THE FREE STATE FOUNDATION
A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
April 26, 2012
Vol. 7, No. 10

AAI's False Alarms About Wireless Ring Hollow

by

Seth L. Cooper *

Consumers are increasingly adopting smartphones and tablet devices running data-rich applications and streaming video content. This makes spectrum an increasingly critical input for wireless carriers. The proposed Verizon/SpectrumCo and Verizon/Cox transactions would enable Verizon Wireless to increase and expand its deployment of next-generation wireless networks. With additional spectrum in use, Verizon could improve coverage and increase capacity to meet surging wireless data traffic demands.

Unlike a merger, the proposed transactions would not reduce the number of competing carriers in the wireless market. Rather, unused AWS-1 spectrum licenses in the 700MHz band would be transferred from cable operators to Verizon.

But a white paper released this month by the American Antitrust Institute (AAI) seeks to put the proposed spectrum license transactions in a negative light. Written by AAI Director of Legal Advocacy Richard Brunell, the AAI paper claims that Verizon's acquisition of additional spectrum would harm the competitiveness of its marketplace rivals. The AAI paper also tries to cast a shadow over the wireless market as a whole.

Unfortunately, AAI's white paper is plagued by compound conceptual problems. Typical of many pro-regulatory proposals for the wireless market, the AAI paper offers a decidedly static outlook that dismisses the effects of dynamic forces in today's wireless market. And it focuses almost exclusively on competitor welfare concerns, seemingly oblivious to consumer welfare concerns that should be the touchstone of competition policy. This emphasis on competitor welfare, rather than consumer welfare, is inconsistent with fundamental, well-established antitrust principles.

The AAI paper's narrative of the wireless market focuses on market share estimates of Verizon and AT&T, primarily at the national level. This despite the fact that regional and local wireless carriers actively serve and compete for consumers. The FCC's latest *Wireless Competition Report* estimates that, as of 2010, approximately 81.7% of the population is served by three or more wireless broadband carriers and 67.8% is served by four or more carriers. These carriers are engaged in vigorous competition with one another to attract and retain consumers, offering an array of wireless broadband service and pricing options.

In addition, the four nationwide wireless carriers confront disruptive competition from regional and local wireless carriers marketing 3G and even 4G wireless services, typically at discount prices. Competitive pressures also come from the prepaid reseller market. Prepaid wireless services are particularly attractive to low-income, price sensitive, and low-usage consumers, including those who do not want data services or do not wish to become multi-year subscribers. According to the FCC's *Wireless Competition Report*, TracFone had some 14 million prepaid customers at the end of 2009.

In the years ahead, diversity in the wireless market is likely to increase through both high-end and low-end product and services. Growing numbers of consumers will own multiple devices, with cross-platform competition continuing to be a critical factor into the future. But the AAI paper also ignores cross-platform competition and potential competition in the market.

According to a comScore report, at 14% the U.S. already ranks highest in the world in the percentage of wireless consumers owning *both* tablets and phones. Consumers are increasingly likely to allocate their bandwidth usage among different devices and different platforms, depending on service capabilities and prices. Wireline broadband offers consumers typically faster speeds and reliability. And technologies such as Wi-Fi roaming and femtocells offer consumers mobility options and the ability to offload data traffic onto wireline broadband networks. This competitive pressure exerted by wireline will put added constraints on the prices charged by wireless providers.

Despite all this, the AAI paper suggests the wireless market is descending into a duopoly and labels Verizon a "dominant" firm. Of course, "dominant" is a loaded term in the telecommunications context. It's a designator for analog-era telephone monopolies subject to legacy regulation. AAI's paper seems to suggest that Verizon possesses power to control prices and output in the wireless market just like an old local telephone monopoly. But empty assertions about duopoly and dominant carriers fail to overcome the abundant *prima facie* evidence of innovation and competition in the wireless market. Critically, the AAI's claims are devoid of any supporting data or empirical analysis.

The AAI paper likewise asserts that Verizon's obtaining additional spectrum through Verizon/SpectrumCo and Verizon/Cox would only give it greater incentive to foreclose competition. Here again is an assertion that dismisses the competitiveness of the market. But the assertion also requires sidestepping the fact that Verizon/SpectrumCo triggers the FCC's spectrum screen triggers for closer examination in only a few market areas, and only by small amounts. Verizon/Cox does not trigger the screen in any area.

The AAI paper tries to get around this by singling out the type of low-band spectrum at issue in the proposed deals as the relevant market. It contends that low-band spectrum is recognized as "more valuable" because it enables broader deployment of wireless networks at reduced costs to carriers and better in-building penetration. The AAI paper maintains that Verizon's acquisition of such spectrum would give it an advantage in terms of prices and service quality offerings.

But if Verizon obtains any price or service quality advantage over competitors it's because Verizon is paying for that advantage. Any cost savings to carriers arising from the unique characteristics of low-band spectrum would be factored into the market price for the spectrum licenses. Presumably, Verizon would also have to recoup on its investment in spectrum through its wireless service offerings to customers, in the face of competition from the national carriers and disruptive rivals. There's nothing problematic about a market competitor like Verizon taking such a calculated risk.

