

ORAL ARGUMENT NOT YET SCHEDULED  
**No. 18-5214**

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IN THE  
**United States Court of Appeals  
for the District of Columbia Circuit**

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UNITED STATES OF AMERICA,  
*Plaintiff-Appellant,*

v.

AT&T INC.; DIRECTV GROUP HOLDINGS, LLC;  
and TIME WARNER INC.,  
*Defendants-Appellees.*

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On Appeal from the  
United States District Court for the District of Columbia  
No. 1:17-cv-2511 (Hon. Richard J. Leon)

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**PROOF REPLY BRIEF OF APPELLANT  
UNITED STATES OF AMERICA  
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## TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES .....	ii
GLOSSARY .....	iv
INTRODUCTION AND SUMMARY OF ARGUMENT.....	1
ARGUMENT .....	4
I.    THE ECONOMICS OF BARGAINING APPLIES TO PAY- TELEVISION NEGOTIATIONS AND PREDICTS A PRICE INCREASE FROM THIS MERGER .....	4
A. AT&T Ignores That The District Court’s Correct Understanding Of The Pay-Television Industry Required Finding That The Economics Of Bargaining Applies.....	5
B. AT&T Fails To Grapple With The District Court’s Erroneous Rejection Of Corporate-Wide Profit Maximization .....	13
C. AT&T’s Discussion Of “Real-World” Evidence Is Incorrect And Incomplete .....	16
II.   AT&T CANNOT JUSTIFY THE DISTRICT COURT’S CLEARLY ERRONEOUS DISMISSAL OF PROFESSOR SHAPIRO’S QUANTIFICATION OF HARM .....	21
A. AT&T Mischaracterizes And Ignores Several Of The District Court’s Overarching Errors .....	22
B. AT&T Does Not Refute The Government’s Showing That The District Court Clearly Erred In Rejecting Professor Shapiro’s Reasonable Inputs .....	28
1. Subscriber Loss Rate .....	28
2. Diversion Rate .....	31
3. DirecTV’s Margin.....	33
CONCLUSION .....	35
CERTIFICATE OF COMPLIANCE	
CERTIFICATE OF SERVICE	

**TABLE OF AUTHORITIES**

	<u>Page(s)</u>
<b>CASES:</b>	
<i>Anderson v. Bessemer City</i> , 470 U.S. 564 (1985) .....	4
<i>Brown Shoe Co. v. United States</i> , 370 U.S. 294 (1962) .....	28
<i>Chi. Bridge &amp; Iron Co. N.V. v. FTC</i> , 534 F.3d 410 (5th Cir. 2008) .....	24
<i>Copperweld Corp. v. Indep. Tube Corp.</i> , 467 U.S. 752 (1984) .....	4, 13, 14
<i>FTC v. Advocate Health Care Network</i> , 841 F.3d 460 (7th Cir. 2016) .....	4
<i>FTC v. H.J. Heinz Co.</i> , 246 F.3d 708 (D.C. Cir. 2001) .....	4, 24, 25
<i>Hosp. Corp. of Am. v. FTC</i> , 807 F.2d 1381 (7th Cir. 1986) .....	25
<i>Sparks v. State</i> , 501 S.E.2d 562 (Ga. Ct. App. 1998) .....	20
<i>United States v. Aetna Inc.</i> , 240 F. Supp. 3d 1 (D.D.C. 2017) .....	21, 28
<i>United States v. E.I. du Pont de Nemours &amp; Co.</i> , 353 U.S. 586 (1957) .....	13
<i>United States v. El Paso Nat. Gas Co.</i> , 376 U.S. 651 (1964) .....	27
<i>United States v. Trans-Mo. Freight Ass'n</i> , 166 U.S. 290 (1897) .....	21

**TABLE OF AUTHORITIES—Continued**

	<u>Page(s)</u>
<i>United States v. W.T. Grant Co.</i> , 345 U.S. 629 (1953) .....	21
<b>REGULATORY PROCEEDINGS:</b>	
<i>In re Comcast Corp.</i> , 26 F.C.C. Rcd. 4238 (2011).....	20
<b>OTHER AUTHORITIES:</b>	
John Nash, <i>Two-Person Cooperative Games</i> , 21 <i>Econometrica</i> 128 (1953).....	12

Deadline

## **GLOSSARY**

MVPD      Multichannel Video Programming Distributor

NBCU      NBC Universal

Deadline

## INTRODUCTION AND SUMMARY OF ARGUMENT

AT&T's brief, which is little more than a revisionist 58-page summary of the district court's opinion, does not remedy the economic and logical inconsistencies in the decision. Tellingly, AT&T rarely defends the court's logic. Instead, it attempts to construct a new opinion, incorrectly elevating a handful of the court's musing footnotes and phrases as if they were holdings.

