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Legal Sidebar

Media Consolidation: *United States v. AT&T* and Implications for Future Transactions

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UPDATE: On July 12, 2018, the Department of Justice filed a notice of appeal in the U.S. Court of Appeals for the District of Columbia Circuit of the district court's decision denying the injunction which would have prohibited AT&T's acquisition of Time Warner. If the government prevails, AT&T could be required to divest itself of Time Warner. Regardless of the outcome, the appellate court's decision may provide additional guidance for the application of Section 7 of the Clayton Act to vertical transactions

The original post from June 29, 2018 appears below.

On June 12, 2018, the U.S. District Court for the District of Columbia (D.C. District Court) ruled that the proposed merger of AT&T, Inc. (AT&T) with Time Warner Inc. (Time Warner) could proceed without conditions, after one of the most closely watched antitrust trials in recent memory. The companies announced their intent to merge in October 2016. After examining the transaction for over a year, the Department of Justice (DOJ) challenged the proposed merger in November of 2017, arguing that consolidation of AT&T, a communications and satellite television provider, with Time Warner, a programming aggregator, would substantially lessen competition in violation of Section 7 of the Clayton Act (15 U.S.C. § 18). The court, after conducting a six-week trial examining the evidence, held that the government had not met its burden of proof under Section 7. The AT&T/Time Warner merger closed on June 14, 2018.

The case drew intense interest because it represented the first time in nearly 40 years that the federal government asked a court to block a proposed transaction between companies that did not compete within the same market, i.e., a "vertical" transaction. (Most transactions challenged under Section 7 involve parties that do compete within the same market, i.e., "horizontal" transactions.) Antitrust experts labeled the case "enormously significant," because challenges to vertical transactions are so rare and thus there is little precedent as to such cases.

This Legal Sidebar will first outline current Section 7 doctrine. It will then discuss the particularities of the government's case against AT&T and Time Warner and the court's decision to allow the transaction to proceed. Finally, it will analyze the decision's implications for the media industry and future antitrust cases, and identify potential considerations for Congress.

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Section 7 of the Clayton Act and Vertical Transactions

Section 7 of the Clayton Act applies to mergers "in any line of commerce" when their effect "may be substantially to lessen competition, or to tend to create a monopoly" unless the merger is statutorily exempt. By prohibiting mergers that negatively affect competition, the Clayton Act aims to preserve competition and to protect the competitive process itself rather than individual competitors. Accordingly, a merger may injure market competitors but not violate antitrust laws. Moreover, because Section 7 of the Clayton Act aims to prevent *future* anticompetitive harms, a transaction need only be likely, rather than certain, to have an anticompetitive effect in order to violate the law.

The Supreme Court has directed lower courts and the antitrust enforcement agencies (DOJ and Federal Trade Commission (FTC)) to conduct an "examination of the particular market – its structure, history, and probable future" when assessing whether a particular transaction would substantially lessen competition. Under the Hart Scott Rodino Act (HSR Act), parties must report all transactions exceeding certain thresholds to the FTC and DOJ prior to their completion and wait to consummate the transaction while one of the two agencies assesses the deal pursuant to Section 7's standard. The agency, after completing its analysis, may then attempt to block the transaction from occurring, negotiate with the parties to place conditions on the deal, or permit the transaction to close.

As noted above, most Section 7 cases involve "horizontal" transactions, where the parties compete with each other in one or more lines of commerce. A horizontal transaction may eliminate a competitor from the affected market, increasing market concentration (i.e., the number of market participants as a function of their shares of the market) and lessening competition. D.C. Circuit precedent and the DOJ and FTC's Horizontal Merger Guidelines establish a presumptive Section 7 violation when a transaction would increase market concentration above certain thresholds. In these cases, the transacting parties may rebut that presumption by offering evidence that the transaction will create procompetitive benefits (e.g., cost-saving efficiencies that could lower consumer prices) that outweigh any possible competitive harm.

No similar presumption of a Section 7 violation applies to review of vertical transactions. Because the parties to vertical mergers do not compete, scholars and antitrust enforcers generally consider such deals less likely than horizontal mergers to eliminate competitors from the relevant markets. Consequently, as the AT&T/Time Warner court noted, there is "no short-cut" to proving a vertical transaction violates Section 7. A plaintiff seeking to prove that a vertical transaction violates Section 7 must present case-specific evidence that the transaction creates a likelihood of anticompetitive effects. In addition, a plaintiff seeking to prove that a vertical transaction violates Section 7 cannot rely on market concentration levels to prove such a violation.

