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AT&T/Time Warner: AAG Search Update, A Closer Look at Litigation Considerations; Burden, Efficiencies Issues Create Litigation Risk, but Remedy, Timing Considerations Could Provide Avenues to DOJ Litigation Victory

Transition Update

According to reports, key players in the Trump administration, including the President himself, continue to oppose AT&T's proposed acquisition of Time Warner. However, a number of recent developments, including the transition team's celebration of the Bayer/Monsanto merger-contingent jobs proposal, and the President's statement that he has not yet "seen any of the facts" of AT&T/Time Warner merger, provide somewhat optimistic signals for ultimate deal clearance.

In the near-term, the most important indicator of the President's willingness to follow through with his campaign trail vow to "never approve" the merger will be his pick to lead DOJ's Antitrust Division. Although a recent Bloomberg report identifies George Mason University School of Law professor Josh Wright as a leading candidate for the position, a source familiar with the matter indicates that top Trump advisers, including Steve Bannon, Jared Kushner, and Peter Thiel, are skeptical of Wright's AAG candidacy, given his close ties to Google.

According to the source, other candidates interviewing for the AAG position include Jones Day antitrust practice group head David Wales, and Delta Air Lines SVP Christine Wilson. If nominated and confirmed, either Wales or Wilson would likely take at least a marginally tougher line on the AT&T/Time Warner merger than Wright, given his unique openness to efficiencies arguments, and documented skepticism of vertical theories of harm.

Litigation Update

Personnel issues aside, as AT&T moves to avoid license transfers that would trigger an FCC review of the merger, the administration's most promising option to scuttle the transaction may involve a DOJ lawsuit, seeking a federal court order to permanently enjoin the merger.

Given antiquated case law—the government has not litigated a vertical merger challenge since 1979—such a move would create substantial uncertainty. And beyond typical horizontal merger litigation challenges, interviewed former Antitrust Division litigators describe a vertical merger challenge as presenting significant DOJ litigation risk, given burden, documentary evidence, and efficiencies issues.

In that same respect, however, the thesis that DOJ cannot successfully litigate a vertical merger challenge is fundamentally incorrect. In fact, DOJ may enjoy a plausible path to scuttling the transaction through litigation, especially given advantages around remedy and timing considerations.

Although litigation issues typically play a key role in DOJ's final posture, a number of factors may diminish litigation risk's importance in this situation. Most importantly, influential White House players continue to oppose the AT&T/Time Warner deal, which the President vowed on the campaign trail to "never approve." The President's post-election escalation of his long-running battle with Time Warner property CNN—and the news media more generally—is an additional factor. And larger-scale political concerns around content and media issues—likely to take on increased importance in a post-net neutrality environment—only add to these considerations. Ultimately, these factors may heighten the DOJ's willingness to pursue litigation, even in the face of uncertain court prospects.

In-depth: Vertical Merger Litigation Considerations

Agencies frequently file lawsuits to enjoin vertical mergers accompanied by simultaneous proposed settlements. Neither the FTC nor DOJ has litigated a vertical merger challenge to decision since 1979. Paucity of litigation, however, does not indicate that the agencies never view vertical mergers as Section 7 violations. In fact, DOJ files complaints alleging that vertical mergers violate the antitrust laws with some degree of frequency, including, in recent years, Google/ITA, UTC/Goodrich, Monsanto/Delta Pine & Land, and Comcast/NBCU.

In the vast majority of vertical challenges, DOJ simultaneously files a proposed settlement to resolve competitive concerns alleged in the complaint. This, however, is a matter of prosecutorial discretion—the Division, despite concluding that the transactions in question violate the Clayton Act—opts to negotiate consent orders, typically including behavioral remedies ostensibly addressing the harm.

A primary driver of this approach is litigation risk, as DOJ's front office is typically hesitant to litigate deals it views as very close calls—especially when a consent order is on the table. "A lot of times the DOJ wants more than a decent chance of winning and will take a cheap settlement to the extent the litigation risk is high enough," says one former DOJ attorney. Ethan Glass, a partner at Quinn Emanuel, and the Division's lead trial attorney in its GE/Electrolux challenge, largely echoes this point. "You're not just going to file a complaint and have a federal judge crush you—you want to have a good chance of winning," Glass explains.

Vertical case law offers limited guidance to modern courts. Although vertical merger litigation is viewed as difficult to win, the actual case law on vertical mergers is not necessarily negative for the government. That said, the existing case law does offer very limited guidance to modern courts evaluating vertical combinations.

In the 1960s and early 1970s, the agencies won a string of challenges to vertical transactions based primarily on foreclosure percentage, or post-merger ability—rather than ability *and* incentive—to exclude rivals. The Supreme Court enjoined the *Brown Shoe* (1962) transaction, for example, partly on a vertical theory, as the acquisition would exclude Brown Shoe's manufacturing rivals from access to Kinney's roughly 2% share of the retail market. The Court reached a largely similar outcome in its most recent vertical merger decision, *Ford Motor Co.* (1972), finding a Section 7 violation where Ford, which purchased about 10% of industry output, acquired a firm manufacturing about 15% of domestic spark plug supply.

