

VERIZON'S DEALS WITH CABLE COMPANIES RAISE SIGNIFICANT COMPETITIVE ISSUES

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Introduction

In December 2011, Verizon Wireless, the country's largest wireless provider,² announced agreements with some of the country's largest cable operators—Comcast Corp., Time Warner Cable Inc., Cox Communications, and Bright House Networks³—to acquire the AWS-band wireless spectrum licenses that the cable companies had acquired at auction in 2006.⁴ The transactions would result in Verizon Wireless acquiring either 20 or 30 megahertz of spectrum in local markets covering approximately 94% of the U.S. population. According to the smaller national wireless carriers, the "transactions will . . . eliminate from the market one of the two remaining large available bands of quality spectrum, which other carriers could rapidly deploy to broaden coverage and enhance competition,"⁵ and "the only sizable allocated but unused block of spectrum that would be suitable for 4G deployment."⁶

¹ This white paper was written by AAI Director of Legal Advocacy, Richard Brunell, rbrunell@antitrustinstitute.org. AAI is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. It is supported by voluntary donations into its general treasury and has no financial interest in this matter. AAI is managed by its Board of Directors, which alone has approved of this white paper.

² Verizon Wireless is a joint venture of Vodafone Group Plc and Verizon Communications Inc., which owns a 55% share, controls the venture, and operates it as one of its two business segments (the other being the Wireline segment, sometimes referred to as Verizon Telecom). At December 31, 2011, Verizon Wireless had 92.2 million retail customers, annual revenues of approximately \$70.2 billion (representing approximately 63% of Verizon's 2011 aggregate revenues), and EBITDA of \$26.5 billion. *See* Verizon Communications Inc., SEC Form 10-K, For the Fiscal Year Ended Dec. 31, 2011, at 2, Ex. 13.

³ Comcast, Time Warner, and Cox are the top three cable television providers, with about 40 million video subscribers, and rank 1, 4, and 5 as the top multichannel video program distributors (MVPDs). Verizon Communications (FiOS) is the 7th largest MVPD. *See* National Cable & Telecommunications Ass'n, Top 25 Multichannel Video Programming Distributors as of Sept. 2011, http://www.ncta.com/Stats/TopMSOs.aspx.

⁴ Verizon is technically acquiring the spectrum from SpectrumCo, LLC—a partnership of Comcast, Time Warner, and Bright House—and from Cox TMI Wireless, LLC. These entities are collectively referred to herein as "the Parties."

⁵ Comments of Sprint Nextel Corp. 16, WT Dkt. No. 12-4 (Feb. 21, 2012).

⁶ Petition to Deny of T-Mobile, USA, Inc. 14, WT Dkt. No. 12-4 (Feb. 21, 2012).

Verizon and the cable companies ("MSOs") also entered into sales agency arrangements under which Verizon Wireless will sell the cable companies' wireline services (video, broadband, voice), and the cable companies will sell Verizon's wireless services "on a market-standard commission basis." The cable companies will sell Verizon Wireless's services under the Verizon brand name at prices set by Verizon, and the customers will become customers of Verizon Wireless for wireless service. Likewise, Verizon will sell the cable companies' services under the cable companies' brand names at prices set by the cable companies, and the customers will become cable company customers for the wireline services. The MSOs also obtained the future option (apparently in four years) to obtain wholesale wireless services from Verizon Wireless to resell as MVNOs (mobile virtual network operators). Finally, the companies entered into agreements to establish a technology joint venture "to develop innovative ways to integrate wireline and wireless services so that consumers can seamlessly use their services across a variety of devices and screens."

According to the Parties, these "Commercial Agreements" are independent from the spectrum sale. ¹⁰ Presumably this means that the spectrum deal is not contingent on regulatory approval of the Commercial Agreements, and the Commercial Agreements are not contingent on regulatory approval of the spectrum deal. The Justice Department and the FCC are both investigating the spectrum sale and related agreements, ¹¹ although the Parties contend that the FCC should not—and has no authority to—review the Commercial Agreements.

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⁷ Joint Opposition to Petitions to Deny and Comments 4 n.3, WT Dkt. No. 12-4 (March 2, 2012) ("Joint Opposition"). The Agency and Reseller Agreements contain exclusivity provisions, but the scope of these provisions is not apparent. *See id.*, Addendum Concerning the Commercial Agreements 14 ("Addendum").

⁸ See id. at 5 ("The Agency Agreements merely authorize the MSOs and Verizon Wireless to act as sales agents for one another – with pricing established in the sole discretion of the principal.").

⁹ Joint Opposition at 4 n.3; *see* Addendum at 7 ("Joint Venture will attempt to develop new technologies and intellectual property for 'the integration of wireline video, voice, and high-speed data services with wireless technologies"").

¹⁰ Joint Opposition at 70 ("The license assignments and Commercial Agreements are separate from, and not contingent on, each other."). However, the transactions are linked from a business perspective. *See Verizon Communications Inc at UBS Media and Communications Conference – Final*, FD (FAIR DISCLOSURE) WIRE, Dec. 7, 2011 (Lowell McAdam, President and CEO of Verizon Communications, explaining that the CEO of Comcast told him, "look, if I sell you this spectrum that puts me on a particular path. I need to have a fallback [MVNO option] that if this doesn't work as well as we had hoped that I am not blocked out of wireless."); Eliza Krigman, *Comcast Executive Defends Verizon-SpectrumCo Deal*, POLITICO, March 8, 2012 (Comcast executive vice president stated, "The transaction is an integrated transaction. There was never any discussion about selling the spectrum without having the commercial agreements.").

¹¹ DOJ issued second requests on Feb. 9, 2012. The FCC issued requests for information on March 8, 2012.

