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**The DOJ's Rather Unusual AT&T/Time Warner Merger Appeal**

**by**

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**I. Introduction and Summary**

The U.S. Department of Justice lost its antitrust lawsuit challenging the merger of AT&T and Time Warner. DOJ had surprised many when its challenge was originally filed, and it surprised many more when it appealed its loss to the Court of Appeals for the District of Columbia Circuit.

The DOJ claimed that the merger would allow AT&T to use Time Warner programming content to raise the costs of the programming to AT&T's rivals, and also that after the merger AT&T would withhold Time Warner programming from rivals to place them at a disadvantage. As a result, DOJ argued, cable television subscribers would be harmed by having to pay higher prices and less video content would be developed after the merger. But as Free State Foundation [scholars explained](#) before the trial, DOJ's case was weak, especially because the video market has become increasingly competitive and dynamic. Consumers now have more alternatives for receiving information and entertainment programming than ever before.

The decision by District Court Judge Richard Leon, who presided over the trial, is firmly grounded in antitrust precedent on all issues of substantive antitrust law. Nonetheless, this decision is important for future vertical merger cases, as well as all other merger challenges under the Clayton Act, for its strong statement that antitrust challenges must be based on persuasive economic evidence that is specific to the particular merger. It is not enough for the government to rely on so-called "hot" documents, evidence of harm from past vertical mergers

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that may not apply today, or general economic principles about possible antitrust harm that possibly might result from vertical mergers.

That DOJ even brought the original challenge to the AT&T/Time Warner merger was somewhat surprising, given that no other vertical mergers had been challenged in court by the government since 1979 and given the arrival of popular new alternative video services giving consumers more abundant choices than ever before. Indeed, at the outset of his opinion, Judge Leon referred to the "veritable explosion" of innovative new video content and advertising offerings in just the last five years due to proliferation of high-speed Internet access. And taking note of the emergence of Netflix, Hulu, Amazon, and other online video programmers and distributors, Judge Leon declared the video market had undergone "tectonic changes."

That DOJ continues to oppose the merger, even after losing badly at trial, is rather unusual for at least four reasons. First, there does not appear to be any clear antitrust principle at stake. Judge Leon's opinion emphasized that vertical mergers can raise significant antitrust concerns, but the question for the court is whether the economic evidence supports DOJ's claim that this particular merger will lead to more harm than benefits. Judge Leon carefully grounded his analysis in standards from established antitrust precedent, which DOJ does not appear to dispute, before proceeding to carefully lay out the factual basis for his conclusion that DOJ had not met its burden.

Second, on appeal DOJ has to show that the district court's ruling was "clearly erroneous." As a legal matter, the district court is the finder of fact. Judge Leon's careful explanation of the reasons why he found certain data at the heart of DOJ's case to be unreliable is entitled to considerable deference.

Third, Judge Leon took the unusual step of explicitly encouraging DOJ not to appeal this decision. While Judge Leon acknowledged that DOJ has the right to appeal, he concluded his decision by declaring his hope that DOJ "will have the good judgment, wisdom, and courage" to forego such an appeal.

Finally, that DOJ continues to try to block this merger lends credence to the claims that it is acting under pressure from President Trump, perhaps in reaction to the coverage of the President by CNN. To be clear, I do not see any evidence that the decisions made by the DOJ in litigating this case and appealing the outcome were motivated by improper political considerations. Even so, given that DOJ's case was questionable in the first place and the appeal unlikely to succeed, it seems rather unusual for DOJ to pursue this appeal when continuing to litigate it may raise concerns in the minds of some about its motivations.

For the most part, DOJ's appellate brief criticisms of Judge Leon's decision miss the mark because they do not address the detailed reasons he gave for why he found specific data that DOJ relied upon to be unreliable. The short section near the end of the brief where the DOJ finally gets around to addressing these data issues falls far short of showing that Judge Leon's findings regarding this data was clearly erroneous.

DOJ had a weak case at trial, as I and others have discussed at length. But after Judge Leon wrote such a narrow and fact-specific opinion that avoided any controversial claims about antitrust law, DOJ's decision to appeal becomes more puzzling. Because most of DOJ's brief does not even address the specific shortcomings Judge Leon identified, DOJ's thinking in bringing its appeal is even more puzzling.

## II. Background on the Parties and the Proposed Merger

In October of 2016, AT&T and Time Warner announced they had entered into an agreement under which AT&T would acquire Time Warner for \$85.4 billion, or \$108.7 billion if assumed debt is included.<sup>1</sup> Over a year later, on November 20, 2017, the Department of Justice announced that it was challenging the merger as a violation of Section 7 of the Clayton Antitrust Act, the main antitrust law provision used by DOJ to challenge mergers it believes will lead to anticompetitive outcomes.<sup>2</sup> DOJ claimed that the merger would allow AT&T to use Time Warner programming content to raise the costs of AT&T's rivals, and also that after the merger AT&T would withhold Time Warner programming from rivals to place them at a disadvantage. As a result, DOJ argued, cable television subscribers would be harmed by having to pay higher prices and less video content would be developed after the merger.<sup>3</sup>

The DOJ challenge to the merger finally went to trial more than a year later, on March 19, 2018. The trial lasted until April 30, 2018.<sup>4</sup> On June 12, 2018, Judge Richard Leon, who presided over the trial in the district court, issued his ruling, in which he denied DOJ's request for an injunction to stop the merger and also took the unusual step of strongly encouraging DOJ against trying to stop the merger.<sup>5</sup>

