

What the Failed AT&T / T-Mobile Merger Means for You



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The AT&T / T-Mobile deal is dead and buried. What does this mean for the telecom industry, and more importantly what does it mean for you, the consumer?

Last March 21, less than a year ago, Dallas-based AT&T surprised the country with proposal to pay \$39 billion for T-Mobile, the fourth-largest carrier in the U.S. The combined carrier as proposed would have a total of 130 million subscribers, leaping ahead of current frontrunner, Verizon Wireless, which has 94 million customers. The two combined companies would control 80 percent of the U.S. wireless market, leaving rival Sprint Nextel in a distant third place. Somehow the deal was also going to create jobs, bring broadband to Grandmafeed starving kids, and cure warts. Or that was how it was supposed to go, anyway.

By now you know the AT&T / T-Mobile deal is dead and buried.

So what happened, and what does this mean for AT&T? Who will be the scapegoat for what in hindsight can be considered a \$4 billion blunder? More importantly, what does it mean for you, the consumer?

It was not supposed to go this way. AT&T CEO Randall Stephenson had championed the merger, sending a bevy of lobbyists to line up support in Washington and promising a plethora of benefits to sweeten the deal. AT&T is no lightweight in the world of lobbying and political donations. The company had good reason to believe it possessed the necessary resources and influence. AT&T's Jim Cicconi is an industry veteran who works with a gaggle of executives like Stephenson, William R. Drexel, D. Wayne Watts and other masterminds behind the deal; all people who are used to having their way. AT&T has made political donations to dozens of top lawmakers, like House Speaker John Boehner and Senate Majority Leader Harry Reid, which exceed \$40 million. There is even a former AT&T employee, William Daley, who is now the White House Chief of Staff. AT&T is in fact one of the top ten spenders on lobbying in the U.S. So which of these guys, if any, fumbled the football and how did the deal go south?

First, as expected, AT&T's merger bid met with stiff opposition from lawmakers, consumers and regulators. The opposition worried that consolidation of an already-limited choice of wireless providers would harm consumers by constraining selection and driving up prices. AT&T's rivals, including Sprint in particular, found sympathetic ears in Washington. Sprint pressed their own lobby into service up to and including their activist CEO. Other factors came into play as well, such as an Obama administration which has vowed to police mergers like these more aggressively, the fact that the Federal Communications Commission (FCC) itself prepared a scathing report critical of the merger, and of course the United States Department of Justice (USDOJ) antitrust suit. In the final analysis, the merger deal which was considered all but a lay down bet last summer - imploded nine months after its euphoric initial announcement.

In a press release dated December 19, 2011, AT&T predictably laid the blame at the feet of the Federal Communications Commission (FCC) regulators and United States Department of Justice (USDOJ). The press release read in part

"The actions by the Federal Communications Commission and the Department of Justice to block this transaction do not change the realities of the U.S. wireless industry. It is one of the most fiercely competitive industries in the world, with a mounting need for more spectrum that has not diminished and must be addressed immediately. The AT&T and T-Mobile USA combination would have offered an interim solution to this spectrum shortage. In the absence of such steps, customers will be harmed and needed investment will be stifled."

Adding insult to injury, the divorce settlement is going to be substantial, even for a behemoth like AT&T. AT&T says that in order to reflect the break-up considerations due to Deutsche Telekom, it will recognize a pretax accounting charge of \$4 billion in the fourth quarter of 2011. Additionally, AT&T is obligated to enter into a long term roaming

agreement with Deutsche Telekom. T-Mobile will receive a package of wireless frequencies from AT&T in 128 market areas, including Los Angeles, Dallas, Houston, Washington and San Francisco. The roaming deal will last at least seven years, and Deutsche Telekom says it will extend T-Mobile's coverage to 10 million more potential customers. Despite the benefits, the future is still uncertain for T-Mobile as we discuss a little later in this article.

In addition to consumer reactions that are generally positive, there are others who are not happy with the outcome in this case. Consider statements released by AT&T rival Sprint immediately after the announcement. Sprint took one of the hardest lines against the merger of any AT&T competitor, with Sprint CEO Dan Hesse making the issue almost a personal quest. Hesse reportedly tripled the amount of time he spent on government affairs in order to block the merger, and made several trips to testify before Congress. Sprint released the following statement:

"Earlier today, AT&T terminated its definitive merger agreement with Deutsche Telekom to acquire T-Mobile USA. This is the right decision for consumers, competition and innovation in the wireless industry."

"From the beginning, Sprint has stood with consumers who spoke loudly and clearly that AT&T's proposed takeover of T-Mobile would create an undeniable duopoly that would have resulted in higher prices, less innovation and fewer choices for the American consumer."

"Sprint commends the Department of Justice, the Federal Communications Commission and the bi-partisan group of state attorneys general who gave voice to the concerns of consumers across the country. We look forward to competing fiercely in the robust, competitive market that exists today and continuing to deliver the world class service and products that consumers have come to expect from Sprint."

