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AT&T and T-Mobile Call Off Their Merger

Allison M. Holt

EI Senior Economist Allison M. Holt, an empirical microeconomist, specializes in quantitative analysis and assessment of damages in antitrust and class action matters.

AT&T and T-Mobile, which announced a prospective merger in March 2011, withdrew their merger application in December. AT&T blamed the merger's demise on the opposition of the U.S. Department of Justice (DOJ), which filed a law suit in August to block the merger, and the Federal Communications Commission (FCC). AT&T claimed that blocking the merger would harm consumers, investment and innovation.

The top four wireless carriers, AT&T, T-Mobile, Verizon and Sprint, provide 90 percent of mobile wireless telecommunications service in the United States. DOJ argued that the high post-merger concentration, both nationally and in almost all local markets, suggests that the loss of one competitor would result in a substantial increase in market power. DOJ also stated that the merger's anticompetitive effects would be worse because T-Mobile was a particularly aggressive competitor both in pricing and innovation. Moreover, entry would be difficult as it would require nationwide spectrum, a national network, a large number of customers to produce scale economies, and a strong brand. Thus, DOJ alleged that the merger would result in consumers facing "higher prices, less product variety and innovation, and poorer quality service."

The FCC's staff report on the merger makes arguments similar to DOJ's. It states that "the unprecedented increase in market concentration" due to the merger would raise prices and lessen innovation and investment in the mobile wireless market. The FCC found no evidence to support AT&T and T-Mobile's claim that the merger would create jobs. In fact, it found that AT&T's internal documents contradicted this claim. The FCC staff found it more likely that the merger would lead to massive job losses as the two firms eliminated overlapping services and operations. According to the report, internal AT&T documents also contradicted the claim that the merger was necessary for AT&T to expand its 4G LTE network to more users. The FCC staff concluded that while AT&T needs more spectrum to increase its capacity, it could meet that need by buying spectrum licenses from companies not using them, as it has been doing.

Because the merger has fallen through, AT&T must now pay Deutsche Telekom, the parent company of T-Mobile, $3 billion cash and also give it $1 billion in wireless assets. In addition, AT&T and T-Mobile subsequently entered into a seven-year roaming agreement for the United States. This agreement will allow T-Mobile to extend its coverage into sections of the country where it previously had no high-speed mobile network.

Also In This Issue

The (Mis)Use of Screens in Economic Analysis

Stuart D. Gurrea and Jonathan A. Neuberger discuss the use of screens in economic analysis. Screens are tools that allow investigators to focus their efforts on areas most likely to reveal problems. By design, screens offer a simplified and frequently imprecise detection tool that does not account for all the relevant economic factors. Failing to recognize the limitations associated with the design and implementation of screens may lead to erroneous conclusions.

The Role of Conduct Remedies in Addressing Merger Competitive Effects

Henry B. McFarland discusses the use of conduct remedies in merger enforcement. The U.S. Department of Justice (DOJ) recently has shown a new willingness to use conduct remedies, particularly access guarantees and information restrictions. These remedies provide the antitrust authorities with a more flexible response to perceived threats to competition, but they also raise a number of serious issues. For example, access guarantees raise the question of how to set the price, terms, and quality of access. Information restrictions may complicate business operations and block merger-related efficiencies. Antitrust authorities should continue to prefer structural to conduct remedies. Moreover, the U.S. antitrust authorities should pay careful attention to how conduct remedies work in the various instances where they were recently applied. In that way, they may learn more about the appropriate use of these remedies.

The (Mis)Use of Screens in Economic Analysis

Stuart D. Gurrea and Jonathan A. Neuberger

A screen is a simple test that identifies likely candidates for a broader and more complex economic analysis. The use of screens in economic analysis typically involves comparing an observation of a variable to a reference value, threshold or benchmark. For example, a measure of the dispersion of a group of prices may be compared to its historical level. Screens are often formalized into statistical tests.

Screens are used in a variety of different contexts. For example, current prices may be compared to levels observed during periods known to be competitive. If that comparison indicates prices are abnormally high, that may trigger a price-fixing investigation. As another example, financial data may be examined to see if they follow an expected pattern or distribution. If certain financial data deviate from the pattern they have followed historically, that anomaly may trigger further investigation. Suppose the data commonly follow Benford's Law, an empirical regularity describing the behavior of the leading digits of the numbers in a data set, but do not follow that pattern in a given period. Other evidence may then be examined to determine whether the anomaly reflects market manipulation or other misconduct.