Soon after the ruling, AT&T and the DOJ reached an agreement that would allow AT&T to complete its acquisition of Time Warner without the DOJ seeking an injunction. If an injunction had been granted, the companies would have had to either extend the date or AT&T would have had to pay Time Warner a \$500 million merger termination fee. Following this agreement, AT&T completed the acquisition of Time Warner.<sup>6</sup>

On August 6, 2018, the DOJ announced that it would appeal Judge Leon's ruling. The DOJ brief in support of its appeal alleged that Judge Leon's ruling was based on his "erroneously ignoring fundamental principles of economics and common sense."<sup>7</sup> DOJ added that "These errors distorted [Judge Leon's] view of the evidence and rendered [the court's] factual findings clearly

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<sup>1</sup> "AT&T to Acquire Time Warner," AT&T Newsroom (October 22, 2016), available at [http://about.att.com/story/att\\_to\\_acquire\\_time\\_warner.html](http://about.att.com/story/att_to_acquire_time_warner.html).

<sup>2</sup> "Justice Department Challenges AT&T/DirecTV's Acquisition of Time Warner," Press Release, U.S. Department of Justice (November 20, 2017), available at: <https://www.justice.gov/opa/pr/justice-department-challenges-attdirectv-s-acquisition-time-warner>.

<sup>3</sup> Complaint, United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc. (November 20, 2017), No. 1:17-cv-02511-RJL, available at: <https://www.justice.gov/atr/case-document/file/1012916/download>.

<sup>4</sup> Ted Johnson, AT&T-Time Warner Trial: Judge Says He'll Have Decision in June. *Variety* (April 30, 2018), available at: <https://variety.com/2018/politics/news/att-time-warner-antitrust-7-1202792380/>.

<sup>5</sup> United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc. (D.D.C., 2018), No. 1:17-cv-02511-RJL, available at [https://ecf.dcd.uscourts.gov/cgi-bin/show\\_public\\_doc?2017cv2511-146](https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2017cv2511-146).

<sup>6</sup> *See, e.g.*, Edmund Lee and Cecilia Kang, "AT&T Closes Acquisition of Time Warner," *The New York Times* (June 14, 2018), available at: <https://www.nytimes.com/2018/06/14/business/media/att-time-warner-injunction.html>.

<sup>7</sup> Proof Brief of Appellant United States of America, United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc. (August 6, 2018), No. 1:17-cv-02511-RJL, at 2, available at: <https://www.justice.gov/atr/case-document/file/1085516/download>.

erroneous, and they are the subject of this appeal."<sup>8</sup> AT&T filed its own appellate brief on September 20, 2018.<sup>9</sup>

AT&T and Time Warner do not directly compete in any significant way, making this a vertical merger of a major multichannel video programming distributor and a major provider of programming, with no meaningful horizontal overlap between the companies. The DOJ does not contest that this is a vertical merger.

AT&T is a major programming distributor through its DirecTV satellite service and its U-Verse wireline broadband service. AT&T is also the second-largest wireless carrier and offers a new DirecTV Now service over both its own and any other wireline or wireless connection. AT&T bundles its AT&T-branded offerings, like cellular service, with both U-Verse and DirecTV programming distribution services at a discounted price to its customers.<sup>10</sup>

Time Warner is primarily a media and entertainment content provider. Time Warner owns CNN (multiple channels), HBO (multiple pay channels), the Turner Broadcasting System (TBS, TNT, truTV, TCM, Cartoon Network, Boomerang, Turner Sports, et.al.), Warner Brothers (Warner Brothers Pictures, Warner Brothers Theaters, Warner Brothers Television Group, DC Comics, and other assets), shares of several joint ventures (e.g., NBA Digital, including NBA League Pass, 10% of Hulu), and other assets. The company acquired by AT&T does not include Time Warner Cable, a horizontal competitor of DirecTV. Time Warner sold its cable operations in 2009.<sup>11</sup> Time Warner also spun off Time, Inc., the magazine company that publishes the magazines *Time* and *Fortune*, among others, in 2014.<sup>12</sup>

### III. Antitrust Standards Used by the District Court at Trial

The merger of AT&T and Time Warner includes no transfer of broadcast licenses, so it was not reviewed by the FCC under its vague "public interest" standard.<sup>13</sup> Instead, the merger review and antitrust challenge were by the Justice Department under Clayton Act standards. The Clayton Act antitrust standards focus on economic effects of the merger, while under the broader "public

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<sup>8</sup> *Id.*, at 2-3.

<sup>9</sup> Proof Brief of AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc., *United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc.* (September 20, 2018), No. 1:17-cv-02511-RJL, available at: <https://investors.att.com/~media/Files/A/ATT-IR/documents/ATT%20Response%20Brief%20to%20DOJ%20Appeal.pdf>.

<sup>10</sup> *See, e.g.*, "DIRECTV Packages for AT&T Wireless Customers" (visited September 27, 2018), available at: <https://www.att.com/att/directvwireless/en/>.

