulation Results: Effect on Output

[Begin AT&T and T-Mobile USA Highly Confidential Information]

[End AT&T and T-Mobile USA Highly Confidential Information]

Merger Simulation Results: Effect on Weighted Average Price

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Merger Simulation Sensitivities

- To verify the robustness of our results to engineering model results, economic assumptions, and margin/diversion data, we conduct the following sensitivity runs:
 - Reduce marginal cost savings by **[Begin AT&T Confidential Information]** **[End AT&T Confidential Information]**
 - Reduce industry elasticity from **[Begin T-Mobile USA Highly Confidential Information]** **[End T-Mobile USA Highly Confidential Information]** to **[Begin T-Mobile USA Highly Confidential Information]** **[End T-Mobile USA Highly Confidential Information]**
 - Raise profit margins from **[Begin AT&T Highly Confidential Information]** **[End AT&T Highly Confidential Information]** to **[Begin AT&T Highly Confidential Information]** **[End AT&T Highly Confidential Information]**
 - Use diversion ratios based on share of subscribers or porting, rather than SOGA

- Our results are robust. The merger is output-expanding in each of our sensitivity runs.

APPENDIX I: SHARE, SOGA AND PORTING DATA.

Diversion Ratio Issue: Data Points

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

APPENDIX II: SIMULATION SENSITIVITIES.

Sensitivity #1
([Begin AT&T Confidential Information] [End AT&T Confidential Information] Marginal Network Cost Efficiencies)

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Sensitivity #2

(Industry elasticity = [Begin AT&T Highly Confidential Information] [End AT&T Highly Confidential Information])

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Sensitivity #3

**(Margin = [Begin AT&T Highly Confidential Information]
[End AT&T Highly Confidential Information] %)**

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

Sensitivity #4 (Diversion based on share of subscribers)

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

APPENDIX III: UPP.

UPP

- UPP focuses on the incentives of a single firm to raise the price of each of its products, holding the prices of all other products (including its own) fixed.
- According to UPP, the merger will lead to upward pricing pressure only if, for each product of the merging firms:

$$\text{GUPPI} = \text{Margin} \times \text{Diversion} > \text{Percentage } MC + \text{Percentage Quality}$$

Ratio Reduction Improvement

- On the following slide, we compare the GUPPI to the sum of the MC and quality efficiencies for the fifteen metro areas.
- The results presented here do not account for all of the quality improvements or cost savings associated with the transaction.

UPP Results

[Begin AT&T Highly Confidential Information]

[End AT&T Highly Confidential Information]

REDACTED - FOR PUBLIC INSPECTION

The White Paper has been redacted in its entirety.