<u>REQUEST FOR INVESTIGATION – DRAFT</u>

Change to Win ("CtW") Investment Group requests that the Securities and Exchange Commission investigate T-Mobile U.S., Inc. ("TMUS") based on substantial evidence of misrepresentations and omissions regarding its calculation of executive pay compensation.

Our examination of TMUS's financial statements found that:

(1) TMUS has miscalculated its overall performance as a percentage of target performance; and
(2) TMUS uses non-standard non-GAAP measures to calculate certain performance metrics without adequately disclosing unconventional aspects of the calculations or material changes to the calculations from previous years that substantially improved the outcome of the performance metrics.

As a result of these misrepresentations and omissions, TMUS's senior executives were paid $4 million more in FY2016 than they would have been had TMUS used the calculations described in its proxy statement.

<u>Change to Win Investment Group</u>

The CtW Investment Group works with pension funds sponsored by affiliates of Change to Win, a federation of unions representing over five million members, to enhance long-term shareholder value through active ownership. These funds invest over $250 billion in the global capital markets and are investors in TMUS.

On November 23, 2016, CtW Investment Group wrote to the Commission requesting an investigation into TMUS's failure to disclose changes to its accounting estimates material to recognizing revenue from it sales of Equipment Installment Plans ("EIPs") and its misleading use of non-GAAP performance measures. In particular, our analysis found that, from Q4 2014 to Q3 2015, the company reduced its Allowance for Credit Losses as a percentage of EIP receivables while the quality of those receivables was deteriorating without disclosing any change in accounting estimates. This reduction resulted in an increase in earnings of $122 million or about 23 percent of net income over those four quarters. Our analysis also found that TMUS repeatedly emphasized non-GAAP performance measures over GAAP measures in its earnings releases without providing in its annual report the information necessary to reconcile reported non-GAAP Adjusted EBITDA to GAAP operating earnings or net income from past periods on an apples-to-apples basis. As discussed in detail below, we believe TMUS continues to mislead shareholders about key performance metrics, and that T-Mobile's misleading representation of its performance resulted in substantially larger payouts to executives in FY2016 than would have been resulted had TMUS's payouts conformed to the disclosures made in its proxy statement.

Background on T-Mobile US, Inc.

TMUS, the third largest wireless carrier in the United States,[1] provides wireless voice, messaging, and data services in the U.S., Puerto Rico and the U.S. Virgin Islands under the TMUS and MetroPCS brands. It is also the fastest growing wireless company in the U.S., based on total customer growth in 2016.[2] It describes itself as an industry disruptor offering "plans that are simple, affordable and without unnecessary restriction" to provide customers with the best value experience.[3] As of December 2016, TMUS sells its phones and service plans at approximately 13,000 TMUS and MetroPCS branded retail locations and 39,000 third-party and national retailer locations.[4]

In late 2012, TMUS announced the appointment of a new executive team, including new CEO John Legere. Prior to joining TMUS, Legere became CEO of Asia Global Crossing in February 2000, then served as CEO of parent company Global Crossing from October 2001 to October 2011. During Legere's tenure at Global Crossing, the company was the subject of federal investigations and shareholder lawsuits into its accounting practices and stock options In 2004, after emerging from bankruptcy, Global Crossing admitted that it had understated its largest expense and would have to restate its financial disclosures.[5] Global Crossing also paid $15 million to settle a lawsuit about the understatement.[6] As discussed in detail below, we believe that questionable accounting practices of the sort seen at Global Crossing have carried over to TMUS.

Legal Authority

Item 402 of Regulation S-K requires a registrant to accurately disclose all material elements of the named executive officers' compensation, including each element of compensation, why the registrant chooses to pay each element, and "[h]ow the registrant determines the amount (and, where applicable, the formula) for each element to pay."[7] The purpose of Item 402 is "to provide to investors material information that is necessary to an

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[1] Ryan Knutson and Chelsey Dulaney, *Sprint Falls Behind T-Mobile in Total Connections*, WALL STREET JOURNAL, Aug. 4, 2015.

[2] T-Mobile US, Inc., Annual Report (Form 10-K), at 3 (Feb. 14, 2017), *hereinafter* T-Mobile 2017 10-K.

[3] *Id*.; Press release, T-Mobile US, Inc., T-Mobile US Reports First Quarter 2015 Results (Apr. 27, 2015).

[4] T-Mobile 2017 10-K, *supra* note 2, at 8.