<sup>11</sup> "Time Warner Cable Separation Information," Time Warner, Inc. (visited October 1, 2018), available at: <http://ir.timewarner.com/phoenix.zhtml?c=70972&p=irol-twcseparation>. Time Warner also sold the AOL Internet content service in 2009. Yinka Adegoke, "Time Warner to spin off AOL on December 9," Reuters (November 19, 2009), available at: <https://www.reuters.com/article/us-aol/time-warner-to-spin-off-aol-on-december-9-idUSTRE5AF5JT20091116>. Time Warner Cable was later acquired by Charter Communications, which has rebranded it as Spectrum in many markets.

<sup>12</sup> "Time Warner Inc. Completes Spin-Off of Time Inc." (Press Release, June 9, 2014), available at: <http://www.timewarner.com/newsroom/press-releases/2014/06/09/time-warner-inc-completes-spin-off-of-time-inc>.

<sup>13</sup> The merger avoided FCC review when Time Warner sold a television station it owned in early 2017, leaving no Time Warner assets that required FCC approval for the transfer of license. Jon Brodtkin, "FCC Helps AT&T and Time Warner Avoid Lengthy Merger Review: Time Warner Sells a TV Station to Avoid Public Interest Review of AT&T Deal," ARSTechnica (April 18, 2017), available at <https://arstechnica.com/tech-policy/2017/04/atttime-warner-merger-is-one-step-closer-to-government-approval/>.

interest" standard the FCC can consider factors other than competitive effects.<sup>14</sup> Perhaps even more importantly, the burden of proof standard is also different. A DOJ antitrust challenge must prove to a trial court why a transaction should be blocked, while the FCC must give affirmative approval for a license transfer.

U.S. antitrust authorities in the past used to regularly challenge vertical mergers under the Clayton Act. Probably the leading case was *Brown Shoe Co. v. United States*, in which the U.S. Supreme Court in 1962 held that vertical mergers could be challenged based on the harm from "foreclosing the competitors of either party from a segment of the market."<sup>15</sup> However, the Supreme Court did not provide much guidance regarding the amount of foreclosure or market conditions necessary for a court to find that the vertical merger was anticompetitive. As a result, U.S. antitrust agencies successfully challenged vertical mergers in the 1960s and early 1970s based on relatively small amounts of foreclosure, with little regard for benefits that consumers might receive from the mergers.<sup>16</sup> Herbert Hovenkamp, a preeminent antitrust scholar, explained the problem with the economic reasoning behind these early vertical antitrust merger challenges:

The problem with the traditional foreclosure analysis was that it was overly aggressive. First, it condemned mergers where the percentage foreclosure was far too small, often less than 10 percent. Second, it had very little theory about how foreclosure could yield reduced output and higher prices. Foreclosure was largely thought of as an evil for its own sake.<sup>17</sup>

The U.S. antitrust agencies eventually took notice of the criticism, and since then they have employed more rigorous economic analysis when reviewing vertical mergers. The last vertical merger successfully challenged by the government was in 1972, when Ford Motor Company bought a supplier, Autolite, based on a foreclosure of ten percent of all U.S. spark plug sales.<sup>18</sup> The last unsuccessful vertical merger challenged in a contested court proceeding by U.S. antitrust agencies was in 1979, when the Federal Trade Commission lost its challenge to truck trailer manufacturer Fruehauf's acquisition of a brake component supplier.<sup>19</sup>

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<sup>14</sup> Some of the "public interest" factors the FCC has considered in the past have included "whether the transaction would protect service quality for consumers, accelerate private sector deployment of advanced telecommunications services, ensure diversity of information sources and viewpoints, [and] increase the availability of children's programming and Public, Educational, and Government programming." Alexander Maltas, Tony Lin, and Robert F. Baldwin III, "A Comparison of the DOJ and FCC Merger Review Processes: A Practitioner's Perspective," *The Antitrust Source* (August, 2016), at 2, available at:

[https://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/aug16\\_maltas\\_8\\_5f.authcheckdam.pdf](https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug16_maltas_8_5f.authcheckdam.pdf).

<sup>15</sup> 370 U.S. 294 at 323-324 (1962).

<sup>16</sup> See, e.g., *U.S. v. Kimberly-Clark Corp.*, 264 F. Supp. 439 (N.D. Cal. 1967) (blocking a vertical merger based on foreclosure of 14 percent of the market).

<sup>17</sup> Herbert Hovenkamp, "Post-Chicago Antitrust: A Review and Critique," *Columbia Business Law Review* (January 2001), at 323-324.

<sup>18</sup> *Ford Motor Co. v. United States*, 405 U.S. 562 (1972), available at:

<https://supreme.justia.com/cases/federal/us/405/562/case.html>.