For that matter, the FCC pointed out in a prior *Wireless Competition Report* that high-band spectrum may offer greater capacity capabilities than low-band spectrum. These technical engineering and business trade-offs are better addressed through bargained-for prices than through disparate regulatory treatment and restraints on particular spectrum bands.

AAI's false alarms about spectrum concentration must also contend with Verizon's recent spectrum sale announcement. Upon successful completion of Verizon/SpectrumCo and Verizon/Cox, Verizon has pledged to sell its lower-band 700MHz spectrum in the A and B blocks.

The AAI's paper also dismisses any spectrum acquisition-related efficiencies to be generated by Verizon's enhanced wireless broadband coverage by insisting hypothetically that smaller carriers would put that spectrum to better use. This line of argument amounts to a standardless standard for evaluating the potential benefits of proposed transactions. It is also an open-ended avenue for the FCC to rely on mere speculations in order to reject or restrict transactions in which a real party has stepped forward and undertaken the risk and expense of making a business deal. In a footnote, the paper seems to concede that engaging in comparative evaluations as a part of a transaction review are likely outside the FCC's authority in implementing the Communications Act.

While court precedents applying the Clayton Act appear to permit comparative evaluations as a factor to be considered in a future competition analysis, this is only fitting in limited circumstances involving markets that are recognized as approaching duopoly. Comparative evaluations of competitors cannot be used in a way that amounts to little more than a hypothetical heckler's veto. And such evaluations certainly can't be used as a tactic to completely disregard innovative and competitive conditions in a market. Dismissal of dynamic competition on the basis of comparative evaluation begs the question. Moreover, technical applications of the Clayton Act are for the U.S. Department of Justice to consider in its review of the proposed transactions, not the FCC.

The AAI paper's dismissal of likely efficiencies created by Verizon/SpectrumCo and Verizon/Cox illustrates a problem that permeates the entirety of its discussion of the proposed deals: it ignores the innovative and competitive processes that are driving today's wireless market. These processes are critical to any analysis of the wireless market's consumer benefits. Their byproducts include the price decreases for wireless voice services witnessed over the last several years and – more importantly – the dramatic transformation of wireless services from being voice-centric to data-centric.

Static market indicators can scarcely capture the dynamism evidenced by the emergence and rapid growth of wireless as a multimedia platform for sophisticated smartphones and tablets featuring unique operating systems and wireless apps. And static considerations can scarcely account for the wireless market's ongoing transition to 4G, which the Verizon/SpectrumCo and Verizon/Cox transactions would help facilitate.

For that matter, the AAI paper's static market share and comparative evaluation concerns concentrate almost exclusively on competitor welfare concerns, rather than consumer welfare. The main text of the AAI paper mentions the word "consumer" just once, not counting its merely quoting the words of others, such as the parties to the proposed transactions. Yet, the benefits of marketplace activities to consumers are the rightful focus of antitrust analysis, not competitor protectionism. Indeed, consumer welfare is the touchstone of modern antitrust jurisprudence.

Perhaps the most disconcerting aspect of AAI's paper is the extent to which it's derivative of arguments sporadically employed by the FCC in recent agency actions. The static and competitor welfare-based arguments contained in the FCC's staff report against the proposed AT&T/T-Mobile merger and the FCC's *AT&T/Qualcomm Order* appear to have encouraged further calls for wireless marketplace intervention.

For the Verizon/SpectrumCo and Verizon/Cox transactions, some analysts suggest the recent announcement by Verizon that it will sell its lower-band 700MHz spectrum in the A and B blocks upon completion of the deals may be the lump of flesh that will satisfy the FCC – and DOJ, for that matter. But regardless of the impact of Verizon's announcement, beware of any narrative of the wireless market that excludes from consideration the underlying innovative and competitive forces at work or the benefits it offers to consumers through next-generation service offerings. With a spectrum crunch looming on the horizon, the FCC's policy imperative should be ensuring a flexible secondary market for spectrum governed by standards reflective of wireless market realities.

* Seth L. Cooper is a Research Fellow of the Free State Foundation, a non-partisan Section 501(c)(3) free market-oriented think tank located in Rockville, Maryland.

Further Readings

Randolph J. May, "Repurposing the FCC," *Perspectives from FSF Scholars*, Vol. 7, No. 8 (April 2, 2012).

Randolph J. May and Seth L. Cooper, Comments of the Free State Foundation – Verizon Wireless's proposed acquisitions of spectrum from SpectrumCo and Cox Communications proceeding (February 21, 2012).

Randolph J. May, "Spectrum Auctions and Communications Policy Reform," *Perspectives from FSF Scholars*, Vol. 7, No. 5 (February 15, 2012).

Seth L. Cooper, "Stifling the Spectrum Market: The Negative Implications of the AT&T/Qualcomm Order," *Perspectives from FSF Scholars*, Vol. 7, No. 4 (January 31, 2012).

Randolph J. May and Seth L. Cooper, "The FCC Staff's Report Against the AT&T/T-Mobile Merger: A Critical Analysis," *Perspectives from FSF Scholars*, Vol. 6, No. 32 (December 20, 2011).