Competition agencies often use screens to help identify market situations that raise antitrust concerns and justify further scrutiny. Government agencies have limited resources and the use of screening tools contributes to efficient antitrust enforcement. Screens may help detect past anticompetitive behavior. For example, certain percentage price increases in an industry or a lack of price variability can be interpreted as possible manifestations of collusion. Screens also may indicate the likelihood that anticompetitive conduct will develop in the future. For example, since 1982, the U.S. Department of Justice, the Federal Trade Commission, and the state Attorneys General use the post-merger Herfindahl-Hirschman Index ("HHI") to assess the likelihood of anticompetitive effects from a merger. This screen is based on interpreting market concentration as a signal of a merger's likely competitive effects. More recently, and for the same purpose, the Upward Pricing Pressure ("UPP") test based on diversion ratios, gross profit margins and efficiencies has been proposed to predict the direction of post-merger price changes in prospective mergers involving differentiated products.

EI Senior Economist Stuart D. Gurrea and EI Principal Jonathan A. Neuberger have extensive experience in the analysis of antitrust matters, calculation of damages, and financial analyses. In particular, they have assessed the reliability of competition analyses based on the use of economic screens

> **"Well-designed screens can be misused if practitioners fail to recognize their limitations."**

The use of screens in economic analysis is justified to the extent that a single structural index or statistic offers a good indicator or signal of a particular economic condition. The strength of a screen, however, depends on the strength of the theory from which it is derived, as well as the proper empirical application of that theory. For example, the strength of a threshold based on a market concentration index to analyze market power depends on the link between market structure and economic conduct and on whether the market is properly defined.

Designing and selecting a screen typically presents a tradeoff between the efficiency and simplicity that justify the use of the screen in the first place and its effectiveness. Screening tools that are data-intensive or difficult to implement can be better applied as part of a full investigation. For example, the data requirements of the UPP test may be hard to satisfy at the initial stages of a merger inquiry. Conversely, screening devices that oversimplify the analysis can be easy to implement but fail to serve their purpose. An effective screen will minimize two types of errors: not finding anticompetitive conduct when it is there (false negatives) and detecting anticompetitive conduct when it is not there (false positives).

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The Role of Conduct Remedies in Addressing Merger Competitive Effects

Henry B. McFarland

EI Vice President Henry B. McFarland has often analyzed the competitive effects of mergers and the desirability of relief proposals. A longer version of this article was published in a recent version of The Threshold.

In dealing with potential anticompetitive effects from a merger, antitrust authorities have long preferred structural remedies, which affect the post-merger ownership of assets, to conduct remedies, which constrain the post-merger behavior of the merged firm. The U.S. Department of Justice (DOJ), however, recently has shown a new willingness to use conduct remedies. DOJ's 2011 "Policy Guide To Merger Remedies" (2011 Guide) describes these remedies as a "valuable tool" to preserve a merger's efficiencies while eliminating its competitive harm. Moreover, DOJ and the Federal Trade Commission (FTC) have used such remedies in a number of recent mergers. Nonetheless, studies by both the Canadian Competition Bureau (CCB) and the European Commission's Directorate General for Competition (DG-Competition) of conduct remedies in past mergers show their effectiveness has been mixed at best.

Conduct remedies are typically used to address perceived problems with vertical mergers and with the holding of minority interests, although in some cases they may be used in horizontal mergers. While, the 2011 Guide describes a variety of different conduct remedies, the conduct remedies used most commonly have been access guarantees and information restrictions. These remedies provide the antitrust authorities with a more flexible response to perceived threats to competition, but they also raise a number of serious issues.

Access guarantees require the merged firm to allow other firms, typically its competitors, access to some of its assets, often intellectual property. Implementing these guarantees raises the problem of how to set the price and terms of access. If the price is set too high or the terms are too onerous, then the relief may be ineffective. If the price is too low or the terms too generous, then there may be inefficient use of the assets involved. Also, for access guarantees to be effective, the quality of the asset involved must be maintained. That is a particularly serious problem in high-technology industries, where the technology being offered to competitors may be allowed to lag behind that of the merged entity, thus putting the competitors at a serious disadvantage.

Several recent consent decrees have addressed this issue by requiring that price, terms, and quality of access be based on competitive benchmarks. For example, prices charged competitors may be based on those charged to other customers that the merged party does not compete with and thus has no desire to foreclose. Alternatively, prices and terms may be based on the levels that prevailed before the merger.

The success of these approaches to setting the price, terms, and quality of access remains to be seen. Often, guaranteeing access requires setting a wide variety of terms and conditions, and it may be very difficult to determine if the terms under which any given firm is offered access are consistent with the consent decree. The DG-Competition study found that access guarantees "have only worked in a very limited number of instances," due to "inherent difficulties" in setting and monitoring the conditions of access. The study concludes that the use of these remedies should be limited to cases where these difficulties can be minimized.

Access guarantees likely will require ongoing monitoring. The CCB study found evidence that a failure to appoint monitors reduced the effectiveness of conduct remedies. Moreover, disputes over the application of the remedies may involve the agencies and the merged firm in protracted litigation. Certain consent decrees have provisions that allow firms that believe they have not been granted appropriate access to apply to DOJ for permission to begin binding arbitration. Such provisions may not always be effective. The CCB study found that in some cases formal arbitration methods were difficult to use.