<sup>19</sup> *Fruehauf Corp. v. FTC*, 603 F.2d 345, (2d Cir. 1979), available at: <https://openjurist.org/603/f2d/345/fruehauf-corporation-v-federal-trade-commission>. Since 1979, U.S. antitrust enforcers consistently have allowed vertical mergers to proceed or have negotiated for behavioral changes rather than suing to seek major divestitures. Former FTC Commissioner J. Thomas Rosch found in his 2007 study that the federal government had only challenged 23 vertical mergers since the unsuccessful 1979 Fruehauf merger challenge. Of those, three were abandoned by the parties, and the others were all approved, most with behavioral conditions to address the alleged harms. J. Thomas

The court in the *Fruehauf* case made it clear that simply identifying a significant share of the market being foreclosed was not enough. The *Fruehauf* court, quoting from *Brown Shoe*, identified some of the economic factors courts should consider in determining whether a vertical merger may harm competition:

Most important among the factors are the nature and economic purpose of the arrangement, the likelihood and size of any market foreclosure, the extent of concentration of sellers and buyers in the industry, the capital cost required to enter the market, the market share needed by a buyer or seller to achieve a profitable level of production (sometimes referred to as “scale economy”), the existence of a trend toward vertical concentration or oligopoly in the industry, and whether the merger will eliminate potential competition by one of the merging parties. To these factors may be added the degree of market power that would be possessed by the merged enterprise and the number and strength of competing suppliers and purchasers, which might indicate whether the merger would increase the risk that prices or terms would cease to be competitive. This list, with some variations, has been the standard framework for analysis of the legality of a vertical merger. Application of these factors may reveal that a vertical merger poses no threat to competition at all, resulting merely in a realignment of sales as a result of “in-house” transactions within the merged enterprise but leaving the number of competing sellers and their market shares unchanged, or that it poses a threatened lessening of competition that may be de minimis, may be of monopoly proportions, or may lie somewhere in between the two (citations omitted).<sup>20</sup>

Some recent vertical mergers have involved large and prominent companies, including media companies, so they, like the AT&T/Time Warner merger, have attracted more scrutiny than other vertical mergers. For example, Comcast’s 2011 acquisition of NBC and NewsCorp’s 2004 acquisition of DirecTV raised similar alleged competitive issues as the AT&T/Time Warner merger, and both were settled with behavioral restrictions that allowed the mergers to proceed without structural changes. In 2017, Amazon’s acquisition of Whole Foods also attracted considerable media attention and objections based on alleged concentration of power over retail sales. But this merger was allowed to proceed about a month after its filing with the U.S. antitrust agencies without any court challenge or consent decree settlement.<sup>21</sup>

#### **IV. DOJ’s Complaint and Theory of Anticompetitive Harm**

In its Complaint filed in the D.C. District Court, the Department of Justice claimed that if the merger was allowed to go forward:

AT&T/DirecTV would hinder its rivals by forcing them to pay hundreds of millions of dollars more per year for Time Warner’s networks, and it would use its increased power to slow the industry’s transition to new and exciting video distribution models that

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Roach, "The Challenge of Non-Horizontal Merger Enforcement," (Speech, New York, NY, September 28, 2007), available at: [https://www.ftc.gov/sites/default/files/documents/public\\_statements/challenge-non-horizontal-merger-enforcement/070927-28non-horizontalmerger\\_1.pdf](https://www.ftc.gov/sites/default/files/documents/public_statements/challenge-non-horizontal-merger-enforcement/070927-28non-horizontalmerger_1.pdf).

<sup>20</sup> *Id.*, at 1082-83, citing *Brown Shoe*, at 328-29.

<sup>21</sup> David McLaughlin and Spencer Soper, "Amazon's Whole Foods Deal Wins Swift U.S. Antitrust Approval," Bloomberg News (August 23, 2017), available at: <https://www.bloomberg.com/news/articles/2017-08-23/amazon-s-whole-foods-deal-wins-fast-track-u-s-antitrust-nod>.



provide greater choice for consumers. The proposed merger would result in fewer innovative offerings and higher bills for American families.<sup>22</sup>

The anticompetitive harm alleged by DOJ arises when the merged company starts to consider the effects of its pricing decisions on DirecTV and AT&T's Internet services, which leads to profit maximizing prices for Time Warner content that are different, and higher, because of the benefits for DirecTV and AT&T's Internet services.<sup>23</sup>

Specifically, the Complaint lays out the following theory of why the combined company will have the incentive to charge more for Time Warner channels than it did before the merger. If the combined company raises its rates for Time Warner programming, some video programming distributors would then pay more for the channels, which means more revenue for the merged company. Other rival programming distributors may choose not to pay. Before the merger, losing those distributors would mean more lost revenue to Time Warner than would be gained from charging the higher prices for programming. But after the merger, according to the DOJ's theory, the combined company can expect to recapture at least some of these revenues when some subscribers who want the Time Warner channels switch to other video programming distributors, including DirecTV or AT&T's U-Verse. The combined company wouldn't need all of these switchers to subscribe to DirecTV or U-Verse, only a portion large enough to make such a price increase more profitable after the merger.<sup>24</sup>

## V. An Overview of Judge Leon's Ruling

It is important to note at the outset that Judge Leon makes no claims about this case establishing any new antitrust doctrine or raising issues that have never been addressed in antitrust cases before. Instead, his decision is heavily focused on what the economic evidence tells him about the net economic impact of the decision. Indeed, Judge Leon made it clear near the beginning of his opinion that he recognized that vertical mergers can have anticompetitive effects.<sup>25</sup>

Judge Leon's written opinion starts with four background sections identifying the relevant markets, describing the parties to the merger, summarizing the procedural history of the case and identifying the legal standard for the district court to apply.<sup>26</sup> It appears from the DOJ brief that

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<sup>22</sup> Complaint, *US v. AT&T Inc., DIRECTV Group Holdings, LLC, and Time Warner Inc.* (D.D.C. 2017) (No. 1:17-cv-02511), at 2, available at: <https://www.justice.gov/opa/press-release/file/1012896/download>.