In this paper, we provide a brief overview of the competitive issues raised by the spectrum acquisition and related Commercial Agreements, based solely on publicly available information.¹² The transactions should be viewed in the context of the abandoned merger of AT&T and T-Mobile, which raised the significant risk that it would have led to the duopolization of the wireless market by AT&T and Verizon.¹³ Blocking that deal preserved T-Mobile as a disruptive fourth player in the national market, but the risk of duopolization remains.¹⁴ Verizon's proposed spectrum acquisition increases that risk,¹⁵ and prevents the spectrum from being used to undermine the market power of the dominant firms rather than entrench it. At the same time, the MSO-Verizon commercial "partnership" raises significant competitive concerns in the markets where they compete or potentially compete for wireless and wireline customers. Prior to this transaction, Verizon was reluctant to facilitate cable's ability to offer a "quad-play" or "wireless solution," apparently to protect its wireless and wireline businesses from competition from cable companies.¹⁶ The

¹² The Commercial Agreements have not been made publicly available, but their contents have been described in general terms by the Parties.

¹³ See THE EFFECT OF AT&T'S ACQUISITION OF T-MOBILE IS LIKELY TO SUBSTANTIALLY LESSEN COMPETITION: A WHITE PAPER OF THE AMERICAN ANTITRUST INSTITUTE (August 2011), http://www.antitrustinstitute.org/~antitrust/sites/default/files/White%20paper.pdf; Applications of AT&T Inc. and Deutsche Telekom AG for Consent to Assign or Transfer Control of Licenses and Authorizations, 26 FCC Rcd 16184, Appendix: Staff Analysis and Findings ¶ 37 (Nov. 29, 2011) ("AT&T/T-Mobile Staff Analysis and Findings") ("As of year-end 2010, AT&T and Verizon Wireless each accounted for over 30 percent of subscribers, and earn over 30 percent of ... the industry's total service revenues; also AT&T accounted for 35 percent and Verizon Wireless for 45 percent of total industry EBITDA.").

¹⁴ See Craig Moffett et al., U.S. Wireless: Picking Winners and Losers in the Wake of the Deal... Raising Target Prices for T, VZ, Leap, and PCS, Bernstein Research, April 5, 2011, at 4 ("The industry is already steaming towards duopoly, and at an accelerating rate, with or without [the AT&T/T-Mobile] merger. Essentially all of [the industry's 2010] growth, and all of the industry's profits, are now being captured by just two companies. . . They dominate capital spending and spectrum purchases. They have the marquee handsets. Their advertising budgets dwarf those of their competitors."); Tim Wu, Professor of Law, Columbia Law School, Creeping Duopoly?, Prepared Testimony Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the Senate Judiciary Comm., Hearing on The Verizon/Cable Deals: Harmless Collaboration or a Threat to Competition and Consumers? at 2 (March 21, 2012) ("We face the prospect of falling into unregulated duopoly almost as if by accident, through choices never really made but made nonetheless.").

¹⁵ See Craig Moffett et al., *Quick Take – Verizon Buys Spectrum From Cable.* . . The End of the World as We Know It, Bernstein Research, Dec. 2, 2011, at 3 ("If approved by the FCC, the deal would amount to an unmistakable step towards the duopolization of the U.S. wireless market, inasmuch [as] it would leave T-Mobile, once again, stranded without a 4G strategy."); id. at 2 (having hypothesized that T-Mobile's "Plan B" was to partner with the cable industry, analyst notes that "[a]pproval would remove one of the only things that could potentially make T-Mobile [a disruptive player], and further widen the gap between the industry's haves and have nots").

¹⁶ In the AT&T/T-Mobile proceeding, an executive of Cablevision (a cable operator not involved in this transaction) stated, "AT&T and Verizon are unwilling to engage in a meaningful wholesale partnership with providers like Cablevision, which would compete head-to-head against those companies in areas where they also provide landline service." Comments of Cablevision Systems Corp., Declaration of Joseph Varello ¶ 8, 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 (May 31, 2011); see also AT&T/T-Mobile Staff Analysis and Findings ¶ 28 ("AT&T and Verizon Wireless were not interested in selling wholesale access to Cablevision, most likely because Cablevision's new 'quad-play' bundle would have made Cablevision a stronger competitor to them, especially when they offer landline service."). Cox itself noted

Commercial Agreements represent an about face, which merits strong scrutiny to determine whether there is an implicit *quid pro quo* by which the MSOs have agreed to limit their wireless competition in exchange for Verizon's limiting its wireline competition, or more generally whether the Parties' incentives to compete have been diminished without offsetting procompetitive benefits.

I. Spectrum Acquisition

Spectrum is an essential input to providing wireless service: a minimum amount of spectrum is needed to operate in a geographic area; additional spectrum is necessary to add technologies (e.g., LTE); and greater spectrum depth enables wireless carriers to expand capacity with less capital investment (e.g., cell towers). It is generally recognized that lower-band ("beachfront") spectrum is more valuable than higher-band spectrum because the propagation characteristics of spectrum below 1 MHz generally allow carriers to serve more users with less infrastructure, and to provide better quality service in buildings.¹⁷ So, carriers that control more spectrum over a given geographic area, especially in the lower bands, have a cost and quality advantage over other carriers which makes it more difficult for the less-endowed carriers to compete. This is not an advantage that they have earned by being more resourceful than rivals; it is an advantage resulting from acquisitions of licenses to use public resources. The spectrum advantage enjoyed by Verizon and AT&T over the rest of the industry likely has contributed to their dominance in market share and profits.¹⁸

that "AT&T and Verizon ... are less likely to support Cox's ability to compete and may, therefore, be less inclined than independent companies like T-Mobile and Sprint to facilitate Cox's entry into the wireless market." Petition of Cox Communications, Inc. to Condition Consent 11, 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 (May 31, 2011).

