AAI Applauds Move to Block AT&T-Time Warner Merger, Sets Record Straight on Vertical Merger Enforcement

The U.S. Department of Justice (DOJ) recently sued to block the proposed merger of AT&T and Time Warner. Combining Time Warner's news, entertainment, and sports video content with AT&T's video distribution pipes would create a large, vertically integrated player in the important media and communications industry. Aside from the competitive problems raised by the deal itself, the merger could hasten a fundamental transformation of the industry. Instead of competition between independent content providers and between independent distributors, we could see markedly weaker competition between just a few integrated video content-distribution systems. The result is likely to be higher prices and lower quality for consumers, less innovation in video content and distribution, and less diversity in the media.

The American Antitrust Institute (AAI)[1] applauds the DOJ's move to block the AT&T-Time Warner merger. It reflects sound enforcement of Section 7 of the Clayton Act in an area of merger control that has been of concern to many policymakers for years. The government has laid out a strong case for how the merger could potentially harm the competitive process and consumers. And contrary to some claims, the DOJ's move to block the merger is supported by a long-standing record of enforcement on vertical mergers. This commentary highlights this record and a number of other important issues for competition enforcement and policy. These include the reality that as antitrust enforcement moves forward, it reflects past experience, evidence, and learning. The commentary also takes up the question of what AT&T-Time Warner may mean for future merger enforcement.

I. The Merits of the Government's Case

The government has laid out a strong case. The complaint articulates two major concerns about how the merger could harm the competitive process and consumers. One is that it would enhance AT&T-Time Warner's bargaining power in negotiating with rival video distributors over access to valuable Time Warner content. Such a tilt in negotiating leverage could disadvantage distribution rivals through higher content prices, leading to higher prices and lower quality for consumers.

A focus on enhanced bargaining power as a mechanism for impeding rivals in vertical mergers has sharpened over the last several years. For example, the FCC relied on enhanced bargaining power in its challenge to Comcast-NBCU, and the DOJ relied on the same

[1] The American Antitrust Institute (AAI) is an independent, nonprofit organization devoted to promoting competition that protects consumers, businesses, and society. We serve the public through research, education, and advocacy on the benefits of competition and the use of antitrust enforcement as a vital component of

concept in evaluating the merger of Comcast and Time Warner Cable.[2] Ironically, DirecTV argued that bargaining theory supported a challenge to the Comcast-NBCU merger.[3] Pairing up critical video content with video distribution in highly concentrated markets stands to frustrate the ability of smaller innovative rivals such as online video distributors trying to enter or to gain a foothold. And it is a predictor that consumers will pay more and get lower quality content across a variety of video distribution channels.

But the complaint contains another, equally powerful claim. Namely, the new vertically integrated AT&T-Time Warner could have an enhanced ability and incentive to act in concert with another vertically integrated video content-distribution rival(s) – Comcast-NBCU. Multiple vertically integrated firms could coordinate among themselves by charging each other higher content prices through "reciprocal" contracts. These higher input prices can push up prices to video distributors and/or deter price-cutting.[4] Moreover, integrated firms can help stabilize such an "agreement" through mechanisms such as most-favored nation clauses.[5] The proposed merger thus aligns incentives for vertically integrated video content-distributors to coordinate in raising their content prices and impeding competition from more innovative and disruptive online distribution rivals.[6]

The DOJ's claims are very compelling. They are similar to those made in connection with numerous previous vertical mergers in the media-communications and other industries.

II. Setting the Record Straight on Vertical Merger Enforcement

AT&T's counter-narrative is weak. AT&T's chief executive, Randall L. Stephenson, said of the DOJ's action: "It defies logic, and it's unprecedented," explaining that the DOJ had a "long history of approving similar mergers."[7] AT&T's General Counsel, David McAtee, described the government's case as a "radical and inexplicable departure from decades of antitrust precedent," going on to say, "[v]ertical mergers like this one are routinely approved because they benefit consumers without removing any competitor from the market."[8]

A departure from previous policy would imply that the government has either waved

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[2] In the Matter of Applications of Comcast Corp., et al., 26 FCC Rcd. 4238, 4255 (2011); Jeff Bliss, *DOJ Examining Bargaining-Leverage Economic Theory in Comcast-Time Warner Cable Review*, MLEX (Oct. 28, 2014), *available at* http://awa2015.concurrences.com/IMG/pdf/mlexcomcastbargaining-1.pdf.

[3] In the Matter of Applications of Comcast Corp. et al., MB Docket No. 10-56, 6, 11-13 (filed June 21, 2010), https://ecfsapi.fcc.gov/file/7020510969.pdf.

[4] Steven C. Salop, *Invigorating Vertical Merger Enforcement* (Nov. 6, 2017), *available at* http://scholarship.law.georgetown.edu/facpub/2002/.

[5] Complaint, United States v. AT&T Inc., No. 1:17-cv-02511 at 20-21 (D. D.C. Nov. 20, 2017), https://www.justice.gov/atr/case-document/file/1012916/download.

[6] *Id.* at 7, 20-21.