In the mid to late 70s, however, the government began to lose a number of vertical challenges, as courts moved toward a less formulaic, more fact-specific approach. In fact, the government's last litigated vertical merger case, *Fruehauf* (2d Cir. 1979), cited *Brown Shoe* for the proposition that foreclosure percentage was not in and of itself dispositive, as "there are no precise formulas for determining whether a vertical merger may probably lessen competition."

Instead, *Fruehauf* read *Brown Shoe* as indicating that discerning anticompetitive effects was a function of "examining…market factors as they exist for the particular merger in issue." In concluding that the FTC had failed to show a "probable anticompetitive impact" of the merger, the *Fruehauf* court examined a number of fact and industry-specific questions, including market concentration, entry barriers, the merging firms' size, and the extent of actual foreclosure.

Burden, documentary evidence issues represent DOJ challenges. In short, the caselaw on vertical mergers provides modern courts relatively little guidance. That said, certain characteristics of the case law—especially when contrasted with the more typical horizontal context—demonstrate DOJ's heightened vertical merger litigation risk.

Per *Philadelphia National Bank*, the government can establish a structural presumption of competitive harm by demonstrating that a merger leads to undue concentration in a properly defined market. This initial *prima facie* showing shifts the burden to the defense, to rebut the presumption by demonstrating that the transaction is not likely to have substantial anticompetitive effects. Once established, this structural presumption is incredibly powerful—as a practical matter, when the government establishes a structural presumption, it almost always prevails in court.

No such structural presumption exists in the vertical context, however, as vertical mergers, necessarily, do not increase market concentration. Rather, the vertical case law provides that the government carries the burden not only on elements including product and geographic market definition, but also on showing a likelihood that the merger's future effect may be to substantially lessen competition. Although the practical impact of this burden is not entirely clear, actually showing anticompetitive effects, rather than simply establishing a presumption of effects through market concentration, is, at the very least, a higher bar to clear.

Burden issues aside, a court's ultimate determination in merger litigation is a fundamentally fact-specific exercise. "While cases are helpful for the guidance on general concepts, these cases are won or lost based upon what do the business documents say and what do the data say and to a certain extent what do the witnesses say," explains Glass. And on this point, the vertical relationship affects not only the government's burden, but also the available documentary evidence.

Agency merger challenges typically emphasize ordinary course documents in which businesspeople detail uniquely close competitive interaction between the target and acquirer. These documents often prove hugely important —in cases including Staples/Office Depot I and Bazaarvoice/PowerReviews, for example, documentary evidence largely drove government litigation victories.

In the vertical context, however, these bad, or "hot," documents are generally less likely to exist. "Businesspeople talk about their competitors all the time and they talk about bids and contracts and customers and price all the time and so you've got a lot of places to look," says Glass. "They don't really have interesting discussions about their suppliers as much." Indeed, because input and customer foreclosure theories rest on potential harm to competitors through exclusionary conduct, rather than straightforward lessening of existing head-to-head horizontal competition, the documentary evidence is, as a general matter, likely weaker in the vertical context—a factor rendering litigation more challenging.

Litigating the fix in the vertical context faces practical challenges. Although burden and documentary evidence issues present hurdles for DOJ, AT&T/Time Warner's underlying vertical issues, notes one former DOJ litigator, represent plausible bases for litigation. "These aren't novel theories, the sort of input foreclosure, raising rivals' costs, customer foreclosure—it's not like they're going into court with something that's made up out of whole cloth," the litigator notes. And in fact, in the vertical context, the government benefits from one advantage that it would not enjoy in a horizontal scenario—AT&T would very likely be forced to litigate the Time Warner deal as originally proposed, rather than as modified by a proposed fix.

An AT&T/Time Warner full-stop challenge would rely heavily on economic evidence indicating that the acquisition would enable AT&T to profitably exclude MVPD/OVD or content competitors, thereby maintaining or expanding upstream or downstream market power. In the event of a lawsuit, however, AT&T could attempt to propose a set of unilateral behavioral restrictions to address these business incentives—perhaps mirroring the Comcast/NBCU conditions—directly to the court as a proposed order.

In practice, any set of proposed conditions would be lengthy, and highly complex, given the nature of programming, licensing, and carriage disputes. This would likely render a court skeptical of such a proposal—especially given that, in any litigation scenario, DOJ would aggressively attack proposed conditions, no doubt highlighting enforceability issues around the 2011 Comcast/NBCU DOJ consent decree and FCC order.

In addition, conduct remedies—which DOJ, in this scenario, would actively reject—require court supervision and monitoring over an extended time period. "I could see a court being very reluctant to in the end enter into a decree that really is behavioral remedies that it will have to continue to litigate for x number of years," says Glass. "The more the court gets educated on these matters, the less likely a court is going to enter into a conduct remedy, a non-divestiture remedy." And AT&T's plans to avoid FCC review, which, if effectuated, would no doubt render the conditions necessary to remedy harm even more complex and extensive, would if anything heighten a court's reluctance to consider unilaterally proposed behavioral remedies.