¹⁷ See Fifteenth Report, Implementation of Section 6002(b) of the Omnibus Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Mobile Wireless, Including Commercial Mobile Services, 26 FCC Rcd 9664, 9834, ¶ 293 (2011) ("Fifteenth Wireless Competition Report") ("low-band spectrum can provide the same geographic coverage, at a lower cost, than higher-frequency bands"); id. at 9835, ¶ 294 ("many wireless providers, including Verizon Wireless and AT&T, have recognized the relative advantages of deploying lower frequency spectrum in urban areas due to its superior in-building coverage characteristics").

¹⁸ Professor Katz, the Parties' economist, notes that while "spectrum access is an important input," "there are many other elements important for commercial success, including investments in network infrastructure, customer service, and marketing." Declaration of Michael L. Katz, An Economic Assessment of Arguments Made by Opponents to SpectrumCo's and Cox's Proposed License Assignments to Verizon Wireless ¶ 12 (Mar. 1, 2012) ("Katz Decl."). He maintains that that "the claim that large spectrum license holdings trigger competitive success is exactly backward; in fact, competitive success triggers a service provider's demand for additional spectrum rights." *Id.* The problem with Professor Katz's argument is that the demand for spectrum is industry-wide, and the fact that Verizon may have well-performed the "other elements important for commercial success" hardly disproves the significance of the size (and quality) of Verizon's spectrum holdings to its market success, not to mention the advantages arising from economies of scale and its legacy wireline network. Katz also argues that Verizon (and AT&T) is a particularly efficient user of spectrum, *see id.* ¶¶ 34, 35, but that contention is flawed because, among other reasons, it assumes that all spectrum has

The risk of spectrum concentration is that it further entrenches the dominant firms by augmenting their cost and scale advantages.¹⁹ Moreover, the acquisition of spectrum by a dominant firm not only gives the firm more spectrum, it also means that non-dominant firms have less. As Professor Wu put its, "Every hertz that Verizon gains is a hertz denied a smaller competitor."²⁰ And by keeping spectrum out of the hands of smaller rivals and potential entrants,²¹ the aggregation of spectrum can lead directly to higher prices and lower output.²² Smaller rivals have a greater incentive to use additional spectrum to increase capacity in order to reduce prices. After all, lower prices reduce profits on the installed base, and smaller firms by definition have a smaller installed base than dominant firms.²³ Moreover, unlike Verizon or AT&T, non-dominant wireless firms have an additional incentive to cut prices because they have no profits from wireline operations that may be lost insofar as low wireless broadband prices induce customers to "cut the cord" and drop landline broadband services.²⁴ The Justice Department has recognized the "foreclosure value" of spectrum to incumbent firms, which are the "benefits gained by preventing rivals from eroding the

equal value, see Reply of T-Mobile, USA, Inc. to Opposition to Petition to Deny at 9-12, WT Dkt. No. 12-4 (Mar. 26, 2012) ("T-Mobile Reply").

¹⁹ See Joint Decl. of Steven C. Salop, et al., ¶ 118, Application of AT&T Inc. and Deutsche Telekom AG for Consent to Transfer Control of Licenses and Authorizations, WT Dkt. No. 11-65 (May 31, 2011) ("combination of economies of scale plus financing advantages can create a vicious cycle that can entrench the dominance of leading firms in a high investment industry like wireless").

²⁰ Wu, *supra* note 14, at 3.

²¹ In AT&T/Qualcomm, the Commission noted, "Post-transaction, AT&T would hold a significant proportion of the available spectrum suitable for the provision of mobile voice or broadband services, particularly below 1 GHz spectrum, that has technical attributes important for other competitors to meaningfully expand their provision of mobile broadband services or for new entrants to have a potentially significant impact on competition." See Application of AT&T Inc. and Qualcomm Incorporated for Consent to Assign Licenses and Authorizations, WT Dkt. No. 11-18, 26 FCC Rcd 17589, 17611, ¶ 51 (Dec. 22, 2011) ("AT&T/Qualcomm Order") (emphasis added).

²² See Implementation of Sections 3(n) and 332 of the Communications Act, 9 FCC Rcd 7988, 8104, ¶ 248 (1994) ("If firms were to aggregate sufficient amounts of spectrum, it is possible that they could unilaterally or in combination exclude efficient competitors, reduce the quantity of service available to the public, and increase prices to the detriment of consumers.").

²³ See AT&T/T-Mobile Staff Analysis and Findings ¶ 78 & n.229 (explaining that firm's incentives to act as disruptive force in market depends on its ability to expand output inexpensively and is inversely related to its market share).

²⁴ See Fifteenth Wireless Competition Report, 26 FCC Rcd at 9871-72 ¶ 367 (noting that while "it is still not clear whether mobile wireless Internet access services can substitute completely for fixed wireline Internet access . . . [m]obile wireless Internet access services could provide an attractive alternative to wireline offerings for consumers who are willing to trade off speed for mobility, and also consumers who are relatively indifferent with regard to the attributes, performance, and pricing of mobile and fixed platforms," and that "advances in wireless technologies, coupled with increase in the supply of spectrum, have the potential to make mobile wireless service a more viable competitor at higher data speeds at some future date").

incumbents' existing businesses," which could be "very high" in "an established oligopoly with large margins between the price and incremental cost of existing broadband services."²⁵

The spectrum deal raises these competitive concerns under the FCC's spectrum aggregation "screen" and under Section 7 of the Clayton Act.