What Are AT&T and T-Mobile's Options Now

Earlier this month, various sources were already reporting that AT&T and T-Mobile might form a joint venture (as opposed to a merger) if their deal fell through. The JV, in theory at least, would combine the assets of the two companies but allow T-Mobile to remain as an independent company. Such a joint venture could possibly allow both companies to realize some of the benefits touted in the merger while avoiding antitrust complaints by the USDOJ. More likely, a joint venture would be used by AT&T as a vehicle to keep from having to pay T-Mobile the full breakup fee of \$3 billion in cash and \$1 billion in spectrum. At least it might allow the deal to begin. Then again T-Mobile might just take the money and run, but a dialogue on joint cooperation between the two might allow AT&T some say in the matter of how the money is used. T-Mobile could conceivably use some of the money to make a few investments that helped both companies. As we reported last time, the deal has probably only just begun, albeit now with a different goal now for AT&T, e.g. damage containment rather than merger approval. Don't underestimate the fact that AT&T may still have some influence with T-Mobile despite the broken engagement.

For example, many analysts believe T-Mobile will still need cash in a year or two despite the \$3 billion AT&T infusion.

Analysts say that the \$3 billion in cash payable by AT&T to Deutsche Telekom will only cover T-Mobile's expenses for 12 to 24 months. Therefore if T-Mobile doesn't find a new partner before that time it risks putting itself into the position of failing to generate enough cash flow to cover capital spending. To generate cash, Deutsche Telekom may have a few options, including reconsidering plans to sell its U.S. tower network. Some of those assets was considered until the AT&T merger hit the table. If a buyer could be found, (AT&T?) it could bring in as much as another \$3 billion. Any potential prospects for raising cash could very well involve AT&T.

Where Does AT&T Go Now?

AT&T will have to rethink other strategies in light of effectively marking time since last March. For example, what about the wireless spectrum AT&T said it so desperately needs? While the collapse of the merger has effectively hosed all hopes of acquiring T-Mobile's spectrum, AT&T will still need to look at other options, and quickly. AT&T still has an alternative to buy Qualcomm's spectrum in order to boost the AT&T 4G network. The FCC should rule on that deal in the first quarter of 2012. AT&T may also seek spectrum deals with one or more cable companies in order to stay competitive with Verizon.

Verizon is the 800 pound gorilla in AT&T's living room, at least according to everything we have read. Therefore expect AT&T to court a few cable companies who are eager to offload their unused spectrum. Many smaller companies with spectrum could also be interested in a partnership. Satellite television provider Dish Network is reportedly interested in a spectrum partnership as well as companies like MetroPCS, CenturyLink, or Leap Wireless, to name a few.

Speaking of Verizon, that company has made a few recent acquisitions itself. Most notable is a \$3.6 billion spectrum deal with Comcast. In an unusual twist here however, an increasingly punchy USDO which has blocked three other deals this year besides AT&T / T-Mobile) announced yesterday that this deal too will be investigated.

Verizon Wireless announced in early December that it intended to purchase 122 AWS spectrum licenses from SpectrumCo, which is itself a joint venture between Comcast, Time Warner Cable and Bright House Networks. Verizon says it needs this capacity in order to build out its 4G LTE network. Like AT&T / T-Mobile, the USDOJ has the power to block this deal too. Stay tuned.

The collapse of the AT&T / T-Mobile merger deal and other stepped up enforcement efforts appears to confirm that the Obama administration has reinvigorated antitrust oversight. It was said that the present administration perceived that enforcement had become weak under its predecessor. The undersigned considers the previous sentence an elegant understatement. Even a few people within that agency have been surprised. We found the following quote among others:

“People in this town didn’t think that the department was willing to take the risk to litigate big, complex cases,” said a senior Justice Department official, who spoke on the condition of anonymity. “But this puts down a very firm marker that we are taking antitrust enforcement very seriously.”

So Who Won and Who Lost?

Arguably the USDOJ has a major feather in its cap. So does the FCC. And in hindsight, the boo-birds are already out with regard to the deal. The Wall Street Journal reported, for example, that a Christmas gift will be sliding down the chimney at Deutsche Telekom, and no gift wrapping required, and complete with a piece of the Grinch stealing Christmas. The article also cited a Security and Exchange Commission (SEC) filing that states that AT&T has three days to pay its former merger partner one of the largest penalties ever paid in a filed corporate deal. Ouch. Most of us will not receive our Visa bills for holiday excesses until next month in January. AT&T has no such luxury. Clearly AT&T is one of the losers.

Who are the big winners in this deal? For now, it’s consumers. While Wall Street has an appetite for captive markets with high returns, more choices in providers equates to lower prices and generally higher quality for consumers. It’s nice to have multiple carriers vie for our business, and maybe it will stay that way for a while.

It is interesting to note that there are eight major oil companies operating in the U.S. today, yet the price at the pump even between providers rarely varies more than a few cents. To entertain the idea here that three nationwide wireless providers was somehow better than four defied all logic. In the end common sense prevailed.

Footnotes

- 1 <http://www.opensecrets.org/lobby/top.php?indexType=s>
- 2 <http://sec.gov/Archives/edgar/data/732717/000073271711000113/letteragreement.htm>

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