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Proposals Like the AT&T/Leap Merger Promise Consumer Benefits

by

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A sure sign of the wireless market's dynamism is the prevalence and popularity of prepaid, no contract pricing options. This segment of the wireless market offers wireless voice and data services at discount prices to cost-conscious consumers. By the end of 2011, there were nearly 71 million prepaid wireless subscribers. And over the last few years, new subscriptions for the prepaid wireless segment have typically outpaced net additions for the postpaid segment.

AT&T's proposal to acquire Leap Wireless is just the latest development in prepaid, no contract wireless market trends. Leap is a facilities-based wireless provider. Its prepaid, no contract "Cricket" brand is offered in several major metropolitan areas. Under the deal, AT&T would leverage the Cricket brand to cater to cost-conscious wireless consumers. Cricket would be made available to millions more through delivery on AT&T's 4G LTE network, which is more expansive than Cricket's network and technologically superior.

The ultimate purpose of this paper is not to expressly endorse or oppose the AT&T/Leap merger. Instead, its purpose is to show how the proposed merger – and other proposals that may be similar – likely enhance overall consumer welfare, which, after all, ought to be the FCC's chief concern. First, AT&T/Leap would, in all likelihood, increase competition for prepaid, no contract options by boosting Cricket brand availability, reliability, and service. Second, AT&T/Leap almost certainly would enhance spectral efficiency by enabling AT&T to utilize Leap's unused spectrum and by better using Leap's underutilized spectrum. Leap is using approximately 42% of its licensed spectrum located within its facilities-based geographical footprint. Meanwhile, outside its footprint, Leap holds AWS and PCS spectrum licenses that are going unused. Its unused spectrum reportedly covers approximately 41 million people. And third, AT&T/Leap would likely improve wireless broadband service capacity and reliability by integrating Leap's cell sites into AT&T's network.

In reviewing the proposed AT&T/Leap combination, it is critical that the FCC's review process follow a proper analysis and that it be completed in an expeditious manner. In particular, the FCC's process should apply market definitions and its spectrum screen in a manner that is consistent with agency precedents – such as its *Verizon/SpectrumCo* and *T-Mobile/MetroPCS*.

The FCC should *not* arbitrarily shrink its product market definitions in the course of conducting its review. Prepaid and postpaid wireless models are primarily price and functionality alternatives for the same product: mobile telephony/broadband services. Separating out the prepaid segment for special scrutiny and regulatory intervention in the merger review process would be unjustifiable in principle, and arbitrary in practice.

Also, the FCC should adhere to agency precedents regarding the amount of spectrum it considers suitable and available for purposes of its spectrum screen. It should *not* suddenly shrink its spectrum screen inventory count in the course of reviewing AT&T/Leap – or any other proposed merger. *Ad hoc* reductions in spectrum inventory would trigger false alarms over spectrum concentration and false pretexts for regulatory intervention. In any event, AT&T/Leap only triggers the FCC's spectrum screen – an analytical tool for commencing, not ending, analysis – in a small number of market areas. Overages above 5 MHz would result in an even smaller number of areas – all of which are subject to competitive pressures from three other nationwide wireless providers.

Finally, the FCC's analysis should concentrate on the potential benefits of AT&T/Leap. That analysis should also consider the serious difficulties Leap would face absent the merger. Namely, Leap's lack of annual profits for several years running, its obstacles to obtaining future capital financing, its lack of sufficient spectrum to offer wider LTE deployment, its subscriber losses, and its rising per subscriber costs. All of those difficulties come in the face of surging demand for next-generation wireless data capabilities and corresponding network traffic increases. At the same time, the FCC's analysis should avoid injecting non-existent hypotheticals about investments by imagined new entrants or competitors, unrelated to the parties to the merger. The FCC often has been guilty of this in the past. Rather, the Commission's analysis should give credit to the large investments that wireless carriers seeking spectrum licenses are actually prepared to make.

