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Six Issues to Watch in the Justice Department Challenge to the AT&T-Time Warner Deal

Jeffrey May (Wolters Kluwer) · Friday, December 1st, 2017

The Justice Department's challenge to AT&T's proposed $108 billion acquisition of Time Warner Inc. is likely the biggest antitrust news story of the year. Much of the attention from the mainstream media has been focused on possible influence by President Trump on the Justice Department's decision to seek divestitures of assets, such as CNN, to get the deal approved. While such speculation might make for an interesting story and might even be considered in a court challenge, the outcome of this case will depend on the same issues that define other merger challenges. The government's complaint to block the combination of Time Warner's video content with AT&T's video distribution platforms was filed on November 20. On December 7, the federal district court in Washington, D.C. will hold an initial status conference in the case. A trial date was yet to be set, but is likely in the first half of 2018. Below are six key issues to watch as they will shape the direction of the case in the coming weeks and months.

1. Precedent. There's been a lot of talk about how the decision to challenge the proposed merger of AT&T and Time Warner is a marked departure from antitrust precedent. But suggesting that vertical mergers get a pass under current law is probably not an appropriate defense of this deal.

Vertical integration is within the prohibitions of Section 7 of the Clayton Act. The Justice Department generally uses its limited resources to focus on horizontal transactions, which are the most likely to raise competition concerns. However, vertical mergers have in fact been challenged over the years. There are so few challenges because there are a small number of vertical mergers and an even smaller number of them that raise competition concerns.

While both federal antitrust agencies have filed only a handful of vertical merger cases in recent decades, the challenge to Comcast/NBC combination is a good example of a vertical merger that raised competition concerns. In 2011, the Justice Department filed a suit alleging that a joint venture between Comcast Corp., which was the nation's largest cable operator and Internet service provider, and NBC Universal Inc. could allow Comcast to limit competition from its cable, satellite, telephone, and online competitors. According to that complaint, the proposed transaction would have allegedly impacted the market for the timely distribution of programming to residential customers. The challenge was resolved without litigation and with a consent decree requiring behavioral remedies. But that does not suggest that similar vertical mergers can be remedied with the same relief. The Justice Department has stated a preference for structural relief to remedy competition concerns raised by mergers. The Justice Department also points out that this latest merger must be viewed in a market transformed by the Comcast/NBC Universal transaction.

2. Relevant market, market power. Most merger challenges that make their way to court rise and fall on market definition. In recent years, the federal antitrust agencies have earned a better track record with the courts in defining markets in a merger challenge.

In the AT&T/Time Warner case, the battle lines are drawn. The government alleges that the "merger would substantially lessen competition among all distributors of professionally produced, full-length video programming subscription services to residential customers in the United States." The government used nearly identical language in the complaint against Comcast and NBC Universal. Against AT&T and Time Warner, the government asserts that "the merger would give the merged company the market power to weaken competing distributors' ability to compete by raising their costs, would allow the merged company to impede emerging and growing rivals, and, furthermore, would result in increased likelihood of oligopolistic coordination." The complaint states that Time Warner's Turner networks—"with their mix of live sports, live news, and entertainment content"—and Home Box Office—"the "World's #1 premium cable network"—have market power.

In its answer, AT&T and Time Warner contend that the government's complaint fails on the threshold issue of identifying a collection of sufficient market power to cause antitrust concern. The government failed to define any appropriate relevant market or markets and failed to establish that the defendants exercise market power with respect to any relevant market, they assert. "[B]y no conceivable measure does Time Warner have anything but insignificant market shares in a rapidly-expanding content marketplace with low barriers to entry and new participation by several of the most well-funded companies in the world," according to the answer. This is a strong argument for AT&T and Time Warner.

3. Efficiencies. While efficiencies arguments have not been very helpful for merging parties at trial, AT&T and Time Warner might have stronger efficiencies arguments to justify their vertical merger than most horizontal merging parties who must overcome more obvious competition problems. The government included its boilerplate assertion in its complaint that the "proposed merger would be unlikely to generate verifiable, merger-specific efficiencies in the relevant markets sufficient to reverse or outweigh the anticompetitive effects that are likely to occur."

