A Fresh Approach to Assessing Consumer Impacts of an AT&T/T-Mobile Merger:
Reexamining the Basic Assumptions about T-Mobile's Pricing

by

Allen Rosenfeld, Ph.D.

M+R Strategic Services

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Introduction: *The Need to Question Conventional Wisdom*

In the four months or so since the proposed merger between T-Mobile USA and AT&T was announced, there has been no shortage of commentary on the Internet and in traditional news media regarding the likely impacts of the merger on consumers and the prices they will have to pay for wireless services if the merger is approved by federal authorities.

A review of those commentaries reveals common, questionable assumptions and suggests that stakeholders could benefit by taking a step back and examining the starting points of their preliminary evaluations of the merger. To produce an accurate understanding of the impacts of any merger requires choosing an appropriate method of analysis. Starting points are critical in avoiding a common tendency to overlook key considerations that will determine whether the merger is a good deal for American consumers.

Many of the commentaries about the likely impacts of the merger on consumers fall into a faulty-assumptions trap, especially regarding the effect of the merger on retail pricing in the wireless industry. The linear logic of those arguments goes something like this: the merger would increase substantially the concentration of the U.S. wireless market in the hands of the two top firms in an oligopolistic industry;[1] competition from a firm with lower retail prices than the other top firms would be eliminated; higher concentration and the elimination of T-Mobile USA would therefore, lead to higher retail prices; as a result, , consumers would be worse off if the merger were approved. In other words, according to the critics, the before-merger situation would be better for consumers than the after-merger situation. Less concentration would be better than more concentration when the post-merger industry no longer contains the alleged lower-priced competitor, in this instance, T-Mobile USA.[2]

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[1] If approved, the merger would increase the combined market share of wireless customers for Verizon and AT&T from 63% to 76%, based on 2009 second-quarter statistics reported by the FCC. U.S. Federal Communications Commission. *Fourteenth Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*. May 20, 2010, p. 31.

[2] See, for example: Takahashi, Dean. "AT&T's Purchase of T-Mobile Will Test Antitrust Law," Mobile Beat. March 20, 2011. (David Balto of the Center for American Progress says in the article, "T-Mobile has been an incredibly important force in the market. AT&T taking it out is not going to be good for consumers and this is going to face very aggressive scrutiny.") http://venturebeat.com/2011/03/20/atts-purchase-of-t-mobile-will-test-antitrust-law/. Another example is an April 12, 2011 letter to Congress from Consumers Union on the merger: "A price analysis survey of the voice and data plans available from AT&T and T-Mobile

This approach is likely to be short-sighted for at least the three following reasons: 1) it ignores potential cost-reductions, resulting from the increased operational efficiency produced by the merger, that would lead to downward price pressure despite the increase in industry concentration; 2) it fails to account for the continuation of T-Mobile USA-like lower-priced plans by AT&T; and 3) it assumes that, in the absence of the merger, T-Mobile USA would continue to be a viable competitor and its current pricing policy would be sustainable into the future.

Although all three issues are critical to producing an accurate assessment of the merger's impacts on consumers, the analysis in this paper focuses on the sustainability of T-Mobile's pricing policy and how assumptions about it can inappropriately bias assessments in an anti-consumer direction.[3]

Fatal Flaws in Many Analyses

A fundamental guiding principle underlying the economic analysis of the impacts of any proposed economic activity is that the analysis must compare apples with apples. The assessment of the consumer impacts of the AT&T/T-Mobile USA merger is no exception. In this instance, the apples that should be compared are consumer outcomes resulting from the merger ***in the post-2012 period*** and consumer outcomes that would occur ***in the post-2012 period*** if the merger did not occur.[4] In other words, it is the two projected outcomes in the post-merger period that should be compared. Instead, many analysts are incorrectly comparing apples (i.e., projected consumer outcomes ***in the post-2012 period***) and

demonstrates that T-Mobile wireless plans typically cost $15 to $50 less per month than comparable plans from AT&T. That finding supports anecdotal observations that T-Mobile is generally a lower-priced carrier than AT&T. It also validates concerns that T-Mobile subscribers eventually migrating to AT&T plans could pay more for service than they would have under a T-Mobile plan—and that T-Mobile's departure from the wireless market would eliminate a relatively low-cost carrier as an option for consumers." http://hearusnow.org/document/consumers-union-letter-to-congress-on-atts-proposed-purchase-of-t-mobile

[3] Regarding the second consideration, AT&T officials have stated that T-Mobile USA customers will be able to keep the pricing plans they locked in with T-Mobile USA should the merger be approved. According to AT&T's formal public position in the press, T-Mobile customers will be able to keep their rate plan and do so for as long as they want to, even when upgrading to a comparable device or when the terms of their agreements end and the service continues on a month-to-month basis.

[4] To simplify the discussion, it is assumed that the merger would not be completed until the end of 2012.

oranges (i.e., consumer outcomes that occurred ***prior to the merger***, such as the current T-Mobile USA's pricing structure). Such a comparison inadvertently (and in this case incorrectly) ensures that the outcome of the analysis will yield negative consumer impacts.