Supreme Court precedent indicates that vertical transactions can present a likelihood of anticompetitive harm by increasing the merged firm's ability to use its existing power in one market to augment its power in a related market. However, though vertical transactions may pose harm to competition in some cases, a number of legal scholars and antitrust enforcers historically have agreed that "many vertical mergers create vertical integration efficiencies" that can result in lower prices or increased services for consumers, which are often considered good for competition. The belief that vertical transactions often benefit competition may have contributed to the lack of court challenges in recent decades. Typically, when examining vertical transactions, government antitrust enforcers reach agreements with the parties to the transaction—in which they place conditions on the transaction intended to alleviate anticompetitive risks—rather than seek to block the transaction under Section 7. The government's challenge to AT&T and Time Warner's merger was therefore unique from its inception.

United States v. AT&T

The merger of AT&T and Time Warner combines, in one entity, one of the nation's largest programming distributors and mobile Internet service providers (AT&T) with a company that owns a great deal of popular programming (Time Warner). Time Warner controls networks such as CNN, TBS, TNT, and HBO. TBS and TNT own lucrative sports broadcasting rights, including portions of NCAA March Madness and the NBA playoffs. HBO produces *Game of Thrones*, *Big Little Lies*, and other popular programs. Time Warner also owns Warner Bros. film studios, which has the rights to some lucrative film franchises, such as Harry Potter. AT&T and Time Warner, in announcing the merger, argued that their combination would allow AT&T to deploy Time Warner's content in new and innovative ways that would benefit customers and help the newly combined company compete against market leaders like Netflix, Amazon Prime, and Hulu. In accordance with the HSR Act, the parties notified the antitrust enforcement agencies of their plans to merge and the DOJ was chosen to conduct the Section 7 analysis.

After reviewing the deal, the DOJ disagreed with the companies' justification of the transaction, and, in asking the district court to block the merger, argued, among other things, that the transaction would ultimately raise prices for many consumers. To understand the DOJ's argument, a brief industry operation background is instructive. Prior to the merger, Time Warner had two primary income sources. First, Time Warner licenses its content to content distributors (e.g., AT&T/DirecTV, Comcast, Verizon) to distribute its programming to the public. These programming licenses are vigorously negotiated by programmers, like Time Warner, and the content distributors. Infrequently, the parties reach an impasse in such negotiations, which can result in a distributor losing the rights to programming for some period of time, known as a "blackout." A blackout causes financial damage to both the programmer, who may lose both subscriber fees from the distributor and advertising money as a result, and the distributor, who may lose subscribers when it loses the ability to distribute the programming to the public. Time Warner's second income source is selling advertising on its various channels (except HBO, which does not accept advertising).

The DOJ presented evidence at trial to support its contention that the Time Warner/AT&T merger could result in raised consumer prices in three ways. Primarily, the government asserted that, with guaranteed distribution from AT&T's mobile and satellite platforms, the merged entity would be more able to threaten programming blackouts and could demand higher licensing fees from other multi-channel video programming providers (MVPDs, e.g., cable providers and satellite providers), which would ultimately be passed on to consumers in the form of higher prices. The government also theorized that the merged company could use its power over distribution channels to harm competing "over-the-top" programming providers that offer streaming content but do not rely on cable or satellite television platforms (e.g., Sling TV, which offers broadcast programming and some cable television channels streaming over the Internet) by restricting their access to "must-have" content (e.g., CNN,TBS, TNT). Lastly, the government posited that the merged company could restrict rival distributors from striking promotional deals with HBO, which lure customers to subscribe to those distributors, thus harming the distributors' ability to attract and maintain subscribers.

The district court disagreed on all counts, holding that the government's proffered evidence was insufficient to support any of its arguments. The court began its opinion with a description of the rapidly changing media landscape where innovative companies like Netflix and other Internet-based entities have challenged older firms to devise new ways to compete, and noted that the AT&T/Time Warner transaction appeared intended to rise to that challenge. The court then discussed the legal standard to apply to the merger. The court recognized that this case was unlike any other in recent history because it involved a vertical transaction, leaving the court with a "dearth of authority" to guide its analysis. The court accepted that vertical transactions "are not invariably innocuous," but was also cognizant of the prevailing view that vertical integration can have significant competitive benefits.