For example, abandoning any real defense of the district court's pervasive error that the merger will not increase AT&T's bargaining leverage *at all*, AT&T hangs its hat on a phrase in a footnote thirty pages into the court's analysis. Section I.A.2, *infra*. AT&T's reading of the footnote, however, is inconsistent with the court's principal finding. Similarly, AT&T defends the court's flawed rejection of Professor Shapiro's testimony by attempting to elide that the court used the wrong number for consumer savings: AT&T simply swaps a different number into its brief without any explanation how the court could have reached it. Section II.A.1, *infra*. These bold attempts to rescue-by-revising the court's opinion are starkly inconsistent with AT&T's repeated ode to deference—and only reinforce the need for remand.

1. The principles of bargaining are accepted by economists and were previously adopted by AT&T and the FCC as fitting the pay-television industry. The district court rejected the economics of bargaining here, but AT&T fails to address the court's inconsistencies in doing so. It cannot explain how Time Warner had leverage from threatening blackouts *before* the merger, but could not have any credible ability to threaten blackouts *after* the merger. AT&T also makes nine baseless claims of waiver—even describing *an analogy* as waived (at 34)—and argues that the court reasonably relied on findings the court did not make. Ultimately, AT&T never resolves the court's errors. This Court should conclude that the economics of bargaining applies and remand with instructions that the district court assess the merger's harm accordingly.

2. AT&T alternatively argues that purported flaws in Professor Shapiro's quantification of harm provide another basis for this Court to affirm. As explained in the opening brief, however, the district court demanded a degree of certainty in excess of Section 7's reasonable-probability standard, and its finding of zero harm is unsupportable. AT&T ignores this argument, mistakenly claims aspects of it are

waived, and once again repeats the court's errors. AT&T fails to justify the court's erroneous findings, making remand unavoidable.<sup>1</sup>

AT&T laments (at 1) that trial was limited to "the fundamental question of whether DOJ had met its burden to prove that the proposed combination violated Section 7 of the Clayton Act." That, of course, was the statutory question posed by the complaint. AT&T sought irrelevant and overly expansive discovery into alleged White House communications, beyond those with the Antitrust Division, but the district court correctly denied that request before trial, and AT&T sought no further review. The only issue on appeal is whether the court's Clayton Act decision is erroneous, and the answer is yes.<sup>2</sup>

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<sup>1</sup> Although the merger closed "[t]hree months ago," AT&T Br. 1, AT&T represented to the district court that it would hold Turner as a separate business unit throughout the appeal, and a court may order divestiture at any later time.

<sup>2</sup> AT&T invokes the same fiction it promulgated in the press, during litigation, that the government's enforcement action was based on selective prosecution. *See* AT&T Br. 1; *see also* Reporters Committee Br. 12-13 (citing a November 2017 news report that the government demanded sale of CNN as a condition of clearing the merger). That media strategy has no basis in reality. For example, AT&T's CEO Randall Stephenson stated publicly that he "never offered to sell CNN." Dealbook, *I Have Never Offered to Sell CNN, AT&T CEO Says*, <https://www.nytimes.com/video/business/dealbook/100000005544436/dealbook-clip-randall-stephenson-att-ceo.html>. As Stephenson later

## ARGUMENT

### I. THE ECONOMICS OF BARGAINING APPLIES TO PAY-TELEVISION NEGOTIATIONS AND PREDICTS A PRICE INCREASE FROM THIS MERGER

AT&T does not dispute that the economics of bargaining might, “in appropriate circumstances,” offer a reliable prediction of the competitive effects of a vertical merger. AT&T Br. 23. AT&T does not dispute the principle of corporate-wide profit maximization set forth in *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 770 (1984). Importantly, AT&T also does not dispute that internally inconsistent factual findings, or errors of logic or economic reasoning, constitute clear error. *See Anderson v. Bessemer City*, 470 U.S. 564, 575, 577 (1985); *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 718-19 (D.C. Cir. 2001); *FTC v. Advocate Health Care Network*, 841 F.3d 460, 464 (7th Cir. 2016) (finding was “clearly erroneous” in Section 7 case because it incorrectly treated economic expert analysis “as if its logic were circular”).