At the core of the flawed apples-and-oranges comparison is an implicit assumption that, in the absence of the proposed merger, T-Mobile USA's current pricing structure would continue to be available to consumers. In the most-general sense, that assumption implies a continuation of the status quo for T-Mobile USA for the foreseeable future. More specifically, it assumes that T-Mobile USA's overall customer strategy, driven by plans priced lower than AT&T's and Verizon's, could be sustained for years to come.[5] A close look at the industry and the competitive outlook for T-Mobile USA, however, casts serious doubt upon the validity of the assumption that T-Mobile USA, going it alone in the absence of the merger, would be able to sustain its pricing strategy and that consumers would be better off if the merger were not approved.

T-Mobile USA's Unsustainable Business Model

If nothing else, the U.S, wireless industry is extremely dynamic. During the past decade, the industry has been characterized by rapid growth, both in the number of customers and the use of specific services such as mobile access to the Internet; successive mergers and acquisitions; rapid technological change in equipment and infrastructure; and so on. In such an explosive business environment, the status quo for a competitor is hardly something that can be taken for granted beyond a short time horizon. Perhaps the best example of a wireless industry player in such a state of flux is T-Mobile USA.

That T-Mobile USA would seek a merger this year is hardly a surprise. Numerous telecomm industry analysts and watchers were predicting the need for a major change of direction for the company. Pessimistic outlooks varied from forecasts of the outright

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[5] The Antitrust Institute alluded to the need to examine the viability of T-Mobile USA's current business model in its preliminary analysis of the proposed merger. "T-Mobile is arguably a maverick firm in the wireless industry and eliminating it through merger increases the risk of post-merger price increases…..The maverick theory may depend, however, on whether T-Mobile can be a viable competitor in the 4G market, if not independently, then as part of another company that would be a competitive threat to the leading wireless companies." *The Acquisition of T-Mobile by AT&T Mobility: Merger Review Issues and Questions*, March 26, 2011. http://www.antitrustinstitute.org/sites/default/files/AAI_Brief%20on%20ATT-T-Mobile.pdf

disappearance of the company in 2012 to the need for the company to acquire another telecomm industry player.[6]

The company, which is wholly owned by the German telecommunications giant, Deutsche Telekom, has been struggling to keep up with its competitors and will continue to do so. Its parent company has no plans to match U.S. competitors in making the enormous investments needed to be at the cutting edge of industry technology, infrastructure and service. [7] Deutsche Telekom has refused to sacrifice investments in its European operations or increase its debt load to provide the level of capital that would have been needed to keep T-Mobile USA at the competitive cutting edge of the U.S. wireless industry. As a result of this investment lag, which has led to lower-quality service, T-Mobile USA's customer base has steadily eroded.[8] The inability to compete with competitors for the most-desirable handset technologies, such as the iPhone, apparently also contributed to the erosion of company's customer base at a critical time for the growth of the industry.[9] And earlier this month the company was dealt another blow by the collapse of its distribution partnership with the retail giant, Radio Shack, which replaced T-Mobile USA with Verizon.[10]

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[6] See, for example: Noyes, Katherine. "Can T-Mobile USA Get Its Groove Back?" CRM Buyer. November 18, 2009. http://www.crmbuyer.com/story/68686.html?wlc=1303858920; Telekom mulling T-Mobile USA IPO: Sources," Reuters. February 5, 2010. http://www.reuters.com/article/2010/02/05/us-deutschetelekom-tmobile-idUSTRE6141ZD20100205?pageNumber=2; "Ten Brands That Will Disappear in 2011: 24/7 Wall St," Huffington Post. June 15, 2010. http://www.huffingtonpost.com/2010/06/18/11-brands-that-will-disap_n_617198.html#slide_image; Kjetland, Ragnhild. "T-Mobile USA Seeks to Ride Beefed Up Network, May Need Partners," Bloomberg News. January 19, 2011. http://www.bloomberg.com/news/2011-01-19/T-Mobile USA-usa-seeks-to-ride-beefed-up-network-may-need-partners.html; Cheng, Roger. "T-Mobile USA Weighs Sale of Some Assets," Wall Street Journal Online. January 20, 2011. http://online.wsj.com/article/SB10001424052748704881304576094022813641048.html;

[7] Kjetland, Ragnhild. "T-Mobile USA Seeks to Ride Beefed Up Network, May Need Partners," Bloomberg News. January 19, 2011; "Deutsche Telekom Ends 'Global Player' Strategy," Deutsche Welle. March 21, 2011. http://www.dw-world.de/dw/article/0,,14927530,00.html.