[7] Cecilia Kang & Michael J. de la Merced*, Justice Department Sues to Block AT&T-Time Warner Merger*, N.Y. TIMES (Nov. 20, 2017), https://www.nytimes.com/2017/11/20/business/dealbook/att-time-warner-merger.html.

[8] Peter Coy, *How a Clever Case Could Kill the AT&T-Time Warner Deal*, BLOOMBERG BUSINESSWEEK (Nov. 21, 2017), https://www.bloomberg.com/news/articles/2017-11-21/at-t-and-time-warner-s-words-may-come-back-to-haunt-them.

through all vertical mergers or taken the same settlement approach in all such cases. The facts tell a very different story. For example, both the DOJ and FTC have a long history of enforcement against vertical mergers. The DOJ Antitrust Division website, which has accessible data on past enforcement actions, shows a first record of a vertical merger challenge in the early 1960s.[9] The data reveal that the agencies have challenged dozens of vertical mergers over the last several decades. In many of those cases, the government resolved competitive concerns through settlements, with remedies embodied in consent decrees. In a number of instances, vertical mergers have been abandoned.

The fact that few of these cases were actually litigated and resolved by a judge does not suggest the cases brought were weak. Most merger challenges, horizontal and vertical, are resolved without litigation. The relevant focus therefore should be on the government's *entire* record of challenging vertical mergers. There is no reason to think that had the government gone to court in such cases, it would not have prevailed in blocking the mergers. Indeed, the fact that companies in dozens of vertical merger cases either abandoned the deal in the face of government opposition, or chose to settle, may signal that they perceived significant litigation risk if they had gone to court.

The data also show that the government has used a mix of structural and conduct (or behavioral) remedies in vertical merger cases. This debunks any narrative that the agencies have always employed the same approach to vertical mergers. From 1994 to 2016, for example, about 27% of the total remedies taken by the DOJ and FTC in vertical merger cases were structural and about 73% were conduct-related.[10]

The graph below shows cumulative remedies (by type) over this period. We note a bump up in conduct remedies in 2010-2011 following a relatively inactive period during the first half of the 2000s. This is likely the basis of claims that behavioral remedies are a historical fixture in vertical merger enforcement. But it cannot be reconciled with a period of activism during the last half of the 1990s where *both* conduct and structural remedies were actively employed. These data support the notion that the DOJ's move to block the AT&T-Time Warner case is not unprecedented, nor a radical departure from decades of previous enforcement.

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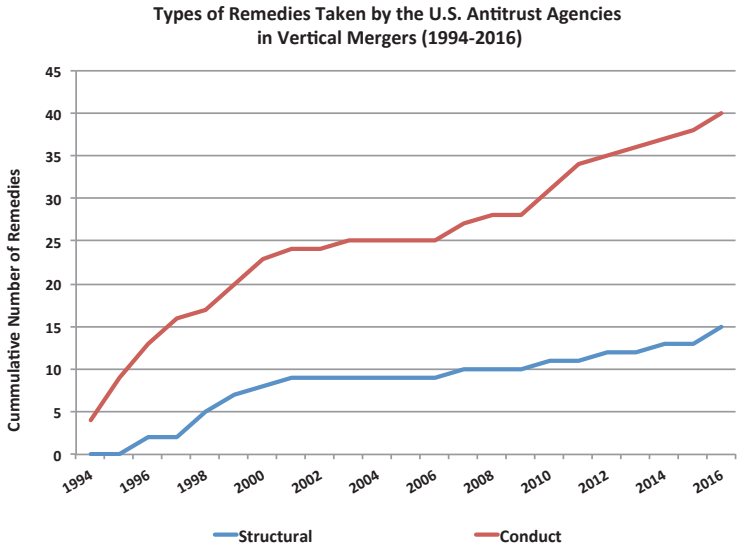
[9] *See Antitrust Case Filings*, U.S. DEP'T OF JUST., https://www.justice.gov/atr/antitrust-case-filings (last visited Dec. 5, 2017). The FTC's website lists merger data going back to 1996. *See Cases and Proceedings: Advanced Search*, FED. TRADE COMM'N, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search (last visited Dec. 5, 2017).

[10] Steven C. Salop & Daniel P. Culley, *Vertical Merger Enforcement Actions: 1994–2016,* h3p://scholarship.law.georgetown.edu/facpub/1529; *see* U.S. DEP'T OF JUST., *Antitrust Case Filings*, https://www.justice.gov/atr/antitrust-case-filings (last visited Dec. 5, 2017); FED. TRADE COMM'N, *Cases and Proceedings: Advanced Search*, FED. TRADE COMMISSION, https://www.ftc.gov/enforcement/cases-proceedings/advanced-search (last visited Dec. 5, 2017).



III. Enforcement is Shaped by Evidence and Experience

AT&T's response to the government's move to block the AT&T-Time Warner merger ignores the fact that agency learning informs enforcement moving forward. The DOJ and FTC consistently update their enforcement approaches based on a variety of analysis and evidence, including the agencies' own studies, reports, and hearings; well-grounded legal, economic, and business scholarship; and retrospectives on consummated mergers. Both agencies have focused in particular on monitoring the effectiveness of merger remedies.