The prepaid, no contract wireless services segment continues to grow, with national carriers like T-Mobile and Sprint firmly established in this segment. Non-facilities-based mobile virtual network operators (MVNOs) like TracFone also serve millions of consumers, enhancing choice and value for wireless consumers. AT&T/Leap should be viewed in light of that market segment backdrop – and also in light of the wireless market's overall competitive conditions and innovative environment. This paper does not take out a position for or against AT&T/Leap, for that is not its ultimate purpose. Rather, its purpose is to show that AT&T/Leap deserves an expeditious review process at the FCC. That process should be consistent with agency precedent and focused on the likely consumer welfare-enhancing benefits that mergers like this one are likely to create.

The Prepaid, No Contract Service Segment of the Wireless Market

Prepaid options have become more popular with wireless consumers over the last few years. As the FCC's *Sixteenth Wireless Competition Report* points out, "the number of prepaid subscriptions grew 29 percent from the end of 2009 to the end of 2011" – from 55 million to nearly 71 million. (There were approximately 218 million postpaid subscribers by the end of 2011.) Between the end of 2009 and 2011, net adds for the prepaid segment typically outpaced net adds for the postpaid segment. Data cited in the *Sixteenth Report* indicates, for instance, some 2 million prepaid net adds in the last quarter of 2011 versus only 1.2 million postpaid net adds.

The growing importance of prepaid, no contract options for cost-conscious wireless consumers is also evidenced by T-Mobile's acquisition of MetroPCS and its prepaid brand. T-Mobile now offers a no contract service option, along with its GoSmart prepaid service. In late July, T-Mobile announced plans to add 15 MetroPCS cities to its footprint to take on a future AT&T/Leap. Similarly, Sprint offers prepaid, no contract options under its Virgin Mobile and Boost brands. And Sprint can be expected to expand availability and reliability of its multi-brand strategy following the FCC's July *Softbank/Sprint/Clearwire Order* (2013).

The competitiveness of the prepaid segment extends beyond facilities-based providers. MVNOs – or resellers– also offer prepaid, no contract wireless services at discount prices. According to the *Sixteenth Report*, "MVNOs often increase the range of services offered by the host facilities-based provider by targeting certain market segments, including segments previously not served by the hosting facilities-based provider." Moreover:

> In 2011, the largest MVNO was TracFone Wireless (TracFone), which had more than 19 million subscribers in the United States at year's end, giving it a subscriber base in the United States that is larger than every facilities-based provider other than the four nationwide providers.

It is in light of the growth and competition in the prepaid, no contract wireless market segment that AT&T recently proposed to acquire Leap Wireless.

The Proposed AT&T/Leap Merger

Leap is a facilities-based wireless provider known primarily for its "Cricket" brand. Cricket operates on a prepaid, no-contract model. It offers voice and data services at discount prices and caters to value-conscious consumers. Some 96 million people reside within Leap's facilities-based footprint. Most of its wireless network offers 3G CDMA EVDO service, while in 11 metropolitan areas – covering some 21 million people – it offers 4G Long-Term Evolution (LTE) service on a narrowband basis. And its licensed spectrum holdings span a geographic area in which nearly 137 million people reside. Leap is not a "nationwide" wireless carrier. However, it does offer some service outside its facilities-based footprint through a combination of roaming agreements with other carriers and by acting as a reseller of other carriers' wireless network services.

AT&T is expected to acquire Leap, as a wholly owned subsidiary, for about $1.3 billion. On July 12, it was announced that AT&T tendered an offer of $15 per share of Leap – an 88% premium to Leap's closing stock price on that same day. The deal's announcement followed Leap's reported loss of $163 million, or $2.09 per share for the quarter ending June, 30, 2012. In fact, Leap has not reported an annual profit in the last seven years. And its June 30 subscriber base of approximately 4.8 million is down more than 20% from its March 31, 2012, reported subscriber base of 6.2 million.

AT&T and Leap have filed an application with the FCC to approve the merger, which includes the transfer of Leap's spectrum licenses and cell sites. The deal is concurrently under review by the U.S. Department of Justice.