A. Spectrum Concentration Under the FCC's "Spectrum Screen"

The FCC uses a "spectrum screen" to measure whether spectrum concentration raises competitive concerns on a local level; it has also considered spectrum aggregation on a national level.²⁶ In prior transactions, the FCC has used an overall spectrum screen of approximately one third of the available spectrum suitable for wireless broadband and telephony services, but it has also separately considered the concentration of spectrum below 1 MHz, because of "its more favorable propagation characteristics."

According to the Parties, the transaction will exceed the FCC's overall spectrum screen in only a few local markets, and boost Verizon's share of spectrum on a national basis from 21% to 26%. The Parties argue that 26% is not significant because it still leaves competitors access to roughly three quarters of the available spectrum. However, this completely ignores the quality of the spectrum held by Verizon and the distribution of the remaining spectrum. The competitive impact of spectrum holdings depends on the *type* of spectrum held by firms, as the Commission

²⁵ Ex Parte Submission of the United States Department of Justice 23, Economic Issues in Broadband Competition: A National Broadband Plan for Our Future, GN Dkt. No. 09-51 (Jan. 4, 2010); see also Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap, 11 FCC Rcd 7824, 7871-72, ¶ 99 (1996) ("CMRS Spectrum Cap Report and Order") (explaining that incumbent providers have incentive to pay more for spectrum to protect continued economic rents); see also Declaration of Judith Chevalier in Support of Petition to Deny of T-Mobile, USA, Inc. ¶ 20, WT Dkt. No. 12-4 (Feb. 21, 2012) ("Chevalier Decl.") (explaining that "in addition to any value the firm derives from the spectrum, additional value is generated by preventing a rival from using that spectrum").

²⁶ See AT&T/Qualcomm Order, 26 FCC Rcd at 17601, ¶ 29. It makes sense to consider spectrum concentration in local markets and on a national level, because competition in wireless markets occurs on both levels. See Complaint ¶¶ 19, 20, United States v. AT&T Inc., No. 1:11-cv-01560 (Aug. 31, 2011).

²⁷ ATT-Qualcomm Order, 26 FCC Rcd at 17610, ¶ 16.

²⁸ See Joint Opposition at 26.

²⁹ See id. at 58 ("The focus of the trigger should be on the total amount of spectrum available to other competitors, not how much an individual carrier holds in any given market.").

recognized in AT&T-Qualcomm.³⁰ And it depends on spectrum concentration. The competitive implications of a situation in which the remaining 74% of spectrum is not being used or is widely distributed are quite different from a situation in which the remaining spectrum is in the hands of another dominant firm and a small number of other firms that are themselves spectrum-constrained.³¹

Under the Parties' own analysis, if this acquisition were permitted, AT&T and Verizon combined would control "only" 47% of the nation's wireless spectrum.³² However, this figure significantly understates the Twin Bells' control, given their dominance of the more valuable spectrum in the lower bands. According to plausible weights suggested by one analysis, AT&T and Verizon would control 59% of the national spectrum and 73% of the spectrum controlled by the four national wireless carriers.³³ The Parties oppose any adjustment to the spectrum screen based on the quality or value of spectrum because they argue that value differs depending on the holder of the spectrum. However, we agree with those who argue that a screen that better accounts for value is preferred to a screen that ignores valuation entirely. Insofar as spectrum is a proxy for capacity,³⁴ it makes little sense to treat high-cost capacity the same as low-cost capacity.

The Parties argue that regardless of the degree of spectrum concentration, the spectrum deal is procompetitive because it enables Verizon to increase its capacity to meet the exploding demand for wireless broadband service, and the cable companies' spectrum is not otherwise being used. The problem with this analysis is that there is no reason to think that the spectrum would remain unused

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³⁰ The Commission separately considered spectrum concentration in bands below 1 GHz, noting that the transaction would result in AT&T and Verizon combined controlling approximately 73% of below 1 GHz spectrum. *See ATT-Qualcomm Order*, 26 FCC Rcd at 17609, ¶ 48. In these circumstances, it found that AT&T's post-merger share (more than one third on a national level) raised competitive concerns, but concluded that such concerns could be resolved short of divestitures. *Id.* at 17611, ¶ 51.

³¹ Spectrum aggregation limits were originally adopted for the purpose of preventing wireless markets from becoming concentrated. *See CMRS Spectrum Cap Report and Order,* 11 FCC Rcd at 7872-73, ¶ 100 (explaining that spectrum cap will result in spectrum share holdings with an HHI below 1900, and probably less).

³² See Joint Opposition at 26.

³³ See Petition to Deny of Free Press 17, WT Dkt. No. 12-4 (Feb. 21, 2012). The latter figure attributes Clearwire's spectrum to Sprint. See also Reply of T-Mobile, USA, Inc. to Opposition to Petition to Deny, Supplemental Decl. of Peter Cramton ¶ 21, WT Dkt. No. 12-4 (Mar. 26, 2012) (showing that Verizon spectrum share would exceed one-third threshold under value-based screen in almost half of the top 100 markets, including eight of the top ten markets).