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admitted under oath, however, AT&T did make such a proposal—which the government rejected. *See* JA\_\_ (Delrahim Decl. ¶ 10); Stephenson Dep. Tr. 175:19-176:11, *available at* <https://www.justice.gov/atr/case-document/358153>.

The only thing the parties meaningfully dispute is whether the economics of bargaining reasonably predicts how negotiations in the pay-television industry will change after this merger. The government's brief explained that the district court's findings logically dictate that the economics of bargaining fits the real world, and the self-serving testimony to the contrary was an improper basis to find otherwise. *See* Gov't Br. 37-61. In response, AT&T ignores, misstates, and doubles down on the court's errors—or it invokes findings the court never made.

**A. AT&T Ignores That The District Court's Correct Understanding Of The Pay-Television Industry Required Finding That The Economics Of Bargaining Applies**

1. AT&T does not reconcile the inherent inconsistency in the district court's opinion. It points to the court's holding that the government "failed to establish that 'the real world fit th[e] premises' underlying" its bargaining model's predictions, AT&T Br. 30, but ignores that the court's predicate findings about the real world preclude that result. The court accepted the premises of the economics of bargaining as applied to the *pre-merger* pay-television industry and found that Time Warner had bargaining leverage, which necessarily came from threatening distributors with blackouts before the merger.

See JA\_\_ (Op. 78); Gov't Br. 43. Then, in a clear error of logic, it abandoned those findings and concluded that a blackout threat would somehow not be credible *post-merger* because a blackout would be too costly for Time Warner. JA\_\_ (Op. 116). The court never explained how what is true pre-merger could be false post-merger. AT&T does not deny this inconsistency; instead, it altogether ignores the court's findings about the pre-merger world.

Regarding the pre-merger world, the district court found that “deals between programmers and distributors are invariably struck in order to avoid long-term blackouts.” JA\_\_ (Op. 72). It also recognized that, pre-merger, Time Warner “enjoys bargaining leverage with distributors,” JA\_\_ (Op. 78), and is not forced to accept “low, take-it-or-leave-it” offers to sell Turner programming, Gov't Br. 43-44. The court supported these findings by citing broad swaths of the government's Proposed Findings of Fact, *see* JA\_\_ (Op. 78), which confirm that the source of Time Warner's bargaining leverage is its threat to withhold valuable Turner programming from distributors—that is, a blackout, *see* Gov't Proposed Findings ¶¶ 114-23, 154-75 (Dkt. No. 123).

Because the source of Time Warner's bargaining leverage is its credible long-term blackout threats, *see id.*, and because the district court found that Time Warner *had* bargaining leverage before the merger, *see* JA\_\_ (Op. 78), it necessarily follows that Time Warner wielded that bargaining leverage before the merger by making credible long-term blackout threats.

The district court identified no other plausible source of Time Warner's leverage; neither does AT&T. These findings about the pre-merger world render clearly erroneous the court's findings that "a blackout would be infeasible" for Time Warner, JA\_\_ (Op. 115), and that, accordingly, "there is an insufficient evidentiary basis to support Professor Shapiro's contention that a post-merger Turner would, or even could, drive up prices by *threatening* distributors with long-term blackouts," JA\_\_ (Op. 116).

2. AT&T tries to sidestep the district court's rejection of the economics of bargaining post-merger by offering a new basis for the court's decision. AT&T claims that even if the walkaway threat of a blackout is credible, the government failed to prove that "Turner's post-merger walkaway position . . . would improve *enough* to" affect the

negotiations with distributors materially. AT&T Br. 32 (citing JA\_\_ (Op. 117 n.36)). AT&T gets the court's reasoning backward. *Because* the court found that a blackout threat was "incredible," the court reasoned that the change to Time Warner's walkaway position was irrelevant, given that the change made blackout threats "only []somewhat less incredible." JA\_\_ (Op. 117). AT&T cannot elevate a stray comment in a footnote to a holding, and its reading is contradicted by the court's repeated statements that there would be no change in bargaining leverage. *See* JA\_\_, \_\_, \_\_, \_\_-\_\_, \_\_-\_\_, \_\_ (Op. 70, 93, 99, 106-08, 111-17, 149). In any event, AT&T merely asserts rather than demonstrates that any change in Time Warner's walkaway position would be too small to matter, and it gives this Court no reason to reject the economics of bargaining.