AT&T/Leap Presents Potential Public Interest Benefits

On its face, the proposed AT&T/Leap merger appears likely to enhance wireless consumer welfare. In all likelihood, AT&T/Leap would: (1) increase competition for prepaid, no contract options by boosting Cricket brand options, reliability, and service; (2) enhance spectral efficiency by enabling AT&T to utilize Leap's unused spectrum and by better using Leap's underutilized spectrum; and (3) improve wireless broadband service capacity and reliability by integrating Leap's cell sites into AT&T's network.

Increase Competition for Prepaid, No Contract Options

Against a backdrop of prepaid segment growth and competition, AT&T/Leap offers expanded competitive alternatives to consumers. AT&T's LTE network now reaches 225 million people – far more than the 96 million in Leap's facilities-based footprint. For consumers, delivery of Cricket service on AT&T's LTE wireless network also means increased wireless broadband data speeds and capabilities along with improved reliability. Reduction in costs associated with roaming and resale agreements would also result from delivery of Cricket service on AT&T's national network. Given Leap's precarious position – with its limited geographical reach, indebtedness hampering its ability to acquire additional capital financing, and increased costs-per subscriber due to churn – AT&T/Leap offers not only a reversal of fortune for the Cricket brand but a new discount service option for millions of cost-conscious consumers.

Enhance Spectral Efficiency by Utilizing Unused Spectrum and by Better Using Underutilized Spectrum

As the *Sixteenth Report* put it:

> Access to spectrum is perhaps the most important input for the provision of mobile wireless services. Demand for these services has grown steadily and sharply in recent years and projections indicate such growth will continue unabated. In order for service providers to meet the demand, they will need to put new spectrum to use and make more efficient use of existing holdings.

AT&T/Leap would do both: put new spectrum to use and make more use of existing holdings. As Cisco's Global Mobile Data Traffic Forecast Update, 2012 - 2017 indicates, North American wireless consumers, who in 2012 used about 752 megabytes (MB) per month, are expected to use an average of 6,171 MB per month by 2017. Spectrum use and efficiency gains stemming from the merger would significantly assist AT&T's ability to meet future mobile demand by AT&T and Cricket subscribers.

Leap is using approximately 42% of its licensed spectrum located within its facilities-based geographical footprint. Meanwhile, outside its footprint, Leap holds AWS and PCS spectrum licenses that are going unused. Its unused spectrum reportedly covers approximately 41 million people.

Those underutilized and unused spectrum resources would be absorbed into AT&T's network and put into heavy use. Integrating Leap's AWS and PCS spectrum licenses into AT&T's LTE network would increase its overall use and capacity. When contiguous spectrum is combined, its capacity increases beyond what separate bands could achieve. Such combination also eliminates the need to reserve guard bands, thereby putting more spectrum directly into use. In approximately 50 cellular market areas (CMAs), Leap AWS spectrum licenses are contiguous to AT&T spectrum. This enables fast-track integration, with future integration following perhaps as early as 60 days of closing. AT&T anticipates integrating Leap spectrum licenses in 160 CMAs within a year of closing.

Improve Wireless Broadband Network Capacity and Reliability by Integrating Cell Sites

Alongside the constraints attending to obtaining spectrum, the FCC acknowledged in its *Sixteenth Report* that "obtaining the necessary regulatory and zoning approvals from state and local authorities" is one of the most "significant constraints faced by wireless services providers that need to add or modify cell sites." Acquiring Leap's cell towers and other cell sites would enable AT&T to avoid often lengthy and costly local government permitting processes for building or upgrading wireless physical infrastructure.

AT&T/Leap would likely result in the integration a few thousand of Leap's cell sites into AT&T's network. This would allow AT&T to increase the scope and density of its network, increasing capacity for wireless data traffic and thereby improving video, web browsing, and other data capabilities demanded by consumers. Such integration and densification would reduce coverage gaps and dropped connections. AT&T would likely decommission those cell sites that create redundancies, and thereby create cost-savings.

