AT&T/Time Warner Merger Clearance Paves Way for Future Transactions

June 13, 2018

Yesterday's federal court clearance of AT&T's purchase of Time Warner[1] without any conditions not only permits this market-changing transaction to proceed but is also likely to encourage other vertical combinations in the media industry and perhaps elsewhere.

The Justice Department ("DOJ") had challenged the $85 billion transaction on the principal ground that the acquisition of "must-have" Time Warner programming assets (HBO, TBS, TNT and CNN) would allow AT&T to impose higher fees on competing distributors, which would be passed on to video programming consumers. The DOJ premised its argument on several assertions about the video programming distribution market: (1) even a small loss of customers could have a large financial impact on programming distributors, including multichannel video programming distributors ("MVPDs"), such as cable TV and satellite providers, and virtual MVPDs which distribute content over the internet; (2) customers lost during content blackouts imposed after negotiation stalemates are unlikely to return, and are expensive to recruit back; (3) internal studies by AT&T's DirecTV unit had shown a number of Time Warner networks, including HBO, to be particularly important to customers; and (4) video programming distributors typically passed price increases on to their customers.

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AT&T countered that imposing higher fees on distributors (or denying distributors access to Time Warner content) would not be a profit-maximizing strategy, and that the transaction would actually provide the opportunity for efficiency in advertising. According to AT&T, the transaction would allow AT&T to better compete in the advertising market with Apple, Google and Facebook, and it would lead to lower prices for subscription television.

Judge Leon rejected the DOJ's positions across the board. The court rejected the DOJ's purported "real-world" evidence of likely anti-competitive effects as speculative, unconvincing or inconsistent with the bulk of real-world evidence. The judge found that "Turner's content is not literally 'must-have'," and any negotiating leverage resulting

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[1] *United States v. AT&T Inc.*, Civ. Case No. 17-2511(RJL) (D.D.C. June 12, 2018).

from the desirability of such content existed before the merger and would not be enhanced by the merger. The court also found no likelihood that the combined company would withhold programming from competing distributors or would gain increased negotiating leverage given the high cost of forgoing affiliate fees and advertising revenue. And the judge found statements of AT&T's competitors opposing the merger to be unpersuasive.

For a host of reasons, mostly based on the court's findings of fact, the judge also rejected the DOJ's expert testimony asserting that the combined company would have increased negotiating leverage that would result in higher prices. The court specifically rejected the expert's reliance on the complex "Nash bargaining model," which the judge likened to a "Rube Goldberg contraption," finding that the model lacked "both 'reliability and factual credibility.'"

As for future transactions, the ruling suggests the following:

- **Dynamic markets**. The media industry is undergoing substantial transformation driven by new technologies. The court largely accepted AT&T's argument that it is difficult to create market power in such markets, which lessens the need for governmental intrusion on antitrust grounds. The court rejected the DOJ's argument that the impact of newer subscription video on demand services ("SVODs") on the broader video programming and distribution market should be disregarded. Parties concerned about antitrust obstacles in media and other dynamic markets may now be emboldened to pursue transactions.

- **Vertical mergers**. Most court challenges by the DOJ and FTC have been to horizontal mergers between competitors. AT&T/Time Warner, by contrast, is a vertical merger; the competitive implications were alleged to arise from the combination of distribution and content. The court's ruling highlighted the challenges of opposing vertical mergers, noting that they typically are pro-competitive to some degree by eliminating "double marginalization" – the combining firms' charging of profit margins at two levels in the supply chain. Even the DOJ's expert predicted that the merger would lead to $352 million in annual cost savings for AT&T's customers. Thus, the enforcement agency must establish that the likely harm to competition exceeds the procompetitive benefit. The court's rejection of the DOJ's efforts to show an anticompetitive effect could dampen the enforcement agencies' appetite for challenging other vertical mergers.

- **Structural Remedies**. AT&T had offered to address competitive concerns by adopting a process to arbitrate complaints by competing distributors that AT&T was overcharging for Time Warner content. In turning down this proposal, the DOJ questioned the effectiveness and desirability of conduct remedies, insisting that, even

in vertical mergers, competition must be protected through structural remedies such as divestitures. That point of view is consistent with the current DOJ leadership's statement that the antitrust agencies should be enforcers of merger law, not regulators of ongoing post-merger conduct. The court, however, found that Turner's commitment to arbitrate disputes with its distributors over renewal terms and not to impose blackouts once arbitration is invoked would likely have "real world effects" on negotiations between Turner and its distributors. The court's ruling may encourage the agency to accept conduct solutions, rather than insist on structural remedies, in future vertical transactions.

In short, although the court's ruling does not break substantial new ground in merger analysis, its careful and detailed application of existing antitrust principles to this significant vertical transaction is likely to encourage additional, substantial transactions in media and other dynamic industries.

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Please do not hesitate to contact us with any questions.

NEW YORK

Daniel M. Abuhoff
dmabuhof@debevoise.com

Michael A. Diz
madiz@debevoise.com

Gary W. Kubek
gwkubek@debevoise.com

William D. Regner
wdregner@debevoise.com

Michael Schaper
mschaper@debevoise.com