

Efficiencies Defense Newly Viable After T-Mobile/Sprint Ruling

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On March 11, T-Mobile and Sprint cleared one of the few remaining roadblocks to their merger by reaching settlement agreements with 12 states and the District of Columbia.

A month prior to those settlements, on Feb. 11, U.S. District Judge Victor Marrero of the U.S. District Court for the Southern District of New York issued an important decision in *New York v. Deutsche Telekom AG* when he rejected a suit brought by 13 states and the District of Columbia to block the merger of T-Mobile and Sprint.

In his order, Judge Marrero gave substantial merit to the merging parties' efficiencies.[1] To achieve this outcome, the merging parties undertook significant and extensive analysis to demonstrate compelling efficiencies.

Efficiencies are generally viewed as cost reductions and nonprice benefits that result specifically from a merger.[2] In T-Mobile-Sprint, the merging parties proposed substantial cost reductions and nonprice benefits, including a lower-cost cellular network, increased network speeds, expedited 5G services and increased network coverage in rural and underserved markets.[3] The efficiencies are planned to be realized post-merger under the T-Mobile and Sprint combined entity.

It is frequently said that no court has allowed an otherwise anti-competitive merger to proceed on the basis of proposed efficiencies.[4] This precedent stems from *U.S. Federal Trade Commission v. Procter & Gamble Co.*, a 1967 U.S. Supreme Court decision, that drew a hard line rejecting efficiencies as a defense to anti-competitive effects resulting from a merger.[5] T-Mobile-Sprint provides an important example of how the consideration of efficiencies by courts appears to be evolving.



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Precedent and Evolution of Merger Efficiencies in Litigation

To understand the current state of efficiencies in litigation, it is important to understand how we got here. Since *Procter & Gamble*, the deciding appellate opinion in *U.S. v. Baker Hughes* in 1990 appears to have opened the door for consideration of efficiencies as a defense to a prima facie case against adverse anti-competitive effects.

Then U.S. Circuit Judge Clarence Thomas, prior to his appointment to the Supreme Court, affirming the appeal of *Baker Hughes*, stated “the Department of Justice’s own Merger Guidelines contain a detailed discussion of non-entry factors that can overcome a presumption of illegality established by market share statistics.” Those “factors include ... efficiencies.”[6]

Further, *Baker Hughes* established a three-part burden framework that includes the requirements that (1) the plaintiff must establish, prima facie, that the merger would result in adverse anti-competitive effects; (2) the defendant must rebut the prima facie case; and (3) the plaintiff must “produce sufficient evidence to overcome [a] successful rebuttal.”[7]

In later cases, such as *FTC v. University Health Inc.* in 1991, *FTC v. v. H.J. Heinz Co.* in 2001 and *FTC v. Arch Coal Inc.* in 2004, efficiencies were considered to offset anti-competitive harms. The *University Health* deciding appellate opinion considered efficiencies and stated:

a defendant who seeks to overcome a presumption that a proposed acquisition would substantially lessen competition must demonstrate that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers.[8]

The *Heinz* deciding appellate opinion stated, “the high market concentration levels present in this case require, in rebuttal, proof of extraordinary efficiencies, which the appellees failed to supply.”[9]

Further, the *Arch Coal* deciding opinion acknowledged efficiencies as a partially offsetting factor and stated:

the existence of ... efficiencies ... remains relevant to an assessment of the post-merger market and the potential benefits to consumers. ... Efficiencies resulting from the transactions, then, provide some limited additional evidence to rebut the claim of post-merger anticompetitive effects.[10]

More recently in *U.S. v. Anthem Inc.* in 2017, the U.S. District Court for the District of Columbia blocked the merger of *Anthem* and *Cigna* and rejected efficiencies by stating that the claimed efficiencies do not outweigh adverse anti-competitive effects.[11]

The merging parties then appealed the decision on the grounds that the district court improperly considered the efficiencies defense. The U.S. Court of Appeals for the District of Columbia Circuit rejected, by majority, the purported efficiencies on the grounds that the argued efficiencies were not cognizable, neither merger-specific nor verifiable, as outlined in the horizontal merger guidelines.[12]

In the appellate opinion, then U.S. Circuit Judge Brett Kavanaugh, prior to his appointment to the Supreme Court, issued a dissenting opinion that stated:

to be verified, the efficiencies and consumer benefits must be "more than mere speculation and promises about post-merger behavior." But they need not be certain. They merely must be probable.

The dissent also stated:

the majority opinion's lack of a square holding on the role of efficiencies in merger cases is some measure of good news because it means that future district courts and future panels of this Court still must follow *General Dynamics*, *Baker Hughes*, and *Heinz*.^[13]

T-Mobile-Sprint's Efficiencies Case

Before the trial brought by the states, T-Mobile and Sprint laid the groundwork for establishing efficiencies by consistently proposing cost reductions and nonprice benefits due to the merger in public campaigns and investigatory replies.^[14] During this time, engineers for the merging parties undertook significant analysis and developed a sophisticated network model based on ordinary course processes that supported these efficiencies.

