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The Justice Department Will Need a Stronger Case Against the AT&T/Time Warner Merger

by

Randolph J. May*and Theodore R. Bolema**

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Based on recent press reports, the Department of Justice may be preparing to challenge the proposed merger of AT&T and Time Warner by seeking to force the merging companies to sell off some or all of the Time Warner video channels as a condition of approval. Put simply, for a vertical merger, this would be unprecedented relief in the modern antitrust era.

Time Warner is a programming content provider, through its CNN, HBO, and Turner channels and its Warner studios. AT&T provides distribution “pipes” for delivery of video content through its DirecTV satellite service as well as its broadband and mobile services. So the proposed combination is a “vertical” merger with no meaningful “horizontal” overlap in lines of business between the companies. Vertical mergers, as opposed to horizontal ones, are rarely challenged under antitrust laws, but the prominence of these companies is attracting more public scrutiny than has been the case with other vertical mergers.

Importantly, the merger includes no transfer of broadcast licenses, so it is not being reviewed by the Federal Communications Commissions under its vague “public interest” standard requiring affirmative approval from the agency. Instead, the review is being conducted by the Justice Department under Clayton Act standards which focus on the economic impact of the merger. The government can only block the merger by proving its case in court.

DOJ may be considering two possible types of competitive harms that could be claimed to result from the merger. The first is that the combined entity will place video content distributors that compete with DirecTV and AT&T’s other video distribution services at an unfair disadvantage by charging them high fees or denying them access to Time Warner content. These restrictions allegedly would allow the new firm to demand higher rates for Time Warner content from rival programming distributors who pay up, while placing competitors who don’t pay for the content at a competitive advantage.

The other harm that conceivably may be alleged is that the new firm would give Time Warner content favorable treatment, including not carrying certain competing channels or giving other channels unfavorable placement or treatment on its distribution platforms.

One problem with these two theories of harm is that they are somewhat at odds with each other. Charging high prices for Time Warner content or cutting off rival distribution systems from Time Warner programming to help AT&T’s own video distribution services will lead to loss of carriage for Time Warner channels, while having AT&T’s distribution services not carry rival content may lead to loss of subscribers for the merged company.

AT&T and Time Warner would also claim significant merger efficiencies due to the transaction, which would offset any alleged competitive harm. DOJ would have to prove to a court that the gains offset the losses, which will be more difficult than proving harm in a conventional horizontal merger case.

U.S. antitrust agencies before the 1980s were harshly criticized by economists and legal scholars for their hostility to vertical mergers based on dubious theories of economic harm. Since the 1980s, vertical mergers rarely have led to antitrust challenges. Similar vertical media mergers, like Comcast’s 2011 acquisition of NBCUniversal, were settled with behavioral restrictions that allowed the merger to proceed without structural changes. These previous cases were settled out of court, so there is very little legal precedent to support the vertical theories of harm that might be raised by the government. Departing from past merger review practices has other costs as well, including sending a chill through a marketplace that has evolved under antitrust enforcement practices that have been followed, predictably, by administrations of both political parties.

In this era of media abundance, both the video distribution and video content markets are characterized by effective competition. The marketplace has become even more dynamic since the 2011 Comcast/NBCU merger as consumers are now far more willing to cut the cord and look to Internet platforms for information and entertainment. Indeed, by early 2017, Amazon Prime subscriptions climbed to 80 million and Netflix surpassed 50 million, and 64 percent of TV households subscribed to Amazon Prime, Hulu, or Netflix. It’s no wonder that shortly after the proposed AT&T-Time Warner merger was announced, Mark Cuban endorsed the proposal, stating: “We need more companies ... with the ability to compete with Apple, Google, Microsoft, and Facebook.” In short, anticompetitive strategies that might have worked in the past will not be as profitable today, due to the likely losses of subscribers to other platforms.

If the Justice Department does seek to force a sale of certain Time Warner channels or seek other structural relief, it will have a tough time in court explaining why this case deviates from antitrust enforcement precedent in which, at most, behavioral conditions were sufficient remedies. And it will have a tough time explaining why such relief is necessary in an increasingly dynamic market in which consumers have more alternatives for receiving information and entertainment programming than ever before.

* Randolph J. May is President of the Free State Foundation, an independent**,** nonpartisan free market-oriented think tank located in Rockville, Maryland. *The Justice Department Will Need a Stronger Case Against the AT&T/Time Warner Merger* was published in *The Hill* on November 17, 2017.

** Theodore R. Bolema is a Senior Fellow of the Free State Foundation.