AT&T-Time Warner merger approved
June 12, 2018
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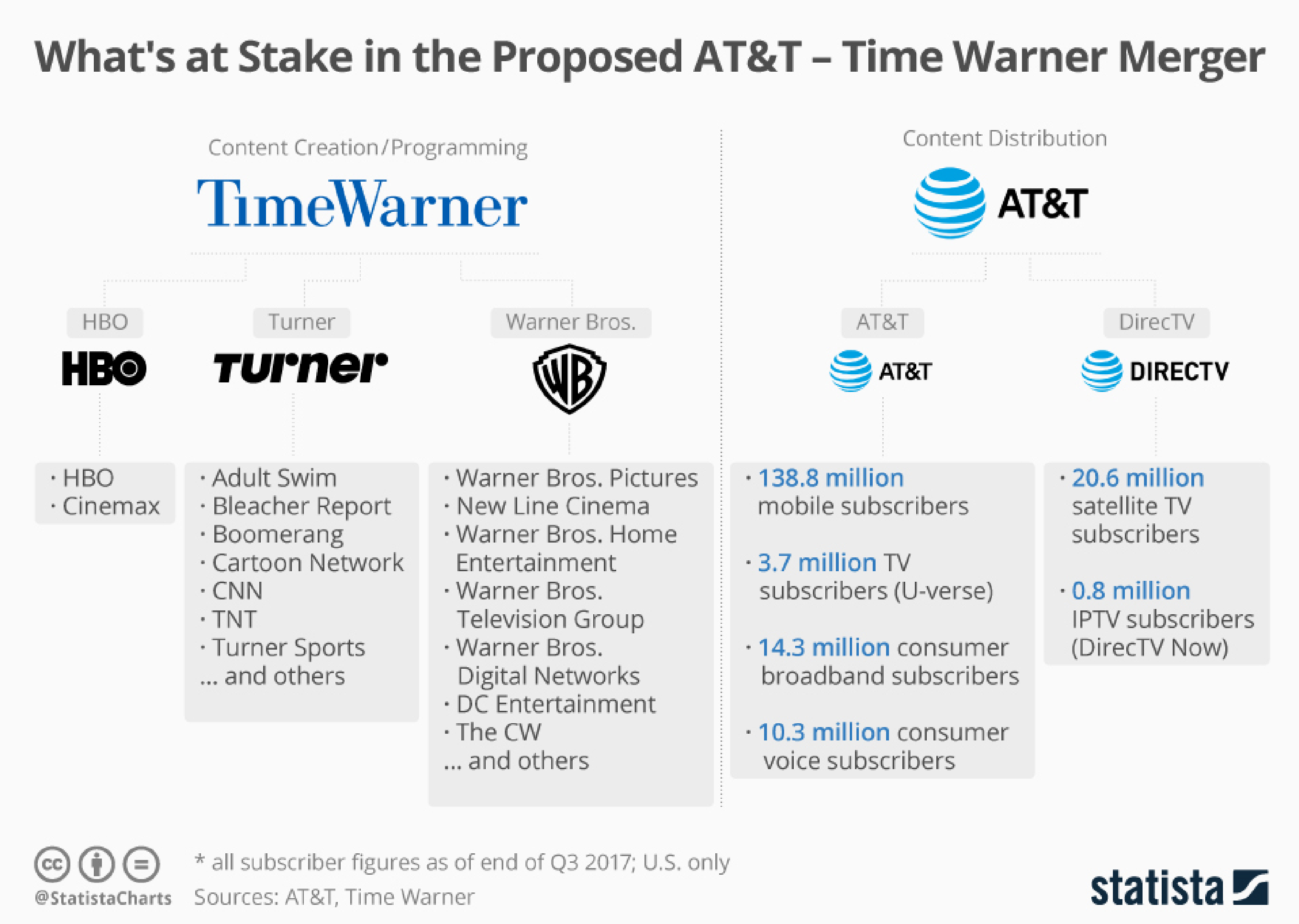
AT&T's merger with Time Warner has lead to one of the most important, but least interesting, antitrust trials in recent history.

The merger itself is somewhat unimportant to consumers. It's about a close to a "pure" vertical merger as we can get in today's world and would not lead to a measurable increase in prices paid by consumers. At the same time, Richard J. Leon's decision to approve the merger may have sent a signal regarding how the anticipated Fox-Disney (or Comcast), CVS-Aetna, and Cigna-Express Scripts mergers might proceed.

Judge Leon of the United States District Court in Washington, said the U.S. Department of Justice had not proved that AT&T's acquisition of Time Warner would lead to fewer choices for consumers and higher prices for television and internet services.

As shown in the figure below, there is virtually no overlap in services provided by Time Warner (content creation and broadcasting) and AT&T (content distribution). We say "virtually" because, through it's ownership of DirecTV, AT&T has an ownership stake in several channels such as the Game Show Network, the MLB Network, and Root Sports. So, not a "pure" vertical merger, but pretty close. Besides no one seems to really care about GSN, MLB, or Root.