³⁴ See CMRS Spectrum Cap Report and Order, 11 FCC Rcd at 7869, ¶ 96 ("Allocated spectrum is an appropriate measurement of market share for purposes of analyzing the need for a spectrum cap because it is a measure of a CMRS carrier's long-term capacity....").

if Verizon does not acquire it. In fact, the entire industry faces capacity constraints, as the Parties themselves acknowledge,³⁵ and but for Verizon's acquisition, it is unlikely the spectrum would remain fallow. For example, the spectrum would be particularly valuable to T-Mobile for the deployment of LTE.³⁶

Moreover, even if Verizon is not guilty of warehousing spectrum, as critics claim it is,³⁷ and it would put the cable companies' spectrum to good use, Verizon has other ways to increase capacity (besides acquiring a broad swath of spectrum) that it would undoubtedly undertake absent this acquisition. Presumably these other ways would require greater capital investment in cell towers and WiFi offloads and so forth, but the cost savings Verizon might enjoy³⁸ can hardly count as a procompetitive effect of the acquisition when it would deny a like advantage to smaller wireless carriers, which are more likely to use the spectrum to put competitive pressure on the market leaders. As Free Press points out, "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."³⁹

B. Section 7 of the Clayton Act

The FCC and DOJ must answer the question whether Verizon's acquisition of the cable companies' spectrum lessens competition as compared to its acquisition by other, non-dominant

³⁵ See Joint Opposition at 5-8.

³⁶ See Chevalier Decl. ¶ 22. A 1952 amendment to the Communications Act provides that transfer applications are to "be disposed of as if the proposed transferee or assignee were making application under section 308 of this title for the permit or license in question; but in acting thereon, the Commission may not consider whether the public interest, convenience, and necessity might be served by transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee." 47 U.S.C. § 310(d). This amendment was intended to apply to comparative qualification issues, not competition concerns. See Applications of MMM Holdings, Inc. for Transfer of Control of Lin Broadcasting Corp., 4 FCC Rcd 6838, 6839 ¶ 8 ("Congress intended the Commission to determine whether the proposed transferee possesses the basic qualifications required of licensees, but that it should not indulge in comparative analyses between the transferee and others, including the existing licensee."), aff'd, 4 FCC Rcd 8243 (1989). In any event, it does not mean that the Commission must consider the public interest benefits of the transfer on the assumption that no other person would make use of the license. Indeed, the premise of spectrum aggregation limits or screens is that spectrum is a scarce resource and that its aggregation should be limited to free up resources for other firms.

³⁷ See, e.g., T-Mobile Reply at 4-5 (noting that Verizon has not deployed the AWS spectrum that it already holds).

³⁸ In its filings, Verizon not undertaken to analyze the cost of alternatives to the spectrum acquisition.

³⁹ Joel Kelsey, Policy Advisor, Free Press, Prepared Testimony Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the Senate Judiciary Comm., Hearing on *The Verizon/Cable Deals: Harmless Collaboration or a Threat to Competition and Consumers?* at 10 (March 21, 2012).

firms (a vertical concern) or, in the alternative, as compared to its retention by the cable companies (an issue of potential competition). This is a straightforward application of the general principle that the competitive effects of a merger are analyzed against the baseline of what would happen but for the merger.⁴⁰

The Parties' economist, Professor Katz, contends that the issue is "whether the proposed transaction would benefit or harm consumers in comparison to the status quo," but that is not the law under Section 7 of the Clayton Act⁴² or under the public-interest standard in the Communications Act. To be sure, merger analysis should not be speculative, and the acquisition ought not to be compared "with a hypothetical transaction involving other parties that competition authorities *might be able to imagine*." However, it is hardly speculative to measure the competitive effects of the spectrum acquisition by Verizon against its acquisition by non-dominant firms or its

⁴⁰ See generally U.S. DEPT. OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 1 (2010) ("Most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not."); Brown Shoe Co. v. United States, 370 U.S. 294, 333 (1962) ("It is the probable effect of the merger upon the future as well as the present which the Clayton Act commands the courts and the [Federal Trade] Commission to examine."). The Justice Department's applied such a forward-looking analysis to the acquisition of a scarce resource in Primestar. In that case, PrimeStar, which was owned by a consortium of cable companies, sought to acquire from News Corp. and MCI a scarce orbital slot licensed for direct broadcast satellite (DBS) service. The government blocked the acquisition on the theory that competition in the multichannel video program distribution market (including cable and satellite-delivered programming) would be less vigorous as a result of the transaction than if the slot were used by an independent (non-cable) owner—either the existing owners (a potential entrant) or the incumbent DBS providers (DirecTV or EchoStar). See Complaint & ¶ 95, United States v. Primestar, Inc., No. 1:98CV01193 (D.D.C. filed May 12, 1998), http://www.justice.gov/atr/cases/f1700/1757.pdf ("The asset to be acquired would be a potent weapon in the hands of a true competitor to cable; it could and would be used to compete aggressively with the dominant cable firms.").

⁴¹ Katz Decl. ¶ 21.

⁴² The but-for world is normally *not* the status quo, but a forward-looking assessment of how the market would develop absent the acquisition. Thus, for example, a firm's current market share may be discounted (or augmented) because it does not reflect the firm's expected future competitive significance, *see United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); HORIZONTAL MERGER GUIDELINES § 5.2, and efficiencies obtained by the acquiring firm are not a "defense" if they would be achieved in any event, *see id.* § 10, and the failing firm defense does not apply where the acquired firm would have been bought by purchaser that posed less danger to competition, *see id.* § 11; *see generally* 5 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1124 (2009) ("[I]n evaluating mergers or other restraints, antitrust law normally compares the level of competition that would exist now and in the future, if the merger or restraint were permitted, with the level that would exist if it were disallowed. For example, a firm is free to go out of business and thus eliminate its own competitive influence in the market, but antitrust law has no conceptual difficulty in limiting the choice of firms to which the existing firm may sell its assets.").

⁴³ See, e.g., Applications of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp. and its Subsidiaries, 12 FCC Rcd 19985 (1997) (applying actual potential competition doctrine and finding that acquisition was anticompetitive because, but for the merger, Bell Atlantic would likely have entered the New York market).