Merger Review: How the FCC Should Analyze AT&T/Leap

Rather than endorse or oppose the AT&T/Leap merger as such, the foregoing section summarized some of the primary competitive and consumer welfare benefits likely to result from the proposed deal. But that summary is premised on a proper analytical framework. In reviewing AT&T/Leap, it is critical that the FCC's analysis be disciplined. In particular, the FCC's merger review process should apply product market definitions and its spectrum screen in a manner that is consistent with agency precedents and that is therefore predictable. The FCC's analysis should also embody a forward-looking approach that is focused on the merging parties and the dynamics of the proposed transaction.

The FCC Should Consistently and Predictably Apply Market Definitions

In reviewing prior mergers involving wireless carriers, the FCC has consistently defined the relevant product market as "mobile telephony/broadband services." The FCC's Wireless Telecommunications and International Bureaus took this approach most recently in the *T-Mobile/MetroPCS Order*. Since both T-Mobile/MetroPCS and AT&T/Leap involve nationwide wireless carriers purchasing prepaid, no contract wireless carriers, the latter merger should be analyzed according to the same market definitions as the former.

FSF President Randolph May and I have often urged the FCC to take cross-platform competition into account in such mergers and consider *broader* market definitions that include fixed wireless and other wireline alternatives. But at the very least, the FCC should not arbitrarily impose any *narrower* market definitions, whether by singling out the prepaid market segment or any other segment.

Prepaid and postpaid services are surely ready substitutes for one another. The very existence and increasing popularity of the prepaid market segment speaks to the sensitivity of wireless consumers to pricing rates and options associated with differing price models. At their core, both prepaid and postpaid wireless offer the same basic services: mobile telephony/broadband services. Separating out the prepaid segment for special scrutiny and regulatory intervention in the merger review process would be unjustifiable in principle, and arbitrary in practice.

The FCC Should Consistently and Predictably Apply Its Spectrum Screen

In analyzing whether spectrum concentration will result from an AT&T/Leap merger, the FCC should adhere to agency precedents regarding the amount of spectrum it considers suitable and available for purposes of its spectrum screen. The FCC should approach all mergers with a consistent and predictable set of standards.

As the FCC described it in its *Verizon/SpectrumCo Order*, "[t]he current screen identifies local markets where an entity would acquire more than approximately one-third of the total spectrum suitable and available for the provision of mobile telephony/broadband services." The spectrum screen is merely an analytical tool, not a cap. Where the screen is triggered in a local market, the FCC identifies that market for further analysis, taking competitive conditions into account.

Plausible arguments exist that the current spectrum screen inventory could be *expanded*, since it does currently include BRS/EBS spectrum or other spectrum resources. But the spectrum screen inventory should *not* be *reduced* in the course of reviewing AT&T/Leap or any other merger. Such an action would bear the hallmarks of arbitrary and self-serving goal-post moving. *Ad hoc* reductions in spectrum inventory should not be made in order to more easily gin up concentration concerns that call for regulatory intervention.

Unfortunately, the FCC's 2011 staff report opposing the proposed AT&T/T-Mobile took this approach. Some of the staff report's exaggerated allegations regarding spectrum concentration and the need for regulatory intervention were premised on a simultaneous downward shift in the amount of spectrum considered suitable and available under its screen. Fortunately, recent FCC precedents have avoided the staff report's approach.

In the *Verizon/SpectrumCo Order* and more recent merger orders the FCC has declined to make any changes to its spectrum screen. It should take that same approach in reviewing AT&T/Leap. As the *Verizon/SpectrumCo Order* noted, the FCC has an ongoing rulemaking in which it is reviewing its spectrum screen policies with an important goal: "to ensure that we have rules of the road that are clear and predictable, and permit parties to incorporate any significant shifts in policy into their pre-transaction planning." Any sudden alterations to its spectrum screen rules, made in the course of a merger review, would make for a thoroughly unclear and unpredictable process that would undermine parties' pre-transaction planning. If such new spectrum screen rules or alterations are truly desirable, they should be made prior to and apart from any particular merger, and subject to public comment and rulemaking procedures.