3. AT&T's other efforts to undermine the government's use of the economics of bargaining are ineffective. AT&T erroneously contends that the government failed to establish that the economics of bargaining fits the pay-television industry, *see* AT&T Br. 26, 33 (citing cases), but there is no meaningful dispute that it does. Notably, AT&T's and DirecTV's own filings before the FCC confirm that fit.

AT&T downplays its prior position, claiming with egregious understatement that those filings only generally “endorsed use of Nash bargaining to assess vertical mergers.” *Id.* at 36. The filings stand for much more: AT&T and DirecTV advocated for the use of the same economics of bargaining to assess the effect of vertical integration between a programmer and a distributor in *this* industry. *See, e.g.*, JA\_\_ (PX0001-017) (DirecTV explaining Comcast-NBCU merger “would change the bargaining dynamic, giving Comcast-owned NBCU the incentive and ability to demand greater compensation”). Importantly, that endorsement undermines AT&T’s current argument that the economics of bargaining does not fit “the relevant industry setting.” AT&T Br. 23. The district court was wrong to discount those filings. *See* FCC Amicus Br. 2 (expressing concern over the court’s “discounting [of] the probative value of submissions made to the FCC”).

AT&T now changes course, adopting the district court’s suggestion that AT&T’s position before the FCC was “informed by the state of the market at the time of the proceeding and the particular inputs to the

models presented to the FCC,” JA\_\_ (Op. 83).<sup>3</sup> The question is whether the economics of bargaining applies to *this* industry—not which “particular” data inputs are currently accurate. There is no dispute that the government used contemporary industry evidence in applying the economics of bargaining to this merger. Aside from “Please!”, JA\_\_ (Op. 83), the court never explained why AT&T’s endorsement (and the FCC’s use) of the economics of bargaining was not compelling evidence of validity, and neither does AT&T.

Moreover, the government did not waive any argument that the district court improperly limited admission of the FCC filings. *Contra* AT&T Br. 36. Indeed, the government offered the full filings throughout trial, such that defense counsel once griped that it was “the fourth or fifth time we’ve passed on this issue.” JA\_\_ (Tr. 3943:19-20); *see* Mar. 19, 2018 A.M. Hr’g Tr. (Dkt. No. 165); JA\_\_, \_\_ (Tr. 3942:8-9, 3945:11-13).

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<sup>3</sup> AT&T, like the district court, describes firms like Hulu and Netflix as exemplifying a shift in the marketplace toward vertically integrated entities. *See* AT&T Br. 7-8; JA\_\_ (Op. 2). In the real world, however, Hulu and Netflix are not at all “vertically integrated” in the sense that AT&T-Time Warner is because, critically, they do not own the means—the wireless or fiber communication access—of delivering content to consumers.

AT&T also cannot credibly claim that the premises underlying the economics of bargaining lack empirical support. *See* AT&T Br. 26.

Witnesses explained that both sides to the negotiation consider a long-term blackout to be the alternative to reaching agreement and therefore often perform empirical “drop analyses” to determine their leverage going into negotiations. *See* Gov’t Br. 46-47.

Even defendants’ own executives testified that Time Warner exercises bargaining leverage by threatening long-term blackouts. Turner executive Coleman Breland testified that, “in recent years,” Time Warner “has come close to going dark with ‘virtually every major distributor.’” JA\_\_ (Tr. 1033:8-13). The threat is credible; Time Warner has blacked out Turner programming four times since 2006. JA\_\_ (Tr. 1042:20-23) (Breland). These blackouts ended only because the distributors made significant concessions; in other words, the prospect that the short-term blackouts would become long-term blackouts forced distributors’ hands. *See* JA\_\_-\_\_ (Tr. 459:21-461:12) (Schlichting/DISH); JA\_\_-\_\_ (Tr. 1045:22-1048:16) (Breland discussing Cable ONE blackout and stating that Turner “prevailed nicely”). Short-term blackouts thus are far from irrelevant, *contra* AT&T Br. 33-34;

Time Warner's use of them bolsters the credibility of its long-term blackout threat.<sup>4</sup>