For example, the FTC has issued two major studies – one in 1999 and one in 2017 – on the effectiveness of divestiture remedies.[11] It is likely that the agency has incorporated the implications of such studies in enforcement approaches and will continue to do so in the future.

Behavioral remedies in particular are well known to be fraught with incentive, compliance, and enforcement problems. They impose rules and requirements on the post-merger operation of the firm but they do not change the merged firm's incentives to exercise market power. This often prompts firms to circumvent the rules. As a result, behavioral remedies require ongoing monitoring and enforcement by the agencies and the courts, which are not well suited to act as regulators. They stand in stark contrast to structural remedies that require firms to divest assets, which permanently change the merged firm's ability and/or incentive to exercise market power.

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[11] FED. TRADE COMM'N, FTC'S MERGER REMEDIES 2006-2012, A REPORT OF THE BUREAUS OF COMPETITION AND ECONOMICS (Jan. 2017), https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf; FED. TRADE COMM'N, A STUDY OF THE COMMISSION'S DIVESTITURE PROCESS, BUR. OF COMP. (Aug. 1999), https://www.ftc.gov/sites/default/files/attachments/merger-review/divestiture.pdf.

These concerns have gained traction in the courts. For example, in the Memorandum Order in Comcast-NBCU, the court was openly skeptical of the conduct remedies included in the Proposed Final Judgment.[12] Judge Leon stated that "because of the way the Final Judgment is structured, the Government's ability to 'enforce' the Final Judgment, and, frankly, this Court's ability to oversee it, are, to say the least, limited" and that "the Government, at the public hearing, freely admitted that '[w]e can't enforce this decree."[13] In an unusual development, Judge Leon delayed approval of the Proposed Final Judgment under the Tunney Act due to concerns over its enforceability and over a non-appealable arbitration process for online video distributors.[14]

Judicial reaction undoubtedly supports the DOJ's growing skepticism about conduct remedies. This is buttressed by analysis that highlights fundamental problems with behavioral conditions. Among other things, Kwoka & Moss note both the paradox and difficulty of "allowing the merger and then requiring the merged firm to ignore the incentives inherent in its integrated structure."[15] They go on to explain that the need for complainants to voluntarily come forward when retaliation is possible undermines compliance with behavioral remedies.[16]

All of this supports the notion that the government can and should learn from evidence, experience, and research in fashioning enforcement approaches moving forward.

IV. What AT&T-Time Warner May Mean for Vertical Merger Enforcement

The lessons of AT&T-Time Warner could be significant. The outcome of the case will arguably affect how other vertical deals fare at the antitrust agencies. For example, Assistant Attorney General Makan Delrahim's signaled recently that DOJ will move away from behavioral remedies in vertical merger cases.[17] If the government prevails in AT&T-Time Warner, competition and consumer advocates will be watching carefully for continuity in where the new enforcement line is drawn.

AT&T-Time Warner also has implications for a broader trend toward vertical integration in other industries such as healthcare, digital online markets, and food and agriculture. The

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[12] United States v. Comcast Corp., 808 F. Supp. 2d 145 (D. D.C. 2011).
[13] *Id.* at 149 (brackets in original).
[14] *Id.* at 149-150. See also John E. Kwoka & Diana L. Moss, *Behavioral Merger Remedies: Evaluation and Implications for Antitrust Enforcement*, 57 ANTITRUST BULL. 979, 994, 1010 (2012). Many believe the behavioral remedies imposed in Comcast-NBCU were subsequently manipulated by the merging parties. *See, e.g.*, Emily Steel, *Comcast's Track Record in Past Deals May Be Hitch for Merger with Time Warner Cable*, N.Y. TIMES (Apr. 21, 2015), https://www.nytimes.com/2015/04/22/business/media/6-senators-urge-rejection-of-comcast-time-warner-cable-deal.html?_r=1 (discussing alleged sidestepping of commitment not to interfere in management and operations of Hulu).
[15] Kwoka & Moss, *supra* note 14, at 982.
[16] *Id.*, at 1009.
[17] Makan Delrahim, Asst. Att'y Gen., Dep't of Just., Antitrust Div., Keynote Address at American Bar Association's Antitrust Fall Forum (Nov. 16, 2017), https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-keynote-address-american-bar.

proposed merger of CVS and Aetna, for example, would combine a health insurer with a large pharmacy benefits manager and retail pharmacy chain. The proposed combination of Monsanto and Bayer vertically integrates genetic traits for crop seeds with seeds and crop protection chemicals. A government win in AT&T-Time Warner could have implications for enforcement in other industries where mergers create vertically integrated behemoths.

These and similar deals pose similar types of issues that are at the forefront of AT&T-Time Warner, including the potential foreclosure of smaller rivals and innovative business models, anticompetitive coordination among a small number of vertically integrated firms, and higher entry barriers. All of these factors point to the importance of enforcement rigor in AT&T-Time Warner.