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TMT INSIGHTS
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A Skeptical D.C. Circuit Hears Oral Argument in the Government's Appeal of the AT&T-Time Warner Merger

On December 6, the Department of Justice confronted a skeptical and aggressive panel of federal appellate judges in its attempt to unwind AT&T Inc.'s acquisition of Time Warner Inc. We predict that the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") will rule in favor of AT&T, affirming the district court's decision.

Background

The DOJ in November 2017 sued to block AT&T's acquisition of Time Warner, alleging that the acquisition would "substantially lessen competition" in violation of Section 7 of the Clayton Act. This acquisition is vertical as AT&T and Time Warner are involved in different levels of the supply chain for television programming – AT&T is a distributor and Time Warner is a creator and aggregator. In comparison to horizontal mergers, vertical mergers are viewed as less likely to lessen competition, and most are viewed as procompetitive or competitively neutral.

At trial – the first time in over forty years that the DOJ had taken a vertical merger to trial – the government's primary theory of harm was that the combined entity would be able to force competing distributors to pay higher prices to carry Time Warner's programming (including HBO, TNT, TBS, and CNN) by threatening to withhold that programming, which in turn would result in those competitors increasing their prices to consumers.

Following a six-week trial before Judge Richard J. Leon, the court rejected the DOJ's challenge to the acquisition in a 172-page decision. It ruled that the DOJ "ha[d] failed to meet its burden to establish that the proposed 'transaction is likely to lessen competition substantially'" and permitted the acquisition to proceed without conditions. According to Judge Leon, the government had "conce[ded] that this vertical merger would result in hundreds of millions dollars in annual cost savings to AT&T's customers," there was "significant, real-world evidence" that contradicted the government's theory of harm, and the government's expert's "model lacks both 'reliability and factual credibility,' and thus fail[ed] to generate probative predictions of future harm."

The acquisition closed in June and the DOJ appealed in July. According to AT&T's general counsel, David McAtee, AT&T was "surprised" by the appeal, given that Judge Leon's "decision could hardly have been more thorough, fact-based and well reasoned."

The December 6 Oral Argument

The oral argument was heard by Judges Judith W. Rogers, Robert L. Wilkins, and David B. Sentelle of the D.C. Circuit – appointed by Presidents Clinton, Obama, and Reagan, respectively.

The panel asked very few questions of AT&T's counsel, and most of those were for clarification. But the DOJ attorney faced a "hot bench," with the three judges frequently interrupting counsel and expressing skepticism toward the government's arguments. The highlights of the oral argument are as follows:

- The DOJ's appeal challenged the district court's factual findings, which are subject to a deferential "clearly erroneous" standard of review. The panel questioned the government's ability to show clear error. Judge Sentelle asked, "Where is the plain error?" and later suggested that there was not any. And Judge Rogers asked, "The problem is, where was the evidence to show that the district court clearly erred?" The DOJ's response was that the district court: (i) was internally inconsistent in finding that the pre-merger bargaining leverage depended on the threat of a blackout of Time Warner's programming and the post-merger bargaining leverage depended on whether a blackout would actually happen; (ii) misunderstood economic principles about how the parties would maximize profits post-merger; and (iii) even if the district court correctly understood the economic principles, its application of them was based on a single piece of evidence (testimony from an NBCUniversal executive) that should have been found to be unreliable. The panel did not appear convinced by these arguments.
- A week after the government filed suit in November 2017, AT&T proposed to the DOJ an arbitration/no-blackout mechanism modeled on the one the DOJ insisted on in the 2011 Comcast-NBCUniversal transaction. According to counsel for AT&T, through this mechanism Turner had "relinquished" its ability to threaten to withhold programming, thereby undercutting the government's theory of harm. Judge Sentelle, in apparent agreement, said "If you have any empty threat of a blackout, you're not going to get a heck of a lot of leverage out of that." Judge Wilkins asked "[h]ow can we just ignore" the district court's findings that the arbitration agreement would have a real-world impact on the marketplace and the parties' bargaining positions. The DOJ disagreed with Judge Wilkins that the district court had made any such findings, argued that the arbitration offer was "too little too late," and attempted to distinguish it from the mechanism used for Comcast-NBCUniversal. Counsel for AT&T confirmed for the panel, "We will honor it [the arbitration/no-blackout arrangement]. The other side will invoke it. And it will have real-world effects."
- Judge Sentelle, who seemed most hostile to the government's position, indicated that mere economic principles and theory are not sufficient for the government to meet its burden at trial. Specifically, Justice Sentelle told the DOJ attorney, "If you're going to rely on an economic model, you have to rely on it with quantification. The bare theorem . . . doesn't prove anything in a particular case. You have to have numbers to make a model work. That's what a model

is." He also reminded the DOJ attorney to "remember where the burdens are." After the DOJ attorney suggested that Judge Sentelle's position was inconsistent with Supreme Court precedent (*Brown Shoe, Inc. v. United States*), Judge Sentelle pointed out that there was no economic modeling in *Brown Shoe*, and therefore that case "has nothing to do with whether you have to use numbers in order to make a model relevant in a real world case."

In an interview with CNBC following the argument, AT&T's CEO, Randall Stephenson, said that AT&T "felt good going in that Judge Leon had written an order that was fact-specific and it was very specific to the AT&T-Time Warner case" and that "after today's hearing, we feel confident." The DOJ has not publicly commented about the oral argument to date.

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It is anticipated that the D.C. Circuit will rule before the end of February 2019, when the agreed upon conditions that would make it easier for AT&T to roll back its acquisition of Time Warner – such as managing the Turner network as part of a separate business unit – expire. After that decision, the losing party can request that the entire D.C. Circuit reconsider the case, but it is very rare for that court to do so. The losing party also can appeal to the Supreme Court, which exercises its discretion to hear a case sparingly. The absence of a disagreement among the circuits and the overall paucity of lower court cases addressing vertical mergers would weigh against a decision by the court to hear an appeal. But given this case's high media and political profile and the absence of guidance from the Supreme Court on the standard for the review of vertical mergers, the Supreme Court might agree to hear the case.

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