Contrary to AT&T's claim, *see id.* at 26-29, Professor Shapiro looked to these real-world facts to conclude that his model applying the economics of bargaining was an appropriate tool for predicting post-merger prices, *see, e.g.*, JA\_\_-\_\_ (Tr. 2193:21-2196:2). He also reviewed "historical evidence" from prior vertical mergers, JA\_\_-\_\_ (Tr. 3889:25-3890:14), but concluded either that those mergers were not comparable or that the available data were insufficient, *see* JA\_\_-\_\_ (Tr. 3828:24-3836:16). Professor Shapiro's application of the economics of bargaining is thus supported by empirical evidence, which explains why AT&T and the FCC would use the economics of bargaining to analyze vertical integration in the pay-television industry.

Finally, there is no merit to AT&T's hyperbolic contention that the economics of bargaining predicts that *any* vertical merger in the pay-

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<sup>4</sup> The government never argued "that bargaining theory requires ignoring whether a threat is infeasible." *Contra* AT&T Br. 31. Instead, it demonstrated that Time Warner threatens distributors by "convincing [them] that if [they do] not act in compliance with [Time Warner's] demands," Time Warner will blackout Turner programming. *See* John Nash, *Two-Person Cooperative Games*, 21 *Econometrica* 128, 130 (1953).

television industry will result in higher programming prices. *See* AT&T Br. 25-26. As the government showed, for a merger to lessen competition substantially in violation of Section 7, the programmer must have the type of content that can drive consumers who lose it to switch, and the distributor must earn a margin on subscribers gained from the switch. *See* Gov't Br. 63. Most vertical mergers do not meet this standard. This one does.<sup>5</sup>

**B. AT&T Fails To Grapple With The District Court's Erroneous Rejection Of Corporate-Wide Profit Maximization**

AT&T unsuccessfully attempts to justify the district court's conclusion that Time Warner would not bargain with DirecTV's interests in mind. That conclusion is contrary to *Copperweld* and the "aim" of Section 7—"to arrest apprehended consequences of intercorporate relationships before those relationships could work their evil." *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586,

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<sup>5</sup> The government's opening brief explained its high standard for challenging vertical mergers. *See* Gov't Br. 1-2, 37. The government has challenged several dozen vertical mergers in the past few decades, and many of those challenges were resolved through settlement. It has also approved some without conditions when it does not find them to meet this standard.

597 (1957). AT&T makes no attempt to defend the court's actual reasoning. Instead, it argues that the court was correct to find (i) that Time Warner would not take into account the interests of DirecTV when negotiating because (ii) Time Warner could not raise Turner prices.

AT&T Br. 34. AT&T gets the court's reasoning backward. The court based its finding (ii) that the merger would not enable an increase in Turner prices in part on its erroneous finding (i) that, contrary to *Copperweld*, programmers do not take into account the interests of affiliated distributors when negotiating. See JA\_\_ (Op. 113-15). AT&T cannot assume the correctness of the court's ultimate conclusion to justify its erroneous predicate finding.

AT&T also fails to acknowledge that there is an irreconcilable inconsistency between the district court's finding that Time Warner will not consider the interests of DirecTV and the court's acceptance that the merger will eliminate double marginalization. If "maximizing [Time Warner's] programming revenues" maximizes corporate-wide profits, AT&T Br. 35, AT&T would not eliminate (or even reduce) double marginalization, *contra* JA\_\_ (Op. 67). Eliminating double marginalization maximizes corporate-wide profits because it *does not*

maximize programming revenues alone, but instead makes “distribution of Turner to its DirecTV customers more profitable.” JA\_\_ (Op. 67). Much of the court’s holding hinges on this error.

AT&T erroneously relies on self-interested testimony that a post-merger Time Warner will remain indifferent to its new owner. *See* AT&T Br. 30. Like the district court, AT&T ignores the inconsistency in its own evidence, conspicuously omitting the AT&T CEO’s trial admission that AT&T would manage the business to maximize profits overall. *See* JA\_\_-\_\_ (Tr. 3471:23-3472:15) (Stephenson).