<sup>23</sup> For an analysis of why the original Complaint described a case the DOJ was unlikely to win, *see, e.g.*, Theodore R. Bolema, "The Proper Context for Assessing the AT&T/Time Warner Merger," *Perspectives from FSF Scholars*, Vol. 13, No. 6 (February 8, 2018), available at:

[http://www.freestatefoundation.org/images/The\\_Proper\\_Context\\_for\\_Assessing\\_the\\_AT\\_T-Time\\_Warner\\_Merger\\_020818.pdf](http://www.freestatefoundation.org/images/The_Proper_Context_for_Assessing_the_AT_T-Time_Warner_Merger_020818.pdf).

<sup>24</sup> The Complaint lays out a similar theory for how a price increase for Time Warner channels could harm competing Internet-based video distribution businesses. If the combined company raises its prices for Time Warner channels and some cable, satellite, or on-line distribution systems do not pay the higher prices, they could be expected to also lose subscribers. In this way, according to the DOJ Complaint, competing Internet-based video distribution services may find it more difficult to establish themselves if they do not have access to the Time Warner channels, which would be another way the AT&T video distribution business would benefit from Time Warner price increases.

<sup>25</sup> *United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc.*, at 6 ("A merger combining a manufacturer with the leading supplier of a key input, for example could allow the combined company to increase the price of the input to the rival manufacturers, raising their costs. Once that company raised its rivals' costs, it could then raise its own price or increase its market share at its rivals' expense (citations omitted)").

<sup>26</sup> *United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc.*, at 7-58.

the government does not have any meaningful objections to Judge Leon's presentation of these background facts. The main section of Judge Leon's decision that follows is his analysis section, which is the focus of the DOJ brief and of this paper.

Vertical mergers in general are less likely to raise competitive concerns than horizontal mergers, because they do not involve combining firms that compete directly and generally lead to at least some efficiency benefits. Thus, the question before Judge Leon was whether the anticompetitive harm the DOJ could demonstrate was enough to outweigh the efficiency benefits. Judge Leon pointed out that the DOJ's main economics witness, Dr. Carl Shapiro, agreed that this is the test the district court was to use when he wrote: "to understand whether the proposed merger will harm consumers, Professor Shapiro explained, it is necessary to 'balance' whether the government's asserted harms outweigh the merger's conceded benefits."<sup>27</sup>

With this standard in mind, Judge Leon began his analysis with the efficiency benefits of the merger. He started by noting: "the Government's lead expert, Professor Carl Shapiro, conceded in his testimony that the merger will cause AT&T to lower the price of DirecTV, resulting in \$352 million in annual savings for DirecTV customers."<sup>28</sup> Professor Shapiro acknowledged that these benefits would be achieved by the elimination of the "double marginalization" (or profit mark-up at two different levels in the distribution process) of programming costs. Of course, AT&T and Time Warner presented evidence through their experts that the efficiency benefits will be several times greater than \$352 million, but for purposes of this analysis, Judge Leon started with a threshold of \$352 million in economic harm that the DOJ would have to prove in order to overcome this conceded efficiency benefit.

Judge Leon then dug deeply into the economic analysis by each side, pointing out their strengths and shortcomings, before concluding that Professor Shapiro's analysis was not a reliable basis for finding any anticompetitive harm due to the merger. While Judge Leon criticized several features of the Shapiro analysis, four in particular appear to have been especially problematic for Judge Leon.

First, Judge Leon explained in detail in a 17-page section of his opinion that he found that Dr. Shapiro's estimate of the number of subscribers who would drop service from their current provider if Time Warner content was not available from that provider was based upon questionable data sources.<sup>29</sup> Second, regarding the number of subscribers who would drop their service if their current provider lost access to Time Warner content, Judge Leon found that the number Dr. Shapiro claimed would actually switch to DirecTV was too high because it failed to account sufficiently for the number of "cord cutters" who dropped service altogether or who switched to online video distributor services like Hulu, Netflix, Vudu, and YouTube.<sup>30</sup> Third, Judge Leon found that the profit margins used by Dr. Shapiro for DirecTV customers were too high and were based on old data which, if replaced with newer data, would reveal considerably lower gains to the merged companies from withholding Time Warner programming from competitors.<sup>31</sup> Fourth, Judge Leon found that Dr. Shapiro failed to incorporate in his model the

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<sup>27</sup> *Id.*, at 68.

<sup>28</sup> *Id.*, at 60.

<sup>29</sup> *Id.*, at 120-137.

<sup>30</sup> *Id.*, at 137-141.

<sup>31</sup> *Id.*, at 141-145.



long-term affiliate agreements between cable systems and Time Warner that gave those cable systems contractual rights that protected them from being cut off from Time Warner programming.<sup>32</sup>

After examining in great detail these problems with the inputs used by Professor Shapiro in his model, the conclusion reached by Judge Leon was fatal to the DOJ's case against the merger:

[T]he evidence at trial showed that Professor Shapiro's model lacks both reliability and factual credibility and thus fails to generate probative predictions of future harm associated with the Government's increased leverage theory. Accordingly, neither Professor Shapiro's model, nor his testimony based on it, provides me with an adequate basis to conclude that the challenged merger will lead to *any* raised costs on the part of distributors *or* consumers – much less consumer harms that outweigh the conceded \$350 million in annual cost savings to AT&T's customers (emphasis in original, citations omitted).<sup>33</sup>

## VI. DOJ's Response to Judge Leon

As the previous section shows, Judge Leon's analysis is based primarily on two factual findings: (1) that the DOJ's main economic witness conceded that the merger would lead to at least some positive efficiency benefits and (2) his finding that the model that DOJ relied upon to estimate the anticompetitive harms were based on inputs that Judge Leon found to be factually unreliable based on the evidence before him.

