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What the AT&T/Time Warner Decision Means for Antitrust Enforcement

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On June 12, 2018, after a six-week trial, U.S. District Court Judge Richard Leon denied the U.S. Department of Justice's request to block AT&T Inc.'s $85 billion acquisition of Time Warner Inc., one of the most high-profile merger challenges in recent years. AT&T is a nationwide communications service provider and owner of satellite pay-TV provider DirecTV. Time Warner owns a collection of television and film content, including CNN, TBS, TNT, HBO and Warner Bros. Importantly, AT&T and Time Warner are not competitors, making this a "vertical" merger rather than a horizontal combination. This was DOJ's first court challenge to a vertical merger since the 1970s.

A vertical merger combines companies operating at different points in a supply chain. Vertical mergers typically receive lighter treatment from antitrust enforcers than horizontal mergers of direct competitors. Unlike horizontal mergers, vertical mergers do not eliminate a competitor, so their potential to reduce competition in the marketplace is more ambiguous. Further complicating vertical merger analysis is the widespread recognition that vertical integration can generate efficiencies such as cost savings, which can benefit consumers. In this case, the merging parties asserted that they would be able to offer lower prices to DirecTV subscribers, which would result in annual savings for customers of over $350 million. Significantly, DOJ's economic expert conceded this benefit.

However, after a lengthy investigation, DOJ nevertheless concluded that the transaction would be harmful to competition overall. DOJ's main concern was that the combination would enable AT&T to use its ownership of Time Warner's "must-have" popular content to increase its bargaining leverage and extract higher fees from traditional video programming distributors such as cable and satellite TV companies, which would be passed on to consumers through higher prices. DOJ also alleged that the proposed combination would slow innovation by giving the merged firm the incentive and ability to impede the growth of online video distribution services, and would allow the parties to restrict competitors' use of Time Warner's HBO network as a promotional tool.

In his 172-page ***opinion***, Judge Leon provided a very fact-specific analysis of how the government failed to meet its burden to show that the combination was likely to substantially lessen competition in violation of Section 7 of the Clayton Act. In so doing, he ruled that DOJ's evidence fell far short of adequately supporting any of its theories of competitive harm. Judge Leon found that the government's case depended on a flawed economic model that raised too many questions about the potential price increase to consumers, noting that it lacked "both reliability and factual credibility," and accepting instead the defendants' economist's attacks on the model's input data and assumptions. Neither was the court persuaded by internal company documents and regulatory filings submitted by DOJ as evidence, or the testimony of competitor witnesses. Though he accepted DOJ's contention that Time Warner's content is valuable and does provide some bargaining leverage, Judge Leon explained that this is already true today, and the government had failed to show how the merger would materially alter the current landscape.

By contrast, the opinion referenced multiple times the changing nature of the industry and the rise in competing internet-based video distribution services, including "virtual" programming distributors such as DISH's Sling TV, Sony's Playstation Vue, Google's YouTube TV, and AT&T's DirecTV Now, as well as subscription video on demand services such as Netflix, Hulu, and Amazon Prime. Judge Leon also noted a shift from reliance on television advertising to targeted digital advertising and seemed to accept defendants' position that the combined company would be able to better compete against large technology companies with powerful digital advertising platforms such as Facebook and Google.

Two days after Judge Leon's decision, AT&T and Time Warner closed their deal, with DOJ announcing that it would not to seek a stay of Judge Leon's ruling pending a possible appeal. DOJ agreed to this only after receipt of a letter from AT&T outlining separations that the parties would put in place between Time Warner's Turner Broadcasting unit and AT&T's communications business until the earlier of February 2019 or the conclusion of any appeal.

While the outcome of this case was a blow to the government, there are a number of broader takeaways:

- Judge Leon's decision turned on specific facts and evidence and certainly should not be seen as removing all antitrust barriers to vertical mergers. However, it highlights the difficulties with successfully challenging a vertical merger on competition grounds and will likely give transacting parties more confidence to pursue large vertical tie-ups. As Judge Leon notes in his opinion, there is no presumption of harm in a vertical merger like there can be in a horizontal merger of competitors. To the contrary, many vertical mergers create efficiencies that can benefit consumers. The government therefore has a high hurdle to establish, through case-specific evidence, that a vertical merger's competitive harms are likely to outweigh any benefits. In his opinion in AT&T/Time Warner, Judge Leon often circled back to the fact that DOJ conceded significant cost savings to DirecTV customers.

- DOJ's challenge in AT&T/Time Warner reflected a significant shift in DOJ policy towards remedies in vertical mergers. In recent months, Assistant Attorney General Makan Delrahim, chief of DOJ's Antitrust Division, has stated a strong preference for structural relief, such as asset divestitures, over the types of "behavioral" conditions that have been used in the past to resolve concerns in vertical transactions, such as non-discrimination commitments, mandatory licensing, and information firewalls. This change in view led DOJ to insist on a structural remedy that would have required AT&T to divest its entire DirecTV business or Time Warner's Turner business, which AT&T refused to do, culminating in litigation. Officials at the other federal antitrust agency, the Federal Trade Commission, have recently made similar comments about preferring structural remedies for vertical mergers. The antitrust agencies' resolve on this issue may be tested, as the decision in AT&T/Time Warner will likely embolden companies in future vertical deals to resist demands for divestitures.

- The nature of the industry can be an important factor in evaluating a merger's likely competitive effect. Antitrust merger analysis is necessarily forward looking, involving an attempt by agencies and courts to make predictions about a transaction's future impact on market conditions. This already challenging exercise is made even more difficult in a rapidly evolving sector. Judge Leon was clearly influenced by a number of trends in what he characterized as a "remarkably dynamic industry." Any future vertical merger challenges are more likely to occur in highly concentrated, traditional markets with high barriers to entry and that do not exhibit rapid change.

- Companies should keep in mind that although the road may now be a little less bumpy for vertical deals, competitors wishing to merge in horizontal combinations will find little or no solace from the AT&T/Time Warner decision. Both federal antitrust agencies have an excellent track record in recent years of successfully challenging problematic horizontal mergers.