[5] Global Crossing press release , Global Crossing Announces Review of Cost of Access Liability and Expected Restatement of Financial Statements" (April 27, 2004), *available at*: https://www.sec.gov/Archives/edgar/data/1061322/000119312504070521/dex991.htm

[6] Marius Meland, *Global Crossing to Settle Class Action Lawsuit*, LAW360, May 26, 2006. "These were not the only instances of questionable accounting practices at Global Crossing. In separate litigation the SEC charged the company and three senior executives with misrepresenting the extent to which certain transactions had improved liquidity in the first half of 2001; the SEC imposed a cease and desist order against the company and civil penalties against those other executives. Securities and Exchange Commission, Litigation Release No. 19279, Three Former Officers of Global Crossing Ltd. Consent to Pay Civil Penalties (Apr. 11, 2005).

[7] 17 CFR § 229.402(b)(iii)-(v).

understanding of the registrant's compensation policies and decisions regarding the named executive officers."[8] As detailed below, TMUS's 2017 proxy statement contain several inconsistencies, misrepresentations, and omissions regarding an element of its executive compensation program.

Inconsistencies and Misrepresentations in Calculation of 2016 STIP

According to TMUS's 2017 proxy statement, the company adopted a short-term incentive plan in 2016 ("2016 STIP"), its cash bonus program for executive officers, stating that it is based entirely on company performance. Company performance is measured by: "Total Service Revenue, Branded Net Additions (Total Branded Customers), Adjusted EBITDA, and Operating Free Cash Flow."[9] TMUS included the chart below regarding the weight, performance goals, and actual FY2016 performance in each of these areas:

Metric	Weight	Minimum Performance (in millions)	Target Performance (in millions)	Maximum Performance (in millions)	Actual Performance (in millions)
Total Service Revenue	30%	$ 25,159	$ 26,483	$ 27,145	$ 27,844
Branded Net Additions	20%	1.274	3.185	4.455	6.605
Adjusted EBITDA	20%	$ 8,151	$ 8,860	$ 9,332	$ 10,391
Operating Free Cash Flow	30%	$ 2,458	$ 3,245	$ 3,559	$ 3,426

TMUS concluded that it "performed above target levels with respect to all four performance metrics in 2016 and above maximum levels with respect to three of the four performance metrics. Overall performance under the 2016 STIP was achieved at 187% of target."[10] The proxy statement also included the table below calculating each officer's 2016 STIP payout value:

Officer	Base Earnings (1) ($)	Target 2016 STIP Percent (as a % of Base Earnings)	Target 2016 STIP Value ($)	Company Attainment	Total 2016 STIP Payout Value ($)
John J. Legere	1,500,000	200%	3,000,000	187%	5,610,000
J. Braxton Carter	724,135	125%	905,168	187%	1,692,665
G. Michael Sievert	800,000	150%	1,200,000	187%	2,244,000
Neville R. Ray	696,539	125%	870,673	187%	1,628,159
Thomas C. Keys	724,136	100%	724,136	187%	1,354,135

There are a number of significant inconsistencies and material misrepresentations and omissions about T-Mobile's calculation of the STIP, as discussed below.

1) **TMUS's reported overall actual performance percentage is inflated because it is significantly higher than the percentage calculated using TMUS's own figures.**

Actual performance on the four target measures described above allegedly determines the size of the STIP payouts. TMUS reported that overall actual performance "was achieved at 187% of target" without explaining how it derived this percentage. And this percentage does not comport with target figures provided by TMUS. As the reproduced STIP Target table below

[8] 17 CFR § 229.402(b) – Instructions to Item 402(b).
[9] T-Mobile US, Inc., Proxy Statement (Schedule 14A), at 28 (Apr. 27, 2017).
[10] *Id.*

shows, dividing the target performance amount by the actual performance amount yields the percentage attained. As noted in the far right column, only one of the metrics – Branded Net Addition at 207% – exceeded its target by anything close to 187%. Moreover, multiplying each metric's percentage attained by that metric's weight yields an overall actual performance level of 128% – far lower than the stated 187%. This miscalculation of the overall actual performance percentage misleads shareholders about both the company's performance and the extent to which executive compensation is based on such performance.

Metric	Weight	Minimum	Target	Maximum	Actual	"% Attained"
Total Service Revenue	30%	$25,159	$26,483	$27,145	$27,844	105.14%
Branded Net Additions	20%	1.274	3.185	4.455	6.605	207.38%
Adjusted EBITDA	20%	$8,151	$8,860	$9,332	$10,391	117.28%
Operating Free Cash Flow	30%	$2,458	$3,245	$3,559	$3,426	105.58%

As shown in the chart below, this apparent inflation of actual performance relative to target performance had a material impact on 2016 STIP payout. As the far right column indicates, this overestimation resulted in nearly $4 million in excess payments to executives.