AT&T then unsuccessfully tries to wave away the district court’s inconsistent treatment of distributor and defense witnesses as “groundless.” *See* AT&T Br. 37. It praises the court for exercising “caution” in evaluating distributors’ testimony, due to their self-interest as DirecTV’s competitors. *See id.* Notably, AT&T offers no explanation for the court’s refusal to exercise the same caution when evaluating the self-interested testimony of defendants’ executives.<sup>6</sup>

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<sup>6</sup> Caution would have been especially appropriate toward AT&T’s CEO’s testimony that post-merger prices could only go down. *See* JA\_\_-\_\_ (Tr. 3506:20-3507:2). AT&T raised DirecTV Now prices by up to 14% merely three weeks after the district court’s decision. *See* Brian Fung, *AT&T Is Hiking the Price of DirecTV Now, Despite Promising Lower*

### C. AT&T's Discussion Of "Real-World" Evidence Is Incorrect And Incomplete

Although AT&T argues the district court's analysis of "real-world evidence" negates the government's predictions of increased bargaining leverage, *see* AT&T Br. 29-30, 37-40, the evidence did no such thing, and the court's analysis otherwise reflects clearly erroneous logic.

1. AT&T incorrectly argues that the district court's factfinding function allowed it to reject distributors' testimony that Turner blackouts would be more likely post-merger. *Id.* at 37-38. The court did so in part on the erroneous ground that the testimony was speculative and contrary to Professor Shapiro's testimony. *See* JA\_\_-\_\_ (Op. 94-98). As Professor Shapiro recognized, a blackout is highly unlikely because both sides want to avoid it by reaching an agreement. That both sides want to reach an agreement, and do so most of the time, is not inconsistent with the distributors' sincere belief that *if* they did not reach agreement, a blackout would occur. *Contra* JA\_\_-\_\_ (Op. 96-97).

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*Consumer Prices in the Time Warner Trial*, Wash. Post (July 3, 2018), <https://www.washingtonpost.com/technology/2018/07/03/att-is-hiking-price-directv-now-despite-promising-lower-consumer-prices-time-warner-trial>. AT&T's convoluted attempts to explain away this testimony are meritless. *See* AT&T Br. 24 n.8.

The district court and AT&T also incorrectly fault the government for not presenting testimony that the distributors would surrender to Time Warner's greater pricing demands. *See* AT&T Br. 29 (quoting JA\_\_ (Op. 98)). No distributor's negotiator could reasonably be expected to commit on the stand to paying higher prices after the merger—nor does Section 7's reasonable-probability standard demand that much. Rather, distributors testified to the requisite reasonable probability of price increases. Charter executive Tom Montemagno stated that he was worried the merger would result in “excessive price, pricing increases.” JA\_\_ (Tr. 1350:12-13). Programming prices would increase, of course, only if distributors are convinced of the heightened threat “that a post-merger Turner could and would go dark,” JA\_\_ (Op. 97), and thus believe they have to accept those higher prices to keep Turner programming, *see* JA\_\_ (Tr. 1350:12-13) (Montemagno); *see also* JA\_\_ (Tr. 108:7-14) (Fenwick/Cox) (similar).

AT&T cannot rehabilitate the district court's faulty conclusion by pointing to testimony from certain distributors who did not think *their* negotiation strategy would change post-merger. *See* JA\_\_ (Op. 93). Such testimony is not an admission “that they would not yield to any

Turner price increases,” AT&T Br. 37, nor is it inconsistent with Professor Shapiro’s prediction that they would so yield. What the merger changes is *AT&T-Time Warner’s* incentive and ability to hold out for more money and thus alter the outcome of the negotiations. Testimony about the *distributors’* post-merger strategy is beside the point.

2. AT&T overstates the district court’s reliance on “real-world evidence” in the form of Professor Carlton’s econometric studies. *See* AT&T Br. 27-29. The court expressly “afforded probative weight” only to his analysis of *one* prior transaction: “the Comcast-NBCU combination.” JA\_\_ (Op. 105). Professor Carlton’s analysis, however, is unsurprising and uninformative because he studied only non-analogous instances of vertical integration—that is, where the government either brought no challenge or settled its challenge with conditions to remedy the merger’s anticompetitive effect.

AT&T repeatedly cries forfeiture of any challenge to Professor Carlton’s analyses, AT&T Br. 21, 27-28, but neither the district court nor AT&T claimed that Professor Carlton’s Comcast-NBCU analysis is an independent basis for decision. It is merely one of many inapposite

pieces of evidence that AT&T offered to cast doubt on the government's bargaining model. The court found this analysis merely "appropriate to consider," JA\_\_ (Op. 105 n.30), not dispositive, and in so doing revealed why it was inapposite. The court-ordered arbitration in Comcast-NBCU was, in the court's view, similar to the "arbitration proceedings envisioned by Turner's offer." JA\_\_ (Op. 104). The court never found, however, that Turner's arbitration offer was properly considered in predicting the likely harms from the merger. Section I.C.3, *infra*.

