United States v. AT&T, Inc.

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916 F.3D 1029 (D.C. CIR. 2019)

I. INTRODUCTION

In *United States v. AT&T, Inc.*,[1] the United States Court of Appeals for the District of Columbia Circuit affirmed the district court's denial of a permanent injunction of the vertical merger between AT&T and Time Warner under Section 7 of the Clayton Act, 15 U.S.C. § 18.[2] The D.C. Circuit applied the "clearly erroneous" standard of review.[3] The court held that the government failed to meet its burden to establish that the proposed merger would likely substantially lessen competition within the multichannel video distribution market.[4]

II. BACKGROUND

On October 22, 2016, AT&T Inc. announced its plan to acquire Time Warner Inc. as part of a $108 billion vertical merger transaction.[5] AT&T Inc. is a distribution company with two traditional Multichannel Video Programming Distributor ("MVPD") products, whereas Time Warner is a content creator and programmer.[6] The merged firm would operate in each segment of the industry's "three-stage chain of production:" content creation; packaging content into networks to be licensed to third-party MVPDs for distribution; and providing on-demand content, directly to subscribers or through licenses with third-party distributors.[7] The government brought suit under Section 7 of the Clayton Act alleging that "the newly combined firm likely would . . . use its control of Time Warner's popular programming as a weapon to harm competition."[8]

Section 7 of the Clayton Act prohibits mergers where "in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition. . . ."[9] The district court applied the *Baker Hughes* burden-shifting framework to

1. United States v. AT&T, Inc., 916 F.3d 1029 (D.C. Cir. 2019).
2. *Id.* at 1031.
3. *Id.* at 1029.
4. *Id.* at 1046.
5. *Id.* at 1035.
6. *Id*.
7. *Id.* at 1033.
8. *Id.* at 1035.
9. *Id.*at 1032 (citing 15 U.S.C. § 18 (2018)).

consider the effect of the proposed merger on competition.[10] Under this approach, the government bears the burden of demonstrating that the merger is likely to substantially lessen competition in the relevant market.[11] Because vertical mergers do not produce immediate change in the relevant market share, the government may not rely on statistics about changes in market concentration to support a presumption of anticompetitive effect.[12] Alternatively, the government must "make a fact-specific showing that the proposed merger is "likely to be anticompetitive."[13] The burden then shifts to the defendant to present evidence that the government's prima facie case "inaccurately predicts the relevant transaction's probable effect" or to "sufficiently discredit" the basis of the underlying government claims, after which the burden of production shifts to the government to present additional evidence.[14] The ultimate burden of persuasion remains with the government.[15] The government must demonstrate more than a mere probability of decreased competition. Rather, the government must show there is a reasonable probability that the proposed merger is likely to substantially lessen competition to successfully bring a Section 7 claim.[16] The district court held that the government "failed to clear the first hurdle in meeting its burden of showing that the proposed merger was likely to increase Turner Broadcasting's bargaining leverage."[17]

At issue on appeal was the district court's factual findings "on its increased leverage theory whereby costs for Turner Broadcasting System's content would increase after the merger, principally through threats of long-term 'blackouts' during affiliate negotiations."[18]

III. ANALYSIS

The court analyzed the evidence in the record to evaluate the government's assertions that the district court erred in finding that the government failed to meet its burden of proof on two grounds: "the district court discarded the economics of bargaining, and the district court failed to apply the foundational principle of corporate-wide profit maximization."[19] The government also argued that the district court "used internally inconsistent logic when evaluating industry evidence and clearly erred in rejecting its expert's quantitative model of harm."[20]

10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.* at 1038.
18. *Id.* at 1031.
19. *Id.* at 1033.
20. *Id.*

A. *Increased Leverage Theory of Harm*

The court found unpersuasive the government's argument that the district court discarded the economics of bargaining or failed to apply the principle of corporate-wide profit maximization.[21] At trial, the government advanced an increased leverage theory of harm in asserting its claim that the effect of the acquisition would substantially lessen competition. The theory is that "by combining Time Warner's programming and DirecTV's distribution, the merger would give Time Warner increased bargaining leverage in negotiations with rival distributors, leading to higher, supracompetitive prices for millions of consumers."[22] The government presented expert opinion forecasting the likely anticompetitive effects of the proposed merger based on a quantitative model, taking into account the Nash economic bargaining theory.[23] The Nash theory stands for the proposition that "the relative loss for each party affects bargaining leverage and when a party has more bargaining leverage, that party is more likely to achieve a favorable price in the negotiation."[24] The resulting model predicted cost savings realized from the elimination of double marginalization, or the elimination of profit margins at two different levels in a vertical supply chain and the extraction of increased fees for its content.[25]