[8] "That Deutsche Telekom needed to make big changes at its struggling US wireless subsidiary was no industry secret. In the end, the subsidiary failed to deliver the numbers – too few customers, too little coverage and too large a gap to the market leaders AT&T Mobility, Verizon Wireless and Sprint Nextel. To stay in the running, Telekom would need to invest billions of dollars in a next-generation high-speed mobile technology. ("Deutsche Telekom Ends 'Global Player' Strategy," Deutsche Welle. March 21, 2011.)

[9] O'Brien, Kevin. "How the iPhone Led to the Sale of T Mobile USA," *New York Times*. March 21, 2011.

[10] Skariachan, Dhanya. "RadioShack Shuns T-Mobile for Verizon," Reuters. July 26 2011. http://www.reuters.com/article/2011/07/26/us-radioshack-idUSTRE76P2KX20110726

T-Mobile USA's monthly 'churn rate' for non-prepaid phones, which reflects the rate at which customers under contract by T-Mobile USA failed to renew those contracts when they expired, demonstrates the company's inability to sustain its contract customer base. Its contract churn rate hit 2.5% in the fourth quarter of 2010, compared to 1.4% for AT&T and 1.0 % for Verizon. The pattern continued in the first quarter of 2011 as the company reported a contract churn rate of 2.4%,[11] losing "471,000 contract customers" in the process.[12] The company's overall churn rate for contract and prepaid customers was 3.6% in that quarter, following an equally disappointing 3.4% and 3.3% for the third and second quarters of 2010, respectively. [13] That's a net loss of nearly 320,000 T-Mobile USA subscribers in the fourth quarter alone.

This pattern of well-above-average churn rates extends back to the middle of the previous decade. For the 2005-to-2008 period, T-Mobile USA's overall churn rate was consistently between 2.7% and 2.9% while the overall churn for Verizon for the same period was under 1.5%.[14]

In short, even though it has offered lower rates for some plans than its competitors, T-Mobile USA's standing in the wireless services industry has been sliding for the past few years. In the absence of much-needed infrastructure investments – and Deutsche Telekom has made it clear that such investments are not a priority -- T-Mobile USA's business model does not appear to be sustainable. Self-imposed lower-than-average revenues per customer combined with a declining customer base and a lack of cutting-edge investment is not likely to be a recipe for long-term success and competitiveness in this dynamic

[11] "T-Mobile Struggles to Compete, Loses Subscribers, Income," Gigacom. May 6, 2011. http://gigaom.com/2011/05/06/t-mobile-struggles-to-compete-loses-subscribers-income/

[12] "Deutsche Telekom Net Falls in Eastern Europe, T-Mobile USA," Bloomberg Business Week. May 6, 2011. http://www.businessweek.com/news/2011-05-06/deutsche-telekom-net-falls-on-eastern-europe-t-mobile-usa.html. See also: Entner, Roger. "T-Mobile Results Show AT&T Arrives Just in Time." http://www.fiercewireless.com/story/entner-t-mobile-results-show-att-arrived-just-time/2011-05-09 . ("It [T-Mobile USA] is losing premium subscribers to Verizon and AT&T, it is losing value conscious subscribers to Sprint, and budget conscious subscribers to the disruptive unlimited providers such as MetroPCS, Leap Wireless, and Tracfone's StraightTalk products.")

[13] "T-Mobile USA Reports Fourth Quarter 2010 Results." T-Mobile USA Press Release. February 25, 2011.

[14] U.S. Federal Communications Commission. May 20, 2010, p. 139.

industry. Consequently, in the absence of a merger, the viability of the stand-alone company could well be in jeopardy.[15]

No Difference in Consumer Prices with or without the Merger

The forgoing analysis has important implications for the understanding of the consumer price impacts of the merger between AT&T and T-Mobile USA. If T-Mobile USA current pricing structure is unsustainable into the future in the absence of the merger, then the with-merger and without-merger scenarios, from a consumer pricing perspective, are expected to produce very similar outcomes. In other words, other things constant, there would be little or no negative price impact, for both current customers of T-Mobile USA and other consumers, as a result of the elimination of T-Mobile as a free-standing company by the merger. For the current T-Mobile USA customers, AT&T has guaranteed their ability to keep current T-Mobile USA pricing plans should they choose to do so. For other consumers, T-Mobile's current pricing structure would not be an available option since it could not be sustained in the future.

[15] "[t]he required substantial investments in LTE in the United States would significantly stretch Deutsche Telekom's financial capability or, alternatively, force Deutsche Telekom to reallocate investments from our core Europe operations into T-Mobile USA, which has been shrinking for the last two years and which is lacking a clear path towards LTE to stay competitive." (Deutsche Telecom Senior Vice President Langheim, quoted in *Acquisition of T-Mobile USA, Inc. by AT&T, Inc.*, April 21, 2011.) See also, O'Brien, Kevin. "How the iPhone Led to the Sale of T Mobile USA," *New York Times*. March 21, 2011. ("In the end, Deutsche Telekom decided the looming costs of its network upgrades in the United States and additional purchases of broadcast spectrum were too risky given the decline in contract customers, Mr. Kitz, the Merck Finck analyst, said.")