⁴⁴ Katz Decl. ¶ 21 (emphasis added).

use by the cable companies, when the *least likely* alternative to the current transaction is the status quo ante (i.e., the cable companies retain the spectrum and do not use it).⁴⁵

Verizon Verizon. As discussed above, there are good reasons to believe that the acquisition of the spectrum by Verizon would be anticompetitive as compared to its acquisition by non-dominant firms. The Parties' economist points out that "large spectrum licenses become available infrequently and with great uncertainty." Hence, the allocation of the cable companies' large block of nationwide spectrum is likely to make a significant competitive difference in the near future. Regardless of whether smaller rivals "need" the spectrum more than Verizon, economics suggests that they are more likely to fully exploit it to disrupt the Twin Bells' duopoly behavior than Verizon. Insofar as the Parties contend that the acquisition will be procompetitive by allowing Verizon to increase its capacity, they should be required to demonstrate that market-wide net cost savings — as compared to alternative means available to Verizon to increase capacity — would increase Verizon's incentive to lower prices more than would be the case if the spectrum were in the hands of a non-dominant firm.

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Potential competition from MSOs. The Parties suggest that the spectrum deal raises no potential-competition issues because the cable companies made a business decision not to construct an independent wireless network before they decided to sell their spectrum to Verizon. If that is correct, then the vertical foreclosure scenario described above is all the more likely. Moreover, the abandonment of the MSOs' efforts to enter would confirm that entry into the wireless market on a

⁴⁵ Comcast maintains that the cable companies made a business decision not to become facilities-based carriers, were looking for a way to have a "wireless solution," and had "explored other options with almost every other participant in the wireless industry, including the sale of the spectrum to other companies . . ." David L. Cohen, Executive Vice President, Comcast Corp., Prepared Testimony Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the Senate Judiciary Comm., Hearing on *The Verizon/Cable Deals: Harmless Collaboration or a Threat to Competition and Consumers?* at 9 (March 21, 2012).

⁴⁶ Katz Decl. ¶ 37.

⁴⁷ See AT&T/T-Mobile Staff Analysis and Findings ¶ 82 (noting that AT&T and Verizon Wireless had behaved in parallel ways, including adopting parallel (and high-priced) strategies in setting the prices and features of their service plans); supra notes 22-25.

⁴⁸ Insofar as the spectrum acquisition merely allows Verizon to reduce the capital expenditures it otherwise would make to increase its capacity, it is not clear how the acquisition would increase its incentive to lower prices at all. *Cf.* FED. TRADE COMM'N & U.S. DEPT. OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES 57 (2006) ("[R]eductions in fixed costs—costs that do not change in the short run with changes in output rates—typically are not expected to lead to immediate price effects and hence to benefit consumers in the short term.").

competitive scale is extremely difficult (even with significant spectrum resources)⁴⁹ and that the harm from duopolization would be significant. Still, the DOJ and FCC should explore whether the cable companies' decision to abandon the prospect of becoming facilities-based carriers was entirely independent of its decision to sell the spectrum to Verizon, not only to determine whether cable entry would otherwise likely have occurred, but also whether the MSOs have implicitly traded their threat of entry as facilities-based carriers in exchange for limitations by Verizon in its wireless or wireline competition with the cable companies. Moreover, insofar as the cable companies likely would have sold their spectrum to a non-dominant firm, potential (and actual) competition from the MSOs as MVNOs partnered with such a firm would be impaired. As discussed in the next section, cable operators selling the wholesale service of a non-dominant firm would be stronger wireless competitors than their commercial agreements with Verizon allow.

II. Commercial Agreements

The Parties argue that the agency agreements are procompetitive because they "provide the MSOs and Verizon Wireless with a quick and efficient path to offer their customers the convenience of a 'one-stop shop' for video, high-speed data, digital voice, and wireless services. Today, AT&T, DIRECTV, Dish Network, CenturyLink, and others offer multiproduct bundles. The Commercial Agreements allow the MSOs and Verizon Wireless to respond to this competition with a top-notch suite of products of their own." Moreover, "If and when the MSOs exercise their reseller option, then customers will have a new option to select a bundle of offerings that includes branded wireless service from the MSOs, along with the MSOs' video, voice and high-speed data services."

However, the agency agreements and reseller option do not merely provide an additional option for consumers; they replace options that the cable companies were already offering. Comcast and Time Warner are investors in Clearwire, and had been rolling out 4G mobile broadband services using Clearwire's network, and 3G mobile data services using Sprint's network.⁵² Moreover, until

⁴⁹ See Complaint ¶ 36, United States v. AT&T, No. 1:11-cv-01560 (noting "high barriers to entry and expansion" in mobile wireless telecommunications markets).

⁵⁰ Addendum at 3.

⁵¹ *Id.* at 4.

⁵² Comcast's mobile data service was marketed as XFINITY 2go. See Press Release, Comcast Corp., Comcast Begins National Rollout of High-Speed Wireless Data Service (June 29, 2009), http://www.comcast.com/About/

just a few weeks before the Verizon Wireless/Cox deal was announced, Cox had been rolling out its own full array of wireless services as an MVNO using the Sprint network.⁵³ The procompetitive benefits of the agency arrangements must be measured against the baseline of what would occur but for the agreements.⁵⁴ For the cable companies, partnering with Verizon may be superior to their partnerships with Sprint and Clearwire, but it is hard to see how competition in the wireless market is benefitted when cable companies become sales agents rather than resellers,⁵⁵ or team up with one of the dominant firms rather than Sprint/Clearwire.⁵⁶ And competition in the wireless market may be significantly impaired if the cable companies, because of their partnership with Verizon Wireless, provide access to their WiFi networks to Verizon but not competing wireless carriers, or otherwise discriminate in the provision of wholesale services like backhaul.⁵⁷

PressRelease/PressReleaseDetail.ashx?PRID=887&SCRedirect=true; Press Release, Clearwire Corp., Clearwire, Comcast and Sprint Expand 4G Mobile Broadband Network Across the Puget Sound Region (July 19, 2011), http://corporate.clearwire.com/releases.cfm; see also Press Release, Clearwire Corp., Clearwire, Time Warner Cable and Sprint Expand New York City Metro 4G Mobile Broadband Network by 21 Percent (July 12, 2011), http://corporate.clearwire.com/releases.cfm.