DOJ's own summary of its position in its appellate brief implies that it recognizes its disagreement is over how to interpret the evidence rather than over any fundamental principle of antitrust law. Most of the arguments DOJ makes in its appellate brief, however, do not directly take on the specific reasons why Judge Leon found Professor Shapiro's analysis unreliable. Instead, DOJ's arguments are broad criticisms of Judge Leon's analysis that do not go to the heart of the problems Judge Leon identified in Professor Shapiro's report and testimony.

DOJ starts its analysis section by claiming that it has proven its case. The DOJ brief confidently asserts that the model used by Professor Shapiro is a conventional model of the economics of bargaining that even Professor Michael Katz, a witness for AT&T, acknowledges is a "mainstream" economics model.<sup>34</sup> That is an accurate statement by the DOJ, but Judge Leon's objections were not to the model, but rather to the inputs that were plugged into the model. The DOJ brief then claims that: "Applying the economics of bargaining to the facts established at trial showed that the reasonably probable effect of the merger was to increase fees paid by distributors other than AT&T's DirecTV for Turner programming, just as the FCC found that an unremedied merger of Comcast with NBCU [in 2011] would have done."<sup>35</sup> But this claim by the DOJ ignores the specific objections that Judge Leon made to the data used in the model, which were the basis for his finding that the "facts established at trial" were not sufficient to support this conclusion.

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<sup>32</sup> *Id.*, at 145-148.

<sup>33</sup> *Id.*, at 149.

<sup>34</sup> Proof Brief of Appellant United States of America, *United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc.*, at 33-34.

<sup>35</sup> *Id.*, at 35.

DOJ then raised three broad objections to Judge Leon's analysis, which it claimed was "contradicted basic economic logic, making it 'so implausible on its face that a reasonable factfinder could not credit it.'"<sup>36</sup> First, DOJ devoted six pages to broad objections to Judge Leon's unwillingness to give weight to statements by programming distributors, and in particular DirecTV before it was acquired by AT&T, raising concerns that vertical integration in general, and particularly following the Comcast/NBCU merger announced in 2010, would lead to higher costs for consumers.<sup>37</sup> The broader issue of the evidentiary value of statements in such documents is addressed in the next section. For now it is sufficient to note that DOJ is arguing about something that "could" happen as a result of vertical mergers in general, or did happen after some past vertical merger. But DOJ is not presenting evidence that this result will necessarily occur as a result of this specific merger. As noted above, Judge Leon has acknowledged that vertical mergers in some cases can lead to anticompetitive harm, but the question is whether vertical integration in this particular case will lead to such harm.

Judge Leon was right to be skeptical of DOJ's attempt to equate statements made about the possible anticompetitive harm that could result from one merger in 2011 to what might happen as a result of a different merger in 2018. The video content and distribution markets and technology are much different now than in 2011, when the Comcast/NBCU merger was settled, making statements made about that particular merger less applicable to today's markets. Since then, the video market has become even more dynamic, with consumers becoming far more willing to "cut the cord," that is, to discontinue their subscriptions with a traditional cable or satellite distributor and look to Internet platforms like Hulu, Netflix, Vudu, or Youtube for their information and entertainment.

The second objection made in the DOJ appellate brief is that: "The District Court's discarding of the economics of bargaining resulted in a deeply flawed assessment of the government's evidence."<sup>38</sup> But that claim is simply not accurate. Judge Leon did not discard the DOJ's model – he rejected the DOJ's application of the model using inputs he concluded were not reliable. DOJ's analysis that follows this broad claim that Judge Leon had rejected the Nash bargaining model used by Professor Shapiro are similar to those discussed in the two previous paragraphs – all claims about the anticompetitive harms that could result from a vertical merger in these industries that are not specifically pertinent to this particular merger.<sup>39</sup>

The third objection made by DOJ is that Judge Leon "erroneously rejected evidence that a merged AT&T-Time Warner would maximize profits of the firm *as a whole* by imposing higher programming costs on rival distributors (emphasis in original)."<sup>40</sup> DOJ's argument is somewhat complicated and relies on its interpretation of several statements by Judge Leon in his opinion.<sup>41</sup> The problem with this argument is that it is another broad claim about how businesses may act after vertical integration, but again is not specifically related to the AT&T/Time Warner merger. One particular point made by DOJ in this section of its brief is worth noting, however. The DOJ brief asserts that: "The district court's analysis of Time Warner's post-merger incentives is also

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<sup>36</sup> *Id.*, at 39, citing *Bishop v. District of Columbia*, 788 F.2d 781, 786 (D.D.C. 1986).

<sup>37</sup> *Id.*, at 40-45.

<sup>38</sup> *Id.*, at 45.

<sup>39</sup> *Id.*, at 45-49.

<sup>40</sup> *Id.*, at 49.