The defendant, AT&T, rejoined with expert analysis of "real-world data" from previous instances of vertical integration within the market demonstrating "no statistically significant effect on content prices."[26] Significantly, the district court gave force to evidence presented by AT&T that revealed that the government's predictive modeling did not take into consideration Turner Broadcasting System's existing irrevocable offers of no-blackout arbitration agreements, which a government expert conceded would necessitate a new model.[27] The government did not present any comparable analysis of "real-world" data for previous vertical mergers in the industry.[28] As a result, the court found that the district court had not misunderstood or misapplied the economic theory, but rather, concluded that the "theory inaccurately predicted the post-merger increases in content costs."[29] Significantly, the court dismissed the government's challenges to the district court's treatment of its economic theories as "largely irrelevant, during the seven- year period" in which the irrevocable offers would be in force.[30]

21. *Id.* at 1040.
22. *Id.* at 1035.
23. *Id.* at 1036.
24. *Id.* at 1039.
25. *Id.* at 1036.
26. *Id.* at 1031.
27. *Id.* at 1031.
28. *Id.* at 1031.
29. *Id.* at 1040.
30. *Id.* at 1041.

B. Dynamic Video Programming and Distribution Market

The court also found that the government's argument that the district court's reasoning in evaluating trial testimony was internally inconsistent was unpersuasive.[31] The court reviewed the evolving nature of the video programming and distribution industry.[32] Traditionally, the market operates in a "three-stage chain of production"[33] with 1) studios or networks creating content, 2) programmers packaging content into networks to be licensed for distribution, and 3) distributors selling bundled networks to subscribers.[34] The licensing of content is facilitated by affiliate agreements whereby distributors pay "affiliate fees" to programmers, negotiated through "lengthy and complicated" "affiliate negotiations."[35] Failure to reach an agreement results in the distributor losing rights to display the programmer's content, resulting in a "blackout" for customers.[36] Because of the economic loss borne by both parties in the event of a blackout—as programmers lose affiliate fee revenues and distributors risk losing subscribers—blackouts are rare.[37] Nonetheless, record evidence suggested that negotiating parties employ threats of blackouts as a negotiating tactic.[38]

At trial, the government presented the defendant's own statements and those of other industry leaders submitted seven years earlier in an administrative proceeding about the anticompetitive effects of a proposed vertical merger on the video programming and distribution industry.[39] Additionally, the government presented testimony from third-party distributors about their concerns and reasons to believe that a merger would increase Turner Broadcasting's bargaining leverage.[40] In response, AT&T presented testimony from executives involved in previous vertical mergers, rebutting the government's theory that the integrated company's increased bargaining leverage would allow AT&T to extract higher costs for its content during affiliate negotiations.[41] The district court found that the third-party testimony "fail[ed] to provide meaningful, reliable support for the [g]overnment's increased leverage theory, while the executives' testimony undermine[d] the persuasiveness of the [g]overnment's proof."[42] As a result, the court found that the record evidence did not demonstrate that the district court clearly erred in discounting the government's testimony because it was "speculative, based on unproven assumptions, or unsupported."[43] The court

31. *Id.* at 1044.
32. *Id.* at 1046.
33. *Id.* at 1033.
34. *Id.* at 1033-34.
35. *Id.* at 1034.
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.* at 1031.
40. *Id.* at 1045.
41. *Id.* at 1036.
42. *Id.* at 1045 (internal quotations omitted).
43. *Id.* at 1038 (internal quotations omitted).

also credited the record evidence that indicated that the video programming and distribution industry had been experiencing "ever-increasing competitiveness"[44] with the emergence of "virtual" multichannel video programming distributors, such as DirecTV Now and YouTube TV, and subscription on-demand content distribution platforms.[45] Due to the dynamism of the market, taken in consideration with the evidence on record, the court found that the government's contention that the district court clearly erred failed.[46]

C. Legal Standard for Evaluating Vertical Mergers

Because Section 7 does not require evidence of certain harm, the district court recognized "the uncertainty regarding the measure of proof for the government's burden."[47] This court, while noting the government's latest guidance on non-horizontal mergers was issued in 1984,[48] was unpersuaded to weigh in, as neither party challenged the standard.[49] Both parties used varying language to articulate the government's burden, including that it must show an "appreciable danger" of competitive harm or that it must show that harm is "likely" or "reasonably probable."[50] The district court concluded that, even if the varying formulations governed, it was nonetheless unnecessary to articulate distinctions.[51] The district court's conclusion that the government had failed to satisfy its burden "would remain unchanged."[52]

IV. CONCLUSION

The court held that the district court did not abuse its discretion in denying a permanent injunction of the vertical merger under Section 7 of the Clayton Act, 15 U.S.C. § 18, because the district court did not err in finding that the government failed to satisfy its burden to establish that the proposed merger was likely to increase Turner Broadcasting System's bargaining leverage to increase the costs of its content.[53] Accordingly, the court affirmed the lower court's decision.[54]

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44. *Id.* at 1046 (quoting *United States v. AT&T Inc.*, 310 F.Supp.3d 161, 241 (D.D.C. 2018)).
45. *Id.* at 1034.
46. *Id.* at 1032.
47. *Id.* at 1037.
48. *Id.* at 1036-37.
49. *Id.* at 1037.
50. *Id.*
51. *Id.*
52. *Id.* at 1037 (citations and internal quotations omitted).
53. *Id.* at 1046.
54. *Id.* at 1046.