During the trial, counsel for both parties acknowledged and implemented the three-part Baker Hughes burden-shifting framework in the respective arguments. To establish a prima facie case, the states argued the post-merger market shares and Herfindahl-Hirschman Index of the national mobile wireless services to retail consumers would presumably lessen competition.^[15]

Thus, T-Mobile and Sprint had the burden of demonstrating that cost reductions and nonprice benefits are substantial enough to overcome potential adverse anti-competitive effects.

Witnesses and counsel for T-Mobile and Sprint presented efficiencies of an expedited 5G rollout, a more robust 5G network for rural and underserved markets and significant network quality improvements. The merging parties also presented efficiencies in the form of marginal cost reductions for the newly merged T-Mobile that result in a 90% reduction in network marginal costs compared to standalone T-Mobile.^[16]

To quantify these marginal cost reductions, the merging parties adapted a sophisticated network congestion model used by T-Mobile engineers. In the ordinary course of business, this network congestion model was cited as being 99 percent accurate to anticipate future network development.^[17] The merging parties' network modeling combined spectrum assets — Sprint's mid-band spectrum assets with T-Mobile's low-band spectrum — and physical network assets, resulting in much higher capacity than the sum of the T-Mobile standalone and Sprint standalone capacities.^[18]

To overcome the merging parties' rebuttal, the states argued that the merging parties' efficiencies did

not overcome the standard of cognizable efficiencies outlined in the guidelines. The states presented two arguments against merger specificity of proposed efficiencies.

One, they argued that the merging parties' network cost reductions are not merger-specific because the merging parties unreasonably assume that the standalone firm would not acquire spectrum in the future to reduce network costs.

Two, the states argued that Sprint's spectrum is not merger-specific because T-Mobile and Sprint have the means to acquire spectrum through other transactions and ventures.[19] For example, T-Mobile or Sprint could acquire or otherwise pursue a business venture with DISH.

The states also presented two arguments against the verifiability of the proposed efficiencies.

One, the states argued that the proposed efficiencies speculate about the value of network speeds to consumers for future 5G real-world uses that are not yet known.

Two, they argued that the merging parties' efficiencies are not verifiable because the cost reductions are derived from an adapted network congestion model generated outside the ordinary course of business.[20]

Judge Marrero's Remarks on Efficiencies in T-Mobile-Sprint

Judge Marrero ruled that the proposed cost reductions and nonprice benefits were both merger-specific and verifiable. Regarding merger-specificity, Judge Marrero agreed with the merging parties that the States' proposed alternatives "present significant practical difficulties and do not promise nearly the same capacity benefits" that the contemplated merger would achieve.

Addressing this contentious point in the case, Judge Marrero stated that complementary spectrum is not readily available to acquire in auctions and would likely be too cost prohibitive for Sprint to acquire. Further, Judge Marrero acknowledged that T-Mobile and Sprint previously attempted to negotiate a transaction with DISH Network and failed.[21]

Regarding verifiability, Judge Marrero was not persuaded by the states' criticisms of the merging parties' adapted network congestion model.[22] Judge Marrero recognized that T-Mobile now uses the adapted network model, generated for purposes of this merger, in the ordinary course of its business — attesting to the reliability of the model for use in economic analysis.

To further support the verifiability of the proposed efficiencies, Judge Marrero noted T-Mobile's 2013 successful acquisition of MetroPCS as support for T-Mobile's track record of carrying out acquisitions with significant efficiencies. Judge Marrero was also not persuaded by the states' argument against valuing network speeds that do not exist yet and compared the argument to that of "airplane speeds and pilotless flying machines in 1920." [23]

Presented with the evidence before the court, and in accordance with precedent cases, Judge Marrero stated that “there is substantial merit to [the merging parties’] claims that the efficiencies ... will lead T-Mobile to compete more aggressively to the ultimate benefit of all consumers.”[24]

Judge Marrero concluded that the merging parties’:

proposed efficiencies are cognizable and increase the likelihood that the Proposed Merger would enhance competition in the relevant markets to the benefit of all consumers. However, mindful of the uncertainty in the state of the law regarding efficiencies and States’ pertinent criticisms, the Court stresses that the Proposed Merger efficiencies it has recognized constitute just one of many factors that it considers and do not alone possess dispositive weight in this inquiry.[25]

Conclusion

Judge Marrero’s decision makes clear that efficiencies are a key, but not absolute, factor in litigation challenging mergers on competitive effects. In this case, the merging parties presented thorough and compelling economic analysis and extensive documentary and ordinary-course evidence that reinforced their efficiency claims. T-Mobile-Sprint demonstrates the substantial level of effort required for merging parties to overcome adverse anti-competitive effects in litigation.