<sup>41</sup> *Id.*, at 46-57.

fundamentally inconsistent with its uncritical *acceptance* of defendants' claimed costs savings (emphasis in original)."<sup>42</sup> But Judge Leon did not uncritically accept the defendants' claims of cost savings. He did discuss how AT&T and Time Warner claimed that the efficiency benefits of the merger would be substantial, but for his conclusion, he relied on Professor Shapiro's testimony conceding efficiency benefits of \$352 million.

In the last few pages of its brief, the DOJ finally gets around to addressing Judge Leon's specific criticisms of the model used by Professor Shapiro. DOJ first disputed whether Professor Shapiro actually conceded efficiency benefits of \$352 million, although it acknowledged that he conceded that there would be some positive benefits.<sup>43</sup> But this does not help the DOJ's position because it still meant that Judge Leon was balancing no evidence of anticompetitive harm against a concession that there would be at least some positive efficiency benefits.

The DOJ brief then offered some specific support for the data used by Professor Shapiro and reasons why Judge Leon was wrong to find this data unreliable for the purposes they were used by Professor Shapiro.<sup>44</sup> But the district court is the finder of facts for the case and criticisms that the judge was wrong to accept certain facts and reject others is a far cry from showing these findings are clearly in error. Just because the DOJ claims these asserted errors were clear errors does not make it so, and the appeals court simply is not competent to make its own assessment of whether these were clear errors. Put another way, Judge Leon presided over a long discovery process and many days of the parties presenting evidence at trial. He heard the detailed descriptions of the data and their reliability from the witnesses and attorneys for both parties, so any appellate court is going to be very reluctant to look at evidence disputes summarized in eight pages of one party's brief and conclude that Judge Leon was clearly wrong.

## **VII. The Problem with "Hot Documents"**

Much of the original DOJ Complaint and the evidence the DOJ presented at trial consisted of quotes from so-called "hot documents," or documents the DOJ claimed support the DOJ theory of harm from the merger or show the anticompetitive intent of the parties. DOJ identified several regulatory filings by the parties and their competitors that DOJ claimed also described how the merger could lead to the harm that DOJ claimed will result from the merger or from similar vertical mergers being proposed or consummated in recent years. Similarly, DOJ claimed that various documents prepared by employees of the merging companies showed that they were already planning to withhold the Time Warner programming or charge more for it after the merger. Another category of documents cited by the DOJ were "ordinary course" documents from third parties that DOJ claimed showed that these parties recognized the anticompetitive harm that could result from this type of vertical integration.

Judge Leon, after reviewing the "hot documents" provided by DOJ, found them to have very little probative value:

With the benefit of foundational testimony, I have considered all of the documentary and testimonial evidence from defendants' files and witnesses upon which the Government relied at trial. Having done so, I nonetheless conclude that the proffered statements and

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<sup>42</sup> *Id.*, at 55.

<sup>43</sup> *Id.*, at 63-64.

<sup>44</sup> *Id.*, at 64-71.

documents admitted are of such marginal probative value that they cannot bear the weight the Government seeks to place on them.<sup>45</sup>

Judge Leon then explained that he found the DOJ's hot documents fell into several different categories, but none of the categories of documents were particularly relevant to the issues before the court. He pointed out that the regulatory filings by AT&T, DirecTV, and Time Warner cited by DOJ were often self-serving because they were from FCC proceedings where a potential outcome for the commenting party was that it would gain an advantage over competitors. Other documents were about types of conduct that DOJ was not alleging would follow this particular merger, were too generic to have any relevance, were too far in the past to be applicable to current market conditions, were predictions from several years ago about future conduct that demonstrably did not happen, were made by low-level employees in documents that did not appear to have ever been seen by the higher-level employees making decisions about the merger, or were statements by the AT&T CEO that were taken out of context.<sup>46</sup>

Judge Leon then concluded:

In short, despite the Government's effort to paint a contrary picture, this is not a case containing direct, probative evidence of anticompetitive intent on the part of high-level executives within the merging company. [AT&T CEO] Stephenson's statements and the Government's other proffered documentary evidence instead suggest, at the very most, that AT&T (or its third-party consultants) recognized that one *possibility* of uniting content and distribution would be to withhold or otherwise limit content from other distributors in an attempt to benefit AT&T's distribution platforms. But evidence indicating defendants' recognition that it could be possible to act in accordance with the Government's theories of harm is a far cry from evidence that the merged company is likely to do so (much less succeed in generating anticompetitive harms as a result.) That is especially true when the Government's documentary evidence is weighed against the considerable contrary evidence – including other evidence related to the motivation for the challenged merger – that came out at trial. Thus, taking such documentary evidence for all it's worth, that evidence is only marginally probative of the viability of the Government's increased-leverage theory of harm (emphasis in original, citations omitted).<sup>47</sup>

Judge Leon makes an important point regarding the hot documents in this case. He did not conclude that hot documents can never be relevant to the case, and indeed documents containing "direct, probative evidence of anticompetitive intent on the part of high-level executives within the merging company" would be highly relevant.<sup>48</sup> The problem Judge Leon saw with the DOJ documents was that even when the documents were written by higher-level employees and were not taken out of context, at best they described the possible anticompetitive benefits to the merging companies from vertical integration generally, but once again the evidence was not specific to this particular merger.

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<sup>45</sup> United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc., at 80.