Conduct remedies that restrict the flow of information, such as by preventing different divisions of a firm from sharing information post-merger, appear less problematic than access guarantees. Nonetheless, these remedies also have some disadvantages. These restrictions may complicate business operations and block efficient contracts. If merger-related efficiencies depend on better coordination of vertically-related segments of the merged firm, these restrictions may block the information flows required for such coordination and thus prevent the firm from realizing those efficiencies.

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Well-designed screens can be misused if practitioners fail ~~to recognize their limitations. Screens are by design not~~ dispositive pieces of evidence but indicators that are calculated with limited resources. In some instances, a test may be insufficient because the range of competition concerns extends beyond the information conveyed by the screen. In other instances, a test may flag cases where a necessary condition for conduct of concern is met, but that condition is not sufficient to conclude that such conduct exists. In many cases, overcoming these limitations calls for a more extensive economic inquiry.

For example, recent litigation concerning manipulation of the Libor (London Interbank Offer Rate)—a reference interest rate derived from individual banks' reported borrowing costs—alleges that concerted action by banks to under-report their borrowing costs led to an abnormally low Libor. In this case, a variety of indicators can be designed to flag anomalies or departures from historical patterns. The strength of these tests will depend on how well they can detect instances of collusive behavior. For example, detection of collusion may be guided by a test designed to flag periods when borrowing costs among banks appear abnormally uniform, under the assumption that such lack of variability is inconsistent with presumed differences across risk profiles. Such uniformity, however, may result from other determinants of individual banks' borrowing costs. Thus the uniformity is not a sufficient basis to conclude that collusion occurred. Banks may have similar expectations about future monetary policy during periods of stability, and this similarity is likely to contribute to homogeneous borrowing costs. The breakdown of a customary price pattern that resulted from legal economic conduct does not necessarily imply that the anomalous price pattern resulted from illicit conduct.

In sum, screens can be useful in a wide variety of economic applications, including applications in antitrust and finance. Overreaching interpretations of the scope and strength of an economic screen, however, may lead to erroneous conclusions. As a result, screens are best utilized when considered together with other pieces of economic information and analysis.

Information restrictions may also be difficult to monitor and ~~enforce. If a merged firm denies a competitor access in vio-~~ lation of a consent decree, then the competitor will know of the denial and have an incentive to complain to the authorities. If a merged firm violates a restriction on information sharing, the violation may be difficult to detect. Moreover, restrictions on information sharing are sometimes put in place to limit coordinated interaction, a horizontal competitive issue. As the firm's competitors would likely benefit from that interaction, they would have no incentive to report the violation. Thus, information restrictions may be costly.

Implementing access guarantees, information restrictions and indeed all conduct remedies raises the question of their duration. DOJ's 2011 Guide does not discuss the typical duration of conduct remedies. Conduct remedies should last until changes in the market mean that they are no longer required, but it is difficult or impossible to predict how long that will be. Too short a period may mean that relief is insufficient. Too long a period may mean that the relief continues when it is no longer beneficial.

The use of conduct remedies raises a number of serious issues, and the antitrust authorities should continue to prefer structural remedies. Because of the difficulties inherent in

EI News and Notes

ABS Arbitration with Republic

Republic Engineered Products Inc. (Republic) sought damages from Acciaierie Bertioli Safau SPA (ABS) for breach of contract. EI Principal Joseph W. McAnneny submitted reports to the arbitration panel disputing the amount of the claim. The panel adopted Dr. McAnneny's key arguments and reduced Republic's damages award close to the amount that he had proposed. Dr. McAnneny's team included EI Vice President Henry B. McFarland and EI Senior Vice President Kent W Mikkelsen. EI worked with Reed Smith LLP, the law firm representing ABS.

Regal Beloit Corporation Acquires AO Smith's Electric Motor Business

EI Principals Philip B. Nelson and William P. Hall assisted Regal Beloit Corporation in obtaining approval of its purchase of the electric motor business of AO Smith. Regal Beloit and the business acquired from AO Smith both manufactured a variety of electric motors. Following an investigation by the Department of Justice, Regal Beloit agreed to sell certain assets to address the Department's competitive concerns. EI worked closely with Howard Fogt and Alan Rutenberg of Foley & Lardner LLP, who represented Regal Beloit.

Armstrong v. DIRECTV Arbitration Award Upheld by FCC

The Federal Communications Commission (FCC) recently upheld an arbitrator's decision that the final offer submitted by Armstrong most closely approximated the fair market value of certain programming carriage rights. EI Principal Stephen E. Siwek submitted a report and testified at a hearing on behalf of Armstrong. He provided a historical benchmark analysis to support Armstrong's claim that the rates in its final offer most closely approximated the fair market value of those rights. He also testified concerning the definition of fair market value and the factors affecting Armstrong's revenue. Armstrong was represented by Proskauer Rose LLP.

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