In other cases such as U.S. v. Aetna Inc. and U.S. v. Energy Solutions Inc., the merging parties were unable to match the robust analysis required by the guidelines and precedent litigation in the way that T-Mobile and Sprint managed to do.[26]

While we can expect T-Mobile-Sprint to be cited in litigation to come, merging parties and enforcers will need to carefully consider how to analyze and present proposed efficiencies in parallel with other factors to overcome respective burdens in analyses of adverse anti-competitive effects.

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[1] New York v. Deutsche Telekom AG, No. 1:19-cv-05434 (S.D.N.Y. Feb. 11, 2020) (hereinafter “T-

Mobile-Sprint”), at 65.

[2] U.S. Dep’t of Justice & Fed. Trade Comm’n, Commentary on the Horizontal Merger Guidelines (March 2006), § 4, available at <https://www.justice.gov/atr/commentary-horizontal-merger-guidelines#42>.

[3] T-Mobile-Sprint at 59.

[4] Fed. Trade Comm’n v. Sysco Corp., 113 F. Supp. 3d 1, 82 (D.D.C. 2015) (“The court is not aware of any case, and Defendants have cited none, where the merging parties have successfully rebutted the government’s prima facie case on the strength of the efficiencies.”). United States v. Anthem Inc., 236 F. Supp. 3d 171, 236–7 (D.D.C. 2017) (“None of the courts that recite the general principles set forth in the efficiencies section of Anthem’s Conclusions of Law ultimately concluded that the claimed efficiencies were sufficiently verifiable or merger-specific to offset the competitive harm...and the defense has not pointed the Court to a single litigated case in which the merging parties were successful in overcoming the government’s case by presenting evidence of efficiencies.”).

[5] Fed. Trade Comm’n v. Procter & Gamble Co., 386 U.S. 568 (1967).

[6] United States v. Baker Hughes, 908 F.2d 981, 985–6 (D.C. Cir. 1990).

[7] Baker Hughes at 992.

[8] Fed. Trade Comm’n v. Univ. Health, Inc., 938 F.2d 1206, 1223 (11th Cir. 1991).

[9] Fed. Trade Comm’n v. H.J. Heinz Co., 246 F.3d 708, 720 (D.C. Cir. 2001) citing to University Health, 1223.

[10] Fed. Trade Comm’n v. Arch Coal, Inc., 329 F. Supp. 2d 109, 153 (D.D.C. 2004).

[11] United States v. Anthem, Inc., 236 F. Supp. 3d 171, 259 (D.D.C. 2017).

[12] United States v. Anthem, Inc., 855 F.3d 345, 359, 362 (D.C. Cir. 2017).

[13] Anthem, 855 F.3d at 375, 379 citing to Heinz at 721 and Baker Hughes at 984.

[14] T-Mobile and Sprint, Creating a 5G Future for All, <https://newtmobile.com/> (last visited Feb. 20, 2020); Mem. Op. & Order, In the Matter of Applications of T-Mobile US, Inc. and Sprint Corp., Fed. Comm’n Comm’n WT Docket No. 18-197 (Nov. 5, 2019), §§ V.B.4 and VI.

[15] T-Mobile-Sprint at 53.

[16] T-Mobile-Sprint at 59, 75.

[17] T-Mobile-Sprint at 73–74.

[18] Mem. Op. & Order, In the Matter of Applications of T-Mobile US, Inc. and Sprint Corp., Fed. Comm'c'n Comm'n WT Docket No. 18-197 (Nov. 5, 2019), at ¶1238.

[19] T-Mobile-Sprint at 77, 66.

[20] T-Mobile-Sprint at 78–79, 75.

[21] T-Mobile-Sprint at 69, 78, 71.

[22] T-Mobile-Sprint at 81.

[23] T-Mobile-Sprint at 82, 79.

[24] T-Mobile-Sprint at 65.

[25] T-Mobile-Sprint at 83.

[26] Christine Hammer was retained by the DOJ in the 2017 enjoined merger of Aetna and Humana. Ms. Hammer evaluated whether the defendants' efficiency claims were verifiable and merger-specific, among other areas. The court found that Ms. Hammer raised valid issues regarding "several categories of claimed efficiencies" as well as "the companies' analyses...that serve to further undermine the reliability of the efficiency claims." Mem. Op., *United States v. Aetna Inc.*, No. 1:16-cv-01494 (D.D.C. Jan. 23, 2017), at 151, 154. Dr. Greg Eastman was retained by the DOJ in the 2017 enjoined merger of EnergySolutions Inc. and Waste Control Specialists LLC involving a proposed \$367 million merger. Dr. Eastman testified that the defendants had not provided sufficient information to reliably quantify the claimed efficiencies. *United States v. Energy Solutions Inc.*, No. 1:16-cv-01056 (D. Del. 2017). The courts ruled in favor of the DOJ in both cases and prohibited the companies from proceeding with the transactions.