Should the FCC adhere to its precedents, AT&T/Leap should fare favorably regarding spectrum aggregation. AT&T/Leap triggers the FCC's screen in only 38 out of 356 CMAs affected by the merger. Of those 38 CMAs, the FCC's screen is exceeded by more than 5MHz in just 17. Also relevant to the analysis, all four nationwide wireless carriers hold spectrum in every CMA affected by AT&T/Leap.

The FCC Should Take a Forward-Looking Approach Focused on the Merging Parties and Their Proposed Transaction

AT&T's proposed merger with Leap and the future competitive dynamics of the merging parties should be the focus of the FCC's merger review. The FCC's analysis should concentrate on the potential benefits of the merger, arising from expanded availability of Cricket's brand on a next-generation wireless network to cost-conscious consumers, increased spectral use and efficiencies resulting from the integration of Leap's unused and underutilized spectrum licenses into AT&T's LTE network, and the improved network capacity and reliability resulting from the addition of a few thousand cell sites to AT&T's network.

That analysis should also consider the serious difficulties that Leap would face absent the merger. Namely, Leap's lack of annual profits for several years running, obstacles to obtaining future capital financing, lack of sufficient spectrum to offer wider LTE deployment, subscriber losses, and rising per subscriber costs. Those difficulties all come in the face of surging demand for next-generation wireless data capabilities and corresponding network traffic increases.

The FCC must avoid clouding its analysis with hypotheticals unrelated to the parties to the merger. Unfortunately, the FCC has previously invoked such hypotheticals as competitive concerns to rationalize regulatory intervention. For instance, in the *AT&T/Qualcomm Order* (2011), the FCC claimed that AT&T would hold a significant portion of available low-band 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."

The FCC's analysis should give credit to the large investments that wireless carriers seeking spectrum licenses are actually prepared to make as opposed to non-existent hypothetical investments by imagined new entrants or competitors. An analytical approach focused on the merging parties themselves and their actual proposal is not only equitable, it's also the law. As 47 U.S.C. § 310(d) states, in reviewing mergers "the Commission may not consider whether the public interest, convenience, and necessity might be served by the transfer, assignment, or disposal of the permit or license to a person other than the proposed transferee or assignee."

Conclusion

The proposed AT&T/Leap merger is the latest development in prepaid, no contract wireless market trends. Without stating an ultimate position for or against the merger, it can still be said that mergers similar to this proposed combination would likely enhance consumer welfare. First, AT&T/Leap would, in all likelihood, increase competition for prepaid, no contract options by boosting Cricket brand availability, reliability, and service. Second, AT&T/Leap would almost certainly enhance spectral efficiency by enabling AT&T to utilize Leap's unused spectrum and by better using Leap's underutilized spectrum. And third, AT&T/Leap would likely improve wireless broadband service capacity and reliability by integrating Leap's cell sites into AT&T's network.

In reviewing AT&T/Leap, it is critical that the FCC's review process be disciplined and follow a proper analysis. In particular, the FCC's merger review process should apply market definitions and its spectrum screen in a manner that is consistent with agency precedents.

The FCC should not arbitrarily shrink its market product definitions in the course of conducting its review. Prepaid and postpaid wireless models are primarily price and functionality alternatives for the same basic product: mobile telephony/broadband services. Also, the FCC should adhere to agency precedents regarding the amount of spectrum it considers suitable and available for purposes of its spectrum screen.

Finally, the FCC's analysis should concentrate on the potential benefits of AT&T/Leap. That analysis should also consider the serious difficulties Leap would face absent the merger. Its analysis should credit the large investments that wireless carriers seeking spectrum licenses are actually prepared to make.

The prepaid, no contract wireless services segment continues to grow, with national carriers like T-Mobile and Sprint established in this segment, and with MVNOs like TracFone enhancing choice and value for wireless consumers. The proposed AT&T/Leap merger should be viewed in light of those market trends. AT&T/Leap deserves an expeditious review process at the FCC that is consistent with agency precedent and focused on the likely consumer welfare-enhancing benefits that the merger would create.

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Further Readings

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