According to the defendants, their merger will "foster innovation in video content and distribution; allow AT&T and Time Warner to use content intelligence to produce and market new content more efficiently and effectively; combine Defendants' complementary capabilities to enable the combined company to provide much needed competition with Google and Facebook, which today dominate digital advertising; and lead to significant cost savings measured in the billions of dollars."

4. Remedies. Apparently, AT&T and Time Warner believed that because behavioral remedies resolved competition concerns in the Comcast/NBC Universal transaction, that such remedies would be sufficient in this matter. As noted above, this latest transaction is being considered in light of that transaction and the corresponding risk of oligopolistic coordination. According to the government, together AT&T/DirecTV and Comcast/NBC Universal "have almost half of the country's MVPD customers" and "would have an increased incentive and ability to harm competition by impeding emerging online competitors that they consider a threat, and increasing the prices for the networks they own." Where behavioral remedies might have been sufficient in the past, they might not be appropriate in this new environment.

Further, the government has stated a strong preference for structural remedies over conduct or behavior remedies. Just days before the complaint against AT&T and Time Warner was filed, Makan Delrahim, Assistant Attorney General in charge of the Department of Justice Antitrust Division, pledged "a return to the preferred focus on structural relief to remedy mergers that violate the law and harm consumers." Delrahim went on to say, however, that "there's a place for considering a behavioral remedy if it will completely cure the anticompetitive harms." He described this in the context of "an unlawful vertical transaction [that] generates significant efficiencies that cannot be achieved without the merger or through a structural remedy."

When media reports surfaced in early November that the Antitrust Division was possibly seeking divestiture of the Time Warner division that includes CNN, or of AT&T's DirecTV operations, AT&T Chairman and Chief Executive Officer Randall Stephenson commented that the company had never offered to sell CNN and had no intention of doing so. Asset sales seem to be off the table. However, the parties are willing to make concessions to address some of the concerns raised by the Justice Department.

The parties seem far apart on a possible settlement. But the government and the parties also were far apart when the Justice Department moved in 2013 to block the merger of American Airlines and US Airways. Ultimately, the government allowed the merger to proceed subject to a series of divestitures that did not encompass all of the markets purportedly threatened by the deal.

5. Business documents. In recent years, the Antitrust Division has used the merging parties' own business documents to bolster its cases to block mergers. This tactic was used in the American Airlines/US Airways complaint. It was used once again against AT&T and Time Warner.

Among other selective quotes, the government's complaint states that AT&T/DirecTV documents demonstrate a belief that "[t]raditional Pay-TV will be a cash cow business to AT&T for many years to come." The complaint goes on to say: "AT&T/DirecTV perceives online video distribution as an attack on its business that could, in its own words, 'deteriorate[] the value of the bundle.' Accordingly, AT&T/DirecTV intends to "work to make [online video services] less attractive."

In their answer, AT&T and Time Warner suggest that these quotes are taken out of context and misleading. However, such quotes can be effective in court and in the court of public opinion. It serves as a reminder to counsel to inform their business people to avoid including hyperbole in business documents.

6. Trial date, time line. Lastly, as with all mergers, delays in resolving the dispute could jeopardize the transaction. AT&T and Time Warner are at odds with the government over when the trial should start.

It has become the practice at the Antitrust Division for cases to be litigated on the merits in the first instance. Unlike the FTC, the Justice Department does not move for preliminary injunctions to be followed by a full-blown case on the merits. (In the case of the FTC, the merits would be considered in an administrative trial.) The Justice Department procedure is often preferred by merging parties.

In this case, the merging parties have asked the district court to set a trial date to begin on February 20, 2018. The government, on the other hand, is arguing for a longer pre-trial discovery period, proposing "a trial-ready date of May 7, 2018, with trial starting as soon thereafter."

Despite a review that has taken more than a year, the government said that additional discovery and pretrial preparation are needed for "recent" evidence from the defendants on the synergies and efficiencies they say the transaction will yield; their post-closing restructuring plans; depositions from employees who have been reassigned since the Justice Department investigation began; 400,000 documents that were withheld or redacted by the defendants during the investigation; and the development of expert testimony.

The later trial date and possible delays in the trial could threaten the deal but also give time for further settlement negotiations. However, AT&T's Stephenson has been quoted as saying "We don't intend to settle this matter out of simple expedience."

A trial date should be set soon. Stay tuned.

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