3. AT&T erroneously criticizes Professor Shapiro's analysis for not incorporating Turner's offer to arbitrate distributor-fee disputes. *See* AT&T Br. 13-14, 38-40. Were distributors to accept the offer, the argument goes, no blackout would result from failing to reach agreement.

Turner's arbitration "commitment" is a meager unilateral attempt at a remedy after the government's suit. It, therefore, cannot overcome the sufficiency of the government's evidence on liability. The offer played a bit part in the district court's analysis—appearing in a footnote only as "extra icing on a cake already frosted." JA\_\_ (Op. 149 n.51); *see also* JA\_\_ (Mar. 13, 2018 Minute Order) (summarily denying

government motion in limine to exclude offer). The court merely adverted to its “confidence,” or “reason to believe,” that the arbitration offer would have some unspecified “real-world effect.” JA\_\_\_, \_\_\_-\_\_\_ (Op. 105 n.30, 149-50 n.51). The court did not rely on its “confidence” in evaluating the government’s evidence or theory of harm. *Contra* AT&T Br. 40. Thus, there was no “challenge” to be “forfeited.” *Contra id.*<sup>7</sup> Because the court stopped short of making factual findings on the arbitration offer, AT&T is implicitly, and inappropriately, asking this Court to make such findings in the first instance.

The district court, like Professor Shapiro, was right not to make much of Turner’s offer. AT&T’s claim that “Turner has irrevocably bound itself,” AT&T Br. 39, is incorrect. Under the law of Georgia (where Turner is headquartered), Turner can revoke the offer prior to acceptance because it made the offer without consideration. *See, e.g., Sparks v. State*, 501 S.E.2d 562, 567 (Ga. Ct. App. 1998).

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<sup>7</sup> The same is true of the district court’s cursory reference to the FCC’s program-access rules, JA\_\_\_-\_\_\_ (Op. 149-50 n.51). *See* AT&T Br. 40 n.16. These rules, however, bar vertically integrated firms only from *discriminatorily* increasing programming prices; they do not bar them from *uniformly* raising prices. *See In re Comcast Corp.*, 26 F.C.C. Rcd. 4238, ¶ 49 (2011) (same for Comcast-NBCU merger).

Moreover, enabling a defendant to avoid liability by promising to modify its behavior temporarily would “allow a party to thwart judicial review through its own machinations” and “create incentives for firms to take similar actions in the future to evade antitrust review.” *United States v. Aetna Inc.*, 240 F. Supp. 3d 1, 78 (D.D.C. 2017) (citing *United States v. W.T. Grant Co.*, 345 U.S. 629, 632 (1953); *United States v. Trans-Mo. Freight Ass’n*, 166 U.S. 290, 309 (1897)). This prospect threatens effective merger enforcement far beyond this case.

## **II. AT&T CANNOT JUSTIFY THE DISTRICT COURT’S CLEARLY ERRONEOUS DISMISSAL OF PROFESSOR SHAPIRO’S QUANTIFICATION OF HARM**

The bargaining model is an accepted and reliable predictor of competitive effects in the pay-television industry, and Professor Shapiro used reasonable inputs to quantify the magnitude of cost increases that AT&T would impose on rivals through negotiations—and the consequent higher prices for consumers—separate and apart from the non-quantifiable harms of the merger, such as reduced choice and stymied innovation, *see* Gov’t Br. 36-37. The district court’s rejection of the quantification is inconsistent with Section 7’s reasonable-probability standard and reflects a misunderstanding of key elements of

the model. The court's skepticism about the particular inputs, in any event, does not justify the ultimate finding of zero price increase to rivals, making a remand necessary.

**A. AT&T Mischaracterizes And Ignores Several Of The District Court's Overarching Errors**

1. The government's brief explained that two of the district court's analytical errors undermine its rejection of Professor Shapiro's modeling. *See* Gov't Br. 63-65. The first involves the court's erroneous conclusion that Professor Shapiro conceded the merger "would lead to \$352 million in annual cost savings on the part of AT&T's customers." JA\_\_ (Op. 57). The court used the wrong number, which AT&T acknowledges by referencing only \$78 million in predicted consumer savings throughout its brief.