⁵³ See Press Release, Cox Communications, Cox Completes Wireless Rollout in California (Sep. 29, 2011), http://cox.mediaroom.com/index.php?s=43&item=564 (noting that Cox Wireless would be available in more than 50% of its footprint by the end of the year).

⁵⁴ See FEDERAL TRADE COMM'N & U.S. DEPT. OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS § 3.3 (2000) ("central question" under rule of reason "is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement").

⁵⁵ The Parties aptly describe the procompetitive benefits of reseller arrangements in isolation, but there is no indication of why the MSO reseller option is only available years in the future, or whether the cable companies will likely use it.

⁵⁶ In support of its merger with T-Mobile, AT&T noted the competitive significance of MVNOs allied with independent wireless firms: "In the past, the Commission has discounted the competitive significance of MVNOs because, until recently, they have generally piggybacked off the networks of *vertically integrated* wireless competitors such as Verizon Wireless or AT&T. . . . [No such] concern arise[s] when cable television providers partner with Sprint or Clearwire to sell wireless services as a part of a 'quad play' bundle with video, high-speed internet, and digital voice service. . . . [S]uch wholesale-retail partnerships can have as much competitive impact as the entry of a new vertically integrated provider" Joint Opposition of AT&T Inc., Deutsche Telekom AG, and T-Mobile USA, Inc. to Petitions to Deny and Reply to Comments 131-32, WT Dkt. No. 11-65 (June 9, 2011).

⁵⁷ The Commission has noted the importance of WiFi to the carriers' efforts to deal with the spectrum crunch. *See* Fifteenth Wireless Competition Report, 26 FCC Rcd at 9872, ¶ 369 ("When deployed to complement mobile wireless networks, local-network wireless technologies may offer solutions to network congestion problems that mobile wireless providers are facing with increasing frequency."). From wireless customers' perspective, WiFi offers the ability to obtain high-speed broadband connectivity without exceeding their plans' wireless data limitations. Comcast and Time Warner have been building impressive WiFi networks, and their profit from the sales of Verizon Wireless service may give them the incentive to withhold (or provide discriminatory) access to those WiFi networks to other wireless carriers, thereby raising the costs of those carriers and compounding the competitive harm of Verizon's spectrum acquisition. *See* Comments of Sprint Nextel Corp. 5-9, WT Dkt. No. 12-4 (Feb. 21, 2012).

Moreover, insofar as the agency agreements permit the cable companies to offer a better "quad play," it comes at some cost to competition in wireline services. Where the cable companies compete against Verizon FiOS, ⁵⁸ it is easy to see how competition over the package of video, voice, high speed broadband, and wireless is diminished when both the cable company and Verizon Wireless offer *the same wireless service* as part of the package, even when they offer a different bundle of video, voice, and high-speed broadband (*e.g.*, XFINITY or FiOS).⁵⁹ The harm to competition is exacerbated when Verizon is able to offer the *exact same bundle of services* as the cable companies.⁶⁰ Verizon maintains that it will not "pull its punches" in competition with the MSOs because it will make much more money selling FiOS than it would signing up subscribers to the MSOs' wireline services.⁶¹ Nonetheless, because Verizon will have some interest in its competitor's revenue stream when it sells the competitor's package of wireline services instead of its own (i.e., the commission on the sale of cable services), or when it loses a sale of quad-play services to the cable company (i.e., the revenue from a wireless subscriber), Verizon's incentive to compete vigorously against the MSOs for FiOS customers will be diminished.⁶² And given the fierce nature of that competition now, the impact of reducing competitive incentives could be significant.⁶³

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⁵⁸ FiOS currently passes about 15% of Comcast's passed homes and 11% of Time Warner's homes. *See* Matthew Harrigan, *Wireless Mission Accomplished! Quite Plausibly*, Wunderlich Securities, Dec. 5, 2011, at 1.

⁵⁹ Presumably, if a cable company lacked a "quad play," competition would force it to offer lower prices and better services on its wireline offerings to induce consumers that value one-stop shopping to forego that feature, or to offer some other wireless service whose price it controls. Competition is not intensified when competitors sell each other's products, especially when the "principal" sets the price of the "shared" product.

⁶⁰ Verizon has offered no procompetitive (or any) rationale for its being able to offer XFINITY, or the Time Warner triple play, instead of FiOS.

⁶¹ Addendum at 8 ("Basic economics confirms that Verizon would only injure itself if it 'pulled its punches' in competition with the MSOs."). Yet Verizon proposes to turn Verizon Wireless into a neutral "Switzerland" vis a vis FiOS and cable, rather than employ its prized asset in the war against cable.

⁶² See COMPETITOR COLLABORATION GUIDELINES § 3.31(a) (marketing collaborations may be anticompetitive "by combining financial interests in ways that undermine incentives to compete independently"); cf. 2010 HORIZONTAL MERGER GUIDELINES § 6.1 (differentiated product merger may have unilateral anticompetitive effects because "[s]ome of the sales lost due to the price rise will merely be diverted to the product of the merger partner").