<sup>46</sup> *Id.*, at 81-90.

<sup>47</sup> *Id.*, at 90-91.

<sup>48</sup> *Id.*, at 90.

## VIII. Why the DOJ Continued Opposition to the Merger Is So Unusual

Thus, that DOJ even brought this challenge to the AT&T/Time Warner merger was somewhat surprising, given that no other vertical mergers had been challenged in court by government since 1979. That DOJ continues to oppose the merger, even after losing badly at trial, is rather unusual in antitrust enforcement for at least four reasons.

First, there does not appear to be any clear antitrust principle at stake. Judge Leon emphasized that vertical mergers can raise significant antitrust concerns, but the question for the court is whether the economic evidence supports DOJ's claim that this particular merger will lead to more harm than benefits. And Judge Leon was careful to ground his analysis in standards from established antitrust precedent, which the DOJ does not appear to dispute, before proceeding to carefully lay out the factual basis for why he concluded that the DOJ had not met its burden.

Second, the DOJ on appeal has to show that the district court's ruling was "clearly erroneous." In other words, DOJ has to do more than show that Judge Leon was wrong in how he interpreted the economic evidence – it has to show that the judge was clearly wrong and overcome the deference the appeals court is required to show to the judge's findings of fact. That is a much more difficult test for DOJ to meet than the test at trial, where DOJ had to show that the merger more likely than not would lead to more economic harm than benefits.

Third, Judge Leon took the unusual step of explicitly encouraging DOJ not to appeal this decision. While Judge Leon acknowledged that the DOJ has the right to appeal, he concluded his decision by urging the government not to appeal:

The Government has had this merger on hold now since October of 2016 when it launched its investigation. In that 18-plus month period, the companies have twice extended the break-up date to accommodate the Government's litigation of this case. During that same period, the video distribution market has continued to evolve at a breakneck pace. The cost to the defendants and the Government to investigate, litigate, and try this case has undoubtably been staggering – easily in the millions of dollars.

If the Government were to ask me to stay this Court's ruling, I would, under the law, have to weigh whether the Government has a strong likelihood of success on the merits and would suffer irreparable harm should be stay be denied, among other things. Well, suffice it to say – as my 170-plus page opinion makes clear – I do not believe that the Government has a likelihood of success on the merits of an appeal. . . .

The Government here has taken its best shot to block the merger based on the law and facts, and within the time allowed. To use a stay to accomplish *indirectly* what could not be done directly – especially when it would case [*sic*] certain irreparable harm to the defendants – simply would be unjust. I hope and trust that the Government will have the good judgment, wisdom, and courage to avoid such a manifest injustice. To do otherwise, I fear, would undermine the faith in our system of justice of not only the defendants, but their millions of shareholders and the business community at large (emphasis in original).<sup>49</sup>

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<sup>49</sup> United States v. AT&T Inc., DirecTV Group Holdings, LLC, and Time Warner Inc. (D.D.C., 2018), at 170-172.

Finally, that DOJ continues to try to block this merger lends credence to claims that it is acting under pressure from President Trump, perhaps in reaction to the coverage of the President by CNN.<sup>50</sup> AT&T and Time Warner earlier had alleged that the DOJ's review of the transaction was unduly influenced by the President's political considerations and asked the court for access to communications between the White House and the Justice Department about the takeover.<sup>51</sup> To be clear, I do not see any evidence that the decisions made by DOJ in litigating this case and appealing the outcome were motivated by improper political considerations. Even so, given that the DOJ case was questionable in the first place<sup>52</sup> and the appeal unlikely to succeed, it seems rather unusual to see the DOJ pursuing this appeal, despite Judge Leon's strong encouragement not to do so.

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<sup>50</sup> For example, former Representative Silvestre Reyes (D-TX), has called for an investigation of whether any improper influence by the President. "The White House May Be Interfering in an AT&T and Time Warner Deal for Political Gain," *The Hill* (November 18, 2017), available at: <http://thehill.com/opinion/technology/361010-the-white-house-may-be-interfering-in-an-att-and-time-warner-deal-for>. ("The merger between AT&T and Time Warner may or may not be a good deal for the American people. However, there is a possibility that the White House and the Department of Justice may have acted out of political payback against CNN and to potentially help their ally Rupert Murdoch acquire the cable network. In the interest of justice and transparency, an investigative unit of the federal government must get to the bottom of this matter immediately.")

<sup>51</sup> See, e.g., David McLaughlin, Scott Moritz, and Sara Forden, "AT&T Ready to Probe the White House's Role in Time Warner Deal," *Bloomberg* (November 13, 2017), available at: <https://www.bloomberg.com/news/articles/2017-11-13/at-t-is-said-ready-to-probe-white-house-role-on-time-warner-deal>.

<sup>52</sup> See, e.g., Theodore R. Bolema, "The Proper Context for Assessing the AT&T/Time Warner Merger," *Perspectives from FSF Scholars*, Vol. 13, No. 6 (February 8, 2018), available at: [http://www.freestatefoundation.org/images/The\\_Proper\\_Context\\_for\\_Assessing\\_the\\_AT\\_T-Time\\_Warner\\_Merger\\_020818.pdf](http://www.freestatefoundation.org/images/The_Proper_Context_for_Assessing_the_AT_T-Time_Warner_Merger_020818.pdf).