Officer	Base Earnings	Target STIP as % of Base	Target STIP $	Company Attainment	Total 2016 STIP Payout	STIP at 128%	Difference
John J. Legere	$1,500,000	200%	$3,000,000	187%	$5,610,000	*$3,840,000*	*$1,770,000*
Braxton Carter	$724,135	125%	$905,169	187%	$1,692,666	*$1,158,616*	*$534,050*
G. Michael Sievert	$800,000	150%	$1,200,000	187%	$2,244,000	*$1,536,000*	*$708,000*
Neville R. Ray	$696,539	125%	$870,674	187%	$1,628,160	*$1,114,462*	*$513,698*
Thomas C. Keys	$724,136	100%	$724,136	187%	$1,354,134	*$926,894*	*$427,240*
Total					**$12,528,960.00**	***$8,575,972.00***	***$3,952,988.00***

2) **TMUS uses non-standard non-GAAP measures to calculate two of the four metrics used to determine the 2016 STIP without adequately disclosing material changes to the calculations that resulted in a significant increase in the 2016 STIP payout.**

TMUS stated in the 2016 proxy statement that Adjusted EBITDA and Operating Free Cash Flow – two of the four metrics that determine STIP – are non-GAAP measures. As discussed in detail below, TMUS' questionable calculations of both metrics—which were not disclosed in the proxy statement—resulted in a significant increase in the 2016 STIP payout.

a) Adjusted EBITDA

In FY2016, TMUS's reported Adjusted EBITDA was $10.4 billion. TMUS's calculation of Adjusted EBITDA, however, changed materially from prior years in two ways that are unrelated to actual performance.

First, and in contrast to its primary competitors, TMUS states that it includes gains on disposal of spectrum licenses in its calculation of Adjusted EBITDA, but for the past two years has without explanation failed to do so. In FY2014, TMUS reported a loss on disposal of spectrum licenses of -$840 million,[11] of which -$720 million was included in Adjusted EBITDA.[12] But in FY2015 and FY2016 TMUS has reported losses on disposal of spectrum licenses of -$163 million and -$835 million respectively,[13] but neither amount was included in Adjusted EBITDA or reported on the reconciliation table provided in either the 10K[14] or the proxy statement.[15] The only explanation available to readers is the following note:

> Gains on disposal of spectrum licenses may not agree to the Consolidated Statements of Comprehensive Income primarily due to certain routine operating activities, such as routine spectrum license exchanges that would be expected to reoccur, and are therefore included in Adjusted EBITDA.[16]

If the loss of $835 million in FY2016 had been included in Adjusted EBITDA as would be consistent with TMUS's description of its calculation of that metric, its reported Adjusted EBITDA would have been $9.6 billion, not $10.4 billion.

Second, since the end of second quarter of FY2015, TMUS has been offering phone leases to customers. When a customer leases a phone rather than purchasing one through TMUS's EIP, the cost of the phone to TMUS is not recorded as an expense (and thus deducted from EBITDA) but rather is capitalized onto the balance sheet and depreciated over the lease term (an expense which is *not* deducted from EBITDA). This provides an additional means to increase reported Adjusted EBITDA without any actual change in sales or profit. TMUS reports that depreciation costs attributable to leased phones in FY2016 were $1.5 billion.[17]

Combining these two undisclosed adjustments to reported Adjusted EBITDA reduces FY2016 performance to $8.05 billion, and would reduce the total amount awarded to the named executive officers under the 2016 STIP plan by $1.2 million. The arbitrary exclusion of spectrum disposals and the impact of lease accounting on Adjusted EBITDA – neither of which is

[11] TMUS 2016 10K pg. 26
[12] TMUS 2016 10K pg. 37
[13] TMUS 2016 10K pg. 26
[14] TMUS 2016 p. 37
[15] TMUS DEF14A 2017 pg. A-1 (after page 65)
[16] TMUS 2016 10K pg. 37
[17] TMUS 2016 10K pg. 37.

disclosed in TMUS's executive compensation description in its proxy statement – masks the fact that the a significant part of the increase in Adjusted EBITDA is largely unrelated to improved performance and therefore should not have contributed to a conclusion that there had been gains sufficient to warrant a significant performance-based payout.

b) **Operating Free Cash Flow**

In addition to the changes in TMUS's calculation of Adjusted EBITDA, TMUS's calculation of Operating Free Cash Flow has deviated from its competitors' and convention. Operating Free Cash Flow is a metric unique to TMUS and which it acknowledges "is not provided in our earnings materials."[18] TMUS's proxy statement directs the reader to Appendix A for information on how Operating Free Cash Flow is measured, but Appendix A contains no reconciliation table or other information that would enable a reader to independently calculate Operating Free Cash Flow and verify TMUS's reports. Instead, Appendix A merely notes that:

> Operating free cash flow is a non-GAAP financial measure as defined and used under the 2016 STIP. It is generally equal to Adjusted EBITDA (calculated using net income determined in accordance with IFRS, which is different from GAAP net income) further adjusted for the change in working capital assets and liabilities (other than those with Deutsche Telekom AG and its affiliates) and non-cash items included in Adjusted EBITDA, less cash paid for capital expenditures (other than spectrum licenses) and other non-recurring cash items that are not representative of normal ongoing operations.[19]

We note that neither the IFRS calculation of net income, nor the relevant figures for changes in working capital assets and liabilities or "other non-recurring cash items" are provided. It is also unclear exactly how Adjusted EBITDA would be "further adjusted" by the non-cash items included in Adjusted EBITDA.

Worse still, many readers of TMUS's proxy statements and earnings materials might easily confuse Operating Free Cash Flow with the widely used liquidity measure Free Cash Flow, which TMUS does report in its earnings releases and financial statements. Because Free Cash Flow is typically defined as Cash from Operations minus Capital Expenditures, readers of the proxy statement might conclude erroneously that reported Free Cash Flow serves as an adequate proxy for Operating Free Cash Flow. Any such confusion would be particularly problematic because TMUS's exclusion of spectrum acquisition costs from capital expenditures sharply increases Operating Free Cash Flow relative to the Free Cash Flow reported in its consolidated financial statements.

The tables below illustrate the significant misunderstanding that is possible given TMUS's failure to disclose its method for calculating Operating Free Cash Flow or to provide a

[18] TMUS 2017 DEF14A pg. 27.

[19] The 2016 STIP does not contain a further explanation of how Operating Free Cash Flow is derived. TMUS 2016 DEF14A pg. 61.

reconciliation between Operating Free Cash Flow and either its own reported Free Cash Flow or a more conventional calculation of that metric. First, the differences between Operating Free Cash Flow and the Reported and Conventional measures is significant in both magnitude and direction:

	2014	2015	2016
Operating Free Cash Flow[20]	$1,298	$2,923	$3,426
Reported Free Cash Flow[21]	-$171	$390	$1,433
Conventional Free Cash Flow	-$3,100	-$4,146	$455

Note in particular that for fiscal year 2015, both Operating and Reported Free Cash Flow increased, while Conventional Free Cash Flow declined. These differences stem from the poorly disclosed differences between TMUS's reported Net Cash Used in Investment and what it calls "Cash Purchases of Property and Equipment." As the table below shows, this difference is large and highly variable, but TMUS does not provide either an explanation of the difference or a reconciliation between these measures.

	2014	2015	2016
(1) Net Cash from Op Activities[22]	$4146	$5414	$6135
(2) Net Cash Used Invest[23]	$-7246	$-9560	$-5680
(3) Cash Purchases P&E[24]	$-4317	$-4724	$-4702
Difference [(2) -(3)]	$-2929	$-4836	$-978
Conventional Free Cash Flow [(1) – (2)]	$-3100	$-4146	$455

If TMUS had used the conventional free cash flow measure calculated above instead of Operating Free Cash Flow, 2016 STIP bonuses paid to the named executive officers would have been $3.5 million lower. If TMUS had used its own reported Free Cash Flow in determining performance for the 2016 STIP, bonuses paid to the named executive officers would have been $2.9 million lower. By utilizing a poorly disclosed and unconventional metric to determine executive pay, TMUS fails to provide readers of its financial statements with the information they would need in order to assess whether this choice of performance metrics is appropriate.

Conclusion

In 2016, TMUS paid its five executive officers over $12 million in short-term incentive bonuses for allegedly surpassing target performance metrics by 187%. But TMUS's assessment of actual performance is flawed and misleading in ways that substantially increased the amount paid to these executives. TMUS's cited actual performance percentage does not comport with

[20] TMUS DEF14A for 2014, 2015, and 2016.
[21] TMUS 2016 10K pg. 26
[22] TMUS 2016 10K pg. 39
[23] TMUS 2016 10K pg. 38
[24] TMUS 2016 10K pg. 39

TMUS's actual performance numbers. And the metrics used to determine actual performance deviate from convention and from TMUS's calculations of those metrics in previous years, even though many of these deviations and changes are not disclosed or explained in the proxy statement. Taken together, these flawed, manipulated, and undisclosed accounting methods resulted in a windfall for TMUS's executive officers.

For these reasons, CtW Investment Group asks the Commission to investigate TMUS's disclosures on executive compensation and order the company to accurately disclose how it derived the amounts paid to executives through its short term incentive plan.