⁶³ Compare Event Brief of Q4 2011 Verizon Earnings Conference Call – Final, FD (FAIR DISCLOSURE) WIRE, Jan. 24, 2012 (Fran Shammo, Verizon EVP and CFO stating, "I know folks are saying that we are overly competitive in pricing") with Verizon Communications Inc at Wells Fargo Technology, Media & Telecom Conference – Final, FD (FAIR DISCLOSURE) WIRE, Nov. 9, 2011 (Shammo stating, "we will use all opportunities to increase prices where we can"). The Parties state, "Verizon has traditionally set the prices for FiOS services on a nationwide basis," Addendum at 9 n.26, implying that the diminished incentives in areas where FiOS and the MSOs overlap will not affect its pricing behavior. Yet it appears that local discounting may be common, especially for new subscribers. See, e.g., Verizon at UBS Media & Communications Conference – Final, FD (FAIR DISCLOSURE) WIRE, Dec. 8, 2009 (John Killian, EVP and CFO of Verizon Communications stating, "We evaluate offers, promotions every week, right? So the local teams are very focused on that, from that perspective.").

The problem of reduced competitive incentives is not limited to areas where FiOS and the cable companies overlap; it extends to all of the areas in which Verizon Telecom and the cable companies compete. Even where FiOS is not offered, Verizon Telecom offers landline voice and DSL internet services, which compete against the cable companies' voice and broadband services. And Verizon had partnered with DIRECTV to offer video services in a "quad play" outside its FiOS footprint in order to compete against the cable companies. As with FiOS, Verizon will have less incentive to push its own wireline services because it profits from the sale of the cable companies' services. In addition, by having an interest in sales of cable services, and giving up its advantage in wireless services, Verizon's incentive to expand its FiOS footprint against the cable companies is lessened. The Parties contend that Verizon made the decision to stop expanding FiOS to new markets over two years ago, but Verizon acknowledged that it could reevaluate that decision, and the disincentive to expand must be counted as an anticompetitive effect of the arrangement.

The "research" joint venture is particularly difficult to evaluate without additional information. While research joint ventures among competitors ordinarily are not problematic if properly structured, the very premise of this venture – to create new technologies that allow for the integration of wireless and wireline services⁶⁷ – raises the risk that it will reduce Verizon's incentive (or ability) to develop technologies that would encourage wireless broadband and video services that

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⁶⁴ See Carol Wilson, Verizon Launches First Quad-Play Bundle, CONNECTED PLANET, Oct. 19, 2009, http://connectedplanetonline.com/home/news/verizon-quad-play-bundle-1019/ ("According to Verizon, its new services are aimed at putting cable competitors on the defensive by offering wireless services they can't currently offer as part of a service bundle, and the pricing is reasonably aggressive."); Press Release, Verizon Communications Inc., Verizon's New "Quad-Play" Bundle Offers Customers Wireless Calling with Home Phone, TV and Broadband in Money-Saving Combinations, Oct. 19, 2009, http://www22.verizon.com/investor/verizons_new_quadplay_bundle_offers_customers_wire.htm. Moreover, Verizon had been working with DIRECTV on plans to develop an LTE fixed-wireless broadband service for the home, which it dropped after the MSO deal was announced. See Comments of DIRECTV, LLC at 2-3, Wt Dkt. No. 12-4 (Feb. 21, 2012).

⁶⁵ See Addendum at 10.

⁶⁶ See Verizon Communications Inc at UBS Media and Communications Conference – Final, FD (FAIR DISCLOSURE) WIRE, Dec. 7, 2011 ("Dec. 7, 2011 Investor Conf.") (Verizon CEO Lowell McAdam noting that if "economics of FiOS begins to get better and better," then he "can reevaluate" the decision to "build out what we said and not any more").

⁶⁷ According to Verizon CEO Lowell McAdam, "we were well down the road in developing [the technology for integrating wireless and wireline services] for FiOS and then the opportunity came up to partner with Comcast... that gives us a nationwide play. Because while we could do it and do it very well within the FiOS footprint, wireless is a national asset and I needed to look for an opportunity to expand that scale." *Id.*

bypass wireline systems.⁶⁸ Moreover, the joint venture may have the incentive to create technologies that integrate wireless and wireline services in the home or at WiFi hotspots in ways that may disfavor wireless carriers other than Verizon Wireless.⁶⁹ Finally, just as the joint marketing arrangements may temper competition between FiOS and cable, they may diminish Verizon's incentive to integrate new technologies in its wireline offerings in unique ways that would differentiate FiOS from the MSOs' offerings.⁷⁰

Conclusion

Verizon's acquisition of a critically important block of spectrum raises significant concerns about the future competitiveness of the wireless market. Verizon's commercial partnership with its formerly fierce cable television rivals compounds the competitive harm in wireless markets, and also raises significant questions about the continued vitality of competition in wireline broadband and video markets, and of future competition between wireless and wireline services.

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⁶⁸ See Wu, supra note 14, at 5 (noting that "4G to the home is a cable replacement, not a complement," and "it is not clear how selling a cable replacement can be consistent with promoting cable's products").

⁶⁹ See Reply Comments of Sprint Nextel Corp. 12, WT Dkt. No. 12-4 (March 26, 2012). These concerns may be alleviated if these technologies were developed in the context of an open standards development process in which all interested parties – wireless carriers, cable companies, software and hardware suppliers, and consumers – participated.

⁷⁰ McAdam explained that "each partner can take the core product and do some innovation on top of that if they choose," Dec. 7, 2011 Investor Conf., *supra*, but the question is whether their incentives to do so are lessened by the agency agreements.