The merger trial was one of the least interesting because the government's case opposing the merger was so weak.

The Justice Department's economic expert, University of California, Berkeley, professor Carl Shapiro, argued the merger would harm consumers and competition in three ways:

1. AT&T would raise the price of content to other cable companies, driving up their costs which would be passed on consumers.
2. Across more than 1,000 subscription television markets, AT&T could benefit by drawing customers away from rival content distributors in the event of a "blackout," in which the distributor chooses not to carry Time Warner content over a pricing dispute. In addition, AT&T could also use its control over Time Warner content to retain customers by discouraging consumers from switching to providers that don't carry the Time Warner content. Those two factors, according to Shapiro, could cause rival cable companies to lose between 9 and 14 percent of their subscribers over the long term.
3. AT&T and competitor Comcast could coordinate to restrict access to popular Time Warner and NBC content in ways that could stifle competition from online cable alternatives such as Dish Network's Sling TV or Sony's PlayStation Vue. Even tacit coordination of this type would impair consumer choices, Shapiro opined.

Price increases and blackouts

Shapiro initially indicated the merger would cause consumers to pay an additional $436 million year, which amounts to an average of 45 cents a month per customer, or a 0.4 percent increase. At trial, he testified the amount might be closer to 27 cents a month and conceded it could be a low as 13 cents a month.

The government's "blackout" arguments seemed to get lost in the shifting sands of shifting survey results. Blackouts mattered, according to Shapiro, because "Even though they don't happen very much, that's the key to leverage." His testimony on the potential for price hikes relied heavily on a study commissioned by Charter Communications Inc., which opposes the merger. Stefan Bewley, a director at consulting firm Altman Vilandrie & Co., which produced the study, testified the report predicted Charter would lose 9 percent of its subscribers if it lost access to Turner programming.

Under cross-examination by AT&T's lawyer, Bewley acknowledged what was described as a "final" version of the study presented to Charter in April last year put the subscriber loss estimate at 5 percent. When confronted with his own emails about the change to 9 percent, Bewley said he agreed to the update after meeting with Charter. At the time of the change from 5 percent to 9 percent, Charter was discussing its opposition to the merger with the Justice Department.

Bewley noted that the change occurred because he saw that some of the figures his team had gathered about Turner networks were outliers, with a range of subcriber losses of 5 percent on the low end and 14 percent on the high end. He indicated his team came up with a "weighted average" of 9 percent.

This 5/9/14 percent distinction seems to be critical to the government's claim the merger would raise consumer prices. Referring to Shapiro's analysis, AT&T-Time Warner's lead counsel, Daniel Petrocelli, asked Bewley: "Are you aware that if he'd used 5 percent there would have been a price increase of zero?" Bewley said he was not aware.

At trial, AT&T and Turner executives testified that they couldn't credibly threaten to withhold Turner programming from rivals because the networks' profitability depends on wide distribution. In addition, one of AT&T's expert witnesses, University of California, Berkeley business and economics professor Michael Katz, testified about what he said were the benefits of AT&T's offer to use "baseball style" arbitration with rival pay TV distributors if the two sides couldn't agree on what fees to pay for Time Warner's Turner networks. With baseball style arbitration, both sides submit their final offer to an arbitrator, who determines which of the two offers is most appropriate.

Under the terms of the arbitration offer, AT&T has agreed not to black out its networks for the duration of negotiations with distributors. Dennis Carlton, an economics professor at the University of Chicago, said Shapiro's model was unreliable because he didn't account for that. Shapiro conceded he did not factor that into his study, saying that he would need to use an entirely different model to study how the arbitration agreement would affect the merger.

Coordination with Comcast/NBCUniversal

The government's contention that, after the merger, AT&T and rival Comcast could coordinate to restrict access to popular Time Warner and NBC content to harm emerging competitors was always a weak argument.

At trial, the Justice Department seemed to abandon any claim that the merged company would unilaterally restrict access to online "virtual MVPDs." The government's case, made by its expert Shapiro, ended up being there would be a "risk" and "danger" that AT&T and Comcast would "coordinate" to withhold programming in a way to harm emerging online multichannel distributors. However, under cross examination, he conceded that his opinions were not based on a "quantifiable model." Shapiro testified that he had no opinion whether the odds of such coordination would be greater than 1 percent.

Doing no favors to its case, the government turned to a seemingly contradictory argument that AT&T and Comcast would coordinate to demand virtual providers take too much content. Emerging online multichannel distributors pitch their offerings as "skinny bundles" with a limited selection of the more popular channels. By forcing these providers to take more channels, the government argued, the skinny bundle business model is undermined in a version of raising rivals costs. This theory did not get much play at trial, but seems to suggest the government was trying to have its cake and eat it, too.

Except in this case, as with much of the government's case in this matter, the cake was not completely baked.

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