Turning to the government's arguments, the court observed that the government had conceded that the merger would create certain cost-savings that would benefit AT&T customers. Ultimately, the court disagreed with the government that the evidence indicated that the anticompetitive costs of the transaction would outweigh the predicted benefits. The court rejected the idea that Time Warner's content is "must-have" in the literal sense, and instead found that distributors that lose the rights to Time Warner content after the merger would nonetheless still be able to compete in the media market. Moreover, the court noted that the government did not argue that any distributors would actually lose the rights to Time Warner content after the merger, as the DOJ's expert predicted that long-term programming blackouts were unlikely to occur. In contrast, the court accepted the defense's arguments that the merged entity's incentives would be to distribute Time Warner's content as widely as possible, thus making it unlikely that any distributors would lose the rights to Time Warner content after the merger. For those reasons, among a few others, the court concluded that the government did not offer sufficient evidence that the merger would raise prices paid by competing distributors for Time Warner content.

The court spent far less time dismissing the government's other two arguments against the deal. Responding to the DOJ's assertion that the AT&T/Time Warner merger could harm competing streaming companies like Sling TV, the court wrote that the benefits of consumers accessing Time Warner content would accrue regardless of whether it was displayed by a competing provider and that streaming content requires an Internet connection, such as AT&T's mobile platform, giving "the combined entity even more reason to distribute Time Warner content as broadly as possible." Finally, in rejecting the possibility that the AT&T/Time Warner merger could limit promotional partnerships between rival distributors and HBO, the court found that such a limitation is antithetical to HBO's business model because the network does not accept advertising, but rather earns money through subscription fees. Therefore, its success is dependent upon the widest possible distribution.

The court ended its analysis by taking the relatively extraordinary step of advising the government not to seek a stay of the court's decision pending appeal. The transaction, in the court's view, had been in limbo far too long, and further delay would cause defendants great injury. Nonetheless, the court clarified that it was in no way suggesting that the government should not seek appellate review of the case.

Implications and Congressional Considerations

The district court cautioned that "the temptation by some to view this decision as being something more than a resolution of this specific case should be resisted by one and all!" Nevertheless, many industry observers have predicted that participants in the media market will view the decision as giving a green light to vertical transactions in the media business, with one former DOJ antitrust official predicting "an avalanche" of new mergers. Indeed, the day after the decision, Comcast announced a bid for 21st Century Fox to rival a bid already submitted by Disney, causing Disney to increase its initial bid, which has already been approved by the DOJ. It is possible that the district court's decision in *United States v. AT&T* may signal the beginning of a new era of mergers in the media industry. The AT&T/Time Warner merger itself may not have immediately clear effects because AT&T has pledged that Time Warner's cable networks would operate independently through February 2019.

The decision also could spark renewed conversations about industry consolidation on Capitol Hill. Certain Members of Congress have expressed concerns about consolidation across numerous industries. In December 2016, shortly after the merger was announced, the Senate Judiciary Committee's Subcommittee on Antitrust, Competition Policy, and Consumer Rights held a hearing examining AT&T's proposed acquisition of Time Warner. If the district court's ruling does trigger a wave of new transactions, Congress might again exercise oversight over the industry to examine the competitive forces driving any proposed mergers.

From a legal perspective, the decision is significant because it represents the first time a court has interpreted whether a vertical transaction would substantially lessen competition in violation of Section 7 in "four decades." Moreover, the court roundly rejected the government's theories of harm, potentially signaling an uphill battle for future challenges to vertical transactions. As noted earlier, in the past, the government's antitrust enforcers have sought to alleviate their concerns with potential competitive harms posed by vertical transactions by negotiating with the parties to place conditions on their behavior following a merger's consummation, rather than challenging those transactions in court. However, the current Assistant Attorney General for the Antitrust Division has expressed skepticism of negotiated behavioral conditions, and some commentators viewed the DOJ's challenge to the AT&T/Time Warner deal as a potential new direction for the department's enforcement philosophy. It is possible that the AT&T/Time Warner ruling may complicate that enforcement philosophy if it is allowed to stand. The DOJ has not yet announced whether it will appeal the decision.

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