Takeaways From AT&T-Time Warner Merger Win

By **Joel Grosberg and Matt Evola** (February 27, 2019)

"[T]here is no need to opine on the proper legal standards for evaluating vertical mergers because, on appeal, neither party challenges the legal standards the district court applied."

—U.S. Circuit Judge Judith W. Rogers, United States v. AT&T Inc.



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Antitrust practitioners and businesspeople hoping to obtain guidance on the legal principles for a challenge to a vertical transaction likely were disappointed to read these words early in Judge Rogers' decision in United States v. AT&T Inc.[1]

In upholding the district court's decision that AT&T's proposed acquisition of Time Warner was unlikely to harm competition, the U.S. Court of Appeals for the D.C. Circuit did not adopt any broad principles on vertical merger enforcement that will make it more or less difficult for the government to challenge future vertical transactions. Nevertheless, the opinion discusses several important principles related to vertical merger enforcement.

The First Vertical Merger Challenge in Decades

This case first arose when the U.S. Department of Justice challenged AT&T's proposed acquisition of Time Warner in 2017. Though the parties attempted to negotiate a behavioral remedy (as was used in a prior vertical transaction in this industry, such as the Comcast Corp.-NBCUniversalmerger), the DOJ insisted on a structural solution and sued to block the transaction.

The DOJ alleged that the vertical integration of Time Warner content with AT&T's video distribution would enable AT&T to raise prices to its competing video distributors, and thus lead to higher prices for consumers' cable bills. Unlike in a horizontal merger, where the government's case benefits from a presumption of anti-competitive effect based on a change in market concentration, in the vertical context, there is no presumption based on market concentration, and the government must make a fact-specific showing that the proposed merger is "likely to be anticompetitive."[2] U.S. District Judge Richard Leon presided over the case at the district court level and found the government's evidence lacking. Judge Rogers and the D.C. Circuit affirmed Judge Leon's ruling.

Judge Leon wrote a very detailed factual opinion, and on appeal, the question for the circuit court was whether the district court's factual findings were clearly erroneous. As a result, the circuit court had to give significant weight to the district court's findings. The DOJ's appeal "rest[ed] on two fundamental errors: the district court discarded the economics of bargaining, and the district court failed to apply the foundational principle of corporate-wide profit maximization."[3]

Nash Bargaining Model Survives, But Real-World Evidence Carries the Day

The DOJ's main theory in the case was that the combination of AT&T's video distribution services, namely DirecTV's satellite TV offerings, and Time Warner's video content would provide Time Warner with increased bargaining leverage when negotiating with other video

distributors that are AT&T's competitors. The theory was based on the Nash bargaining model, an economic theory utilized to analyze two-party bargaining situations positing that when one party would arguably have a greater loss from failing to reach an agreement, the other party has increased bargaining leverage.[4]

At the district court, Judge Leon upheld the Nash model as a viable theory of harm for merger challenges. The D.C. Circuit agreed and emphasized that in the vertical merger context the government does not have to establish quantitative evidence of a price increase because "[v]ertical mergers can create harms beyond higher prices for consumers, including decreased product quality and reduced innovation."[5] This is an important finding that could enable the government to challenge vertical transactions on criteria other than higher prices.

Despite recognizing the Nash model as a viable theory, the district court was persuaded it didn't accurately predict the outcomes in this case based on evidence from trial, including the real-world results of the Comcast-NBCU merger. Because the district court accepted the model, but determined that the "real-world evidence" did not support it, the circuit court disagreed with the DOJ on this point of appeal.[6]

The Copperweld View of Corporations

On the second issue, the circuit court noted that Copperweld Corp. v. Independent Tube Co.[7] adopted as a principal of antitrust law that "[c]ompanies with multiple divisions must be viewed as a single actor, and each division will act to pursue the common interests of the whole corporation."[8] The DOJ argued that the district court failed to properly take this into account when analyzing how the merged entity would behave post-merger.

The circuit court found that Judge Leon properly considered this issue despite failing to cite to Copperweld in his decision. In particular, the circuit court stated that Judge Leon was correct in placing weight on "real-world" evidence that when a programmer and distributor merge, it is still in the best interests of the merged entity as a profit maximizer to license programming broadly to other distributors.

Other Notes

Unilateral Behavioral Remedies, "Extra Icing on a Cake Already Frosted"

The circuit court referenced the AT&T unilateral arbitration offer as something that Judge Leon considered in his analysis of the potential harms presented by this transaction, noting it was further explanation for why the government's evidence was unpersuasive. After the DOJ sued, but before trial, AT&T "sent letters to approximately 1,000 distributors 'irrevocably offering' to engage in 'baseball style' arbitration at any time within a seven-year period ... [an offer] designed to 'address the government's concern[s].'"[9] It was somewhat surprising that the district court considered these agreements because they were unilaterally offered, and it was questionable whether they would be enforceable.

Although the D.C. Circuit expressed no opinion on the merits of this unilateral behavioral remedy, Judge Rogers did comment that its existence rendered some of the DOJ's economic modeling incomplete. The DOJ's economic expert conceded he did not take the agreements into account. The consideration of these agreements demonstrates that if merging parties can convince the district court judge to consider or accept a unilateral remedy offer into evidence, it can impact the government's ability to meet its burden of showing harm.

Witness Testimony Matters

This case also demonstrates the importance of witness testimony, especially testimony based on real-life facts rather than theories. The DOJ argued that the district court was internally inconsistent in evaluating testimony from industry witnesses, discounting the testimony of third-party video content distributors (competitors in the vertical merger context) while seeming to rely on testimony from the parties themselves.

The district court, noted that the potential for self-interest was not the only reason that the competitor testimony was of little probative value. Much of the third-party testimony "consisted of speculative concerns and did not contain any analysis or factual basis to support key assumptions."[10] The testimony by the merging parties, in contrast, was based on prior experience in the industry dealing with vertically integrated entities. This testimony was persuasive at the district court level, and the D.C. Circuit agreed.

A Victory for AT&T, Not Necessarily for Vertical Mergers

In sum, the circuit court was unpersuaded by the DOJ's arguments, and the deference afforded to a district court's fact-specific inquiries won out. The fact-specific nature of this appellate decision, however, also makes it unlikely to change how the antitrust agencies approach future vertical merger enforcement.

Nevertheless, the D.C. Circuit opinion demonstrates the difficulties that the government will continue to face in challenging a vertical transaction. In particular, it demonstrates that vertical cases, especially those not based on a foreclosure theory, cannot rely on simply alleging that the combined entity has an important product or a high market share. Rather the government needs to show clear harms that outweigh any credited efficiencies. Overall, this means that a vertical merger case presents more difficulties for the DOJ and FTC than a horizontal case and poses a higher risk for the government should the case go to trial.

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[1] United States v. AT&T, Inc., No. 18-5214, 2019 WL 921544, at *5 (D.C. Cir. Feb. 26, 2019).

[2] Id. at *2.

[3] Id.

[4] Id. at *6.

[5] Id. at *13.

[6] Id. at *7.

[7] Copperweld Corp. v. Independent Tube Co., 467 U.S. 752, 771 (1984).

[8] AT&T, Inc., No. 18-5214, 2019 WL 921544, at *10.

[9] Id. at *4.

[10] Id. at *12 (citations omitted).