Courts may view efficiencies arguments more favorably in the vertical merger litigation context. Although the AT&T/Time Warner vertical relationship would render litigating the fix a challenge, it could also provide uniquely fertile ground for an efficiencies defense. While efficiencies are oft-litigated, the Supreme Court has never formally adopted an efficiencies defense, and no district court has ever cleared a merger based on a showing that purported efficiencies would overcome competitive harm.

In the vertical context, however, such a defense may prove more fruitful. "When you have horizontal mergers and no efficiencies argument has ever been bought, that's a precedent. When there's some assertion of efficiencies in a vertical merger and you've got all this economic literature about why vertical deals are generally efficient including stuff the DOJ itself has written, you can see a generalist judge saying I feel more comfortable listening to these arguments," says a former DOJ litigator.

An additional issue is the Non-Horizontal Guidelines. Although the Guidelines have not been updated since 1984, and are largely out of step with modern economic thinking, the Guidelines state: "the Department will give relatively more weight to expected efficiencies in determining whether to challenge a vertical merger than in determining whether to challenge a horizontal merger."

To be clear, this language is not binding on DOJ, let alone the courts. In that same respect, courts typically view the Guidelines as persuasive, and this language, despite its inclusion in a relatively outdated document, could provide additional ammunition for an efficiencies defense.

Guidelines issues aside, AT&T will argue that double marginalization-driven, merger-specific cost savings would be largely competed away through lower consumer prices in downstream MVPD/OVD and mobile markets. Input and customer foreclosure theories, by contrast, rely on a more complex interaction than simple elimination of head-to-head-competition—instead involving AT&T profitably pursuing exclusionary post-merger strategies, thereby harming competitors to the point that they are unable to constrain AT&T's downstream market power.

This, again, speaks to the complexity inherent in vertical merger litigation, where post-merger price effects, although plausible, are a less straightforward proposition than in the horizontal context.

Threat of extended trial date; appeal. Although efficiencies could prove unusually potent in the vertical context, DOJ may benefit from one final non-merits issue—timing. Unlike the parties, where timing delay drives substantial strategic and financing uncertainty, the government faces no real timing constraints. And, in the litigation context, DOJ can use this asymmetry to its advantage.

At the outset, DOJ may demand a delayed trial date. Timing is almost always a contested issue, with the parties typically proposing a relatively expedited trial date (often around 90 days post-complaint), and DOJ a relatively extended trial start (often 180 days+ post-complaint). A judge's timing decisions can in many cases prove dispositive—given timing and outcome uncertainty, parties are typically are hard-pressed to keep their deals together for a number of months post-complaint. Although trial date decisions are litigation-specific and depend on factors including the Judge's schedule, DOJ often effectively uses timing as an additional count in its complaint—a successful tactic, when viewed against the extensive list of deals that have fallen apart post-complaint.

Even to the extent AT&T were to win a favorable trial schedule timeline, the prospect of appeal looms as a second potential timing hurdle. Given the antiquated, unsettled case law, a judge would be extremely hard-pressed to author a vertical decision in 2017 without raising multiple appealable issues of law. And, even in the event of a court loss, DOJ could telegraph an intent to appeal, in a move to embroil the situation in prolonged litigation, regardless of district court outcome.

In such a scenario, DOJ would seek a stay pending appeal in response to a district court loss—typically a 50/50 proposition. In the FTC's *Whole Foods* and *LabCorp* district court losses, for example, appellate courts denied stays, paving the ways for the *Whole Foods* transaction's close, and the *LabCorp* hold separate order's dissolution. However, in two recent FTC hospital merger challenges, Penn State Hershey/Pinnacle and Advocate/NorthShore, courts did grant stays pending appeal shortly after the FTC's district court losses—moves that precluded the deals' close through the roughly four and a half month appeal process. Added to typical five to six month district court litigation timeline, a granted stay raises the real prospect of a ten month—or longer—litigation path to close post-complaint.

In fact, DOJ could pursue an appeal even if a court were to deny a stay. This exact scenario occurred in *Whole Foods*, where the FTC won a favorable decision in the DC Circuit almost a year after the transaction had closed—a situation that ultimately led to substantial post-close structural relief. So although the absence of a stay may free the parties to close their transaction, an agency appeal, if successful, can lead to an appeals or district court decision enjoining the merger post-consummation—for the parties, an extremely unwelcome proposition.

In short, the agencies benefit from substantial timing advantages. Although DOJ typically does not avail of itself of the option to appeal district court losses in merger litigation, the prospect of such a move could drive substantial timing and outcome uncertainty. And the difficulty inherent in prevailing in vertical merger litigation notwithstanding, DOJ's willingness to telegraph an intent to appeal any adverse district court ruling could substantially diminish parties' willingness to litigate.