AT&T ignores, however, that the district court's conclusion reflects its misunderstanding of the modeling. The court's acceptance of the model's prediction of annual savings cannot be reconciled with its rejection of the model's prediction of consumer harm. *See* JA\_\_ (Op. 149). Both are outputs of the same model; one cannot be right and somehow the other wrong.

AT&T also ignores that the district court's analysis is incomplete. The court first incorrectly asserted that the government did not prove "the challenged merger would lead to *any* raised costs on the part of distributors," JA\_\_ (Op. 149), but that conclusion was illogical given that no one at trial claimed the harm was as low as zero, *see* Gov't Br. 63-64. The court then stated there were "\$352 million in annual cost savings on the part of AT&T's customers," JA\_\_ (Op. 57), and that the government did not prove "price increases that outweigh [those] conceded . . . benefits to consumers," JA\_\_ (Op. 71 n.23). The \$352 million figure, however, is an estimate of *AT&T's* savings from the elimination of double marginalization, *see* JA\_\_-\_\_ (Tr. 2250:22-2253:15), not an estimate of consumer-level benefits. For the court's crediting of those savings to AT&T to be meaningful to a Section 7 analysis, the court must also (i) determine the extent to which AT&T would pass on those savings to consumers, and (ii) balance the passed-on savings against the consumer harm. *See* Gov't Br. 63-64. The court did neither, making a remand necessary for the court to perform the correct analysis.

Lastly, both AT&T and the district court repeatedly call the savings a “concession.” It is not. The government’s inclusion of savings in its modeling “served as a redoubt against [defendants’] evidence” that procompetitive benefits of the merger “would offset the merger’s substantial lessening of competition.” *Chi. Bridge & Iron Co. N.V. v. FTC*, 534 F.3d 410, 424 (5th Cir. 2008). The defendants retained the burden of producing evidence of procompetitive benefits, including the elimination of double marginalization. Whether they have done so is a question for remand.

2. The district court’s second analytical error was demanding a degree of certainty in quantifying the harm to competition inconsistent with Section 7’s reasonable-probability standard. Gov’t Br. 4-5, 64-65; *see, e.g., Heinz*, 246 F.3d at 719 (it is not the government’s “burden to prove [consumer price effects] with ‘certainty’”). The court compounded the error by failing to give the government credit for proving any increase in Turner carriage fees *at all*. Predicting future competitive effects requires reliance on imperfect data and economic models that simplify the real world, JA\_\_ (Tr. 2475:15-16) (Carlton) (“as I said at the beginning, there’s never perfect evidence, you know, probably in any

case”), and hence the predictive judgment is “necessarily probabilistic and judgmental rather than demonstrable,” *Heinz*, 246 F.3d at 719 (quoting *Hosp. Corp. of Am. v. FTC*, 807 F.2d 1381, 1389 (7th Cir. 1986)). The court required precise quantification of harm—a standard contrary to law.

AT&T ignores the government’s argument and wrongly claims that aspects of it are waived. AT&T contends that the government “identifies no flaw in the district court’s assessment of the reliability of Professor Shapiro’s modeling results,” AT&T Br. 45, overlooking the section of the government’s brief devoted to that argument, *see, e.g.*, Gov’t Br. 64-71. AT&T also unsuccessfully attempts to bolster the court’s “assessment,” first by using a demonstrative exhibit that was not admitted as evidence and therefore should be disregarded. *See* AT&T Br. 43-44, 54. It then trivializes the model’s predicted harm to consumers by arbitrarily describing the predicted price increase from higher Turner carriage fees in terms of the percentage increase to a monthly cable bill. *See id.* at 43-44, 54. The product that is the subject of the bargaining model, however, is the portion of the bill accounting for the cost of Turner programming—what Professor Shapiro

conservatively estimates will increase for consumers by a net of \$286 million annually. JA \_\_, \_\_-\_\_ (Tr. 2255:7-22, 2258:23-2259:13). That is not trivial.

Next, AT&T mistakenly contends the government forfeited its challenge to the district court's criticism of Professor Shapiro's analysis for lacking "statistical tests," JA \_\_ (Op. 120 n.38). *See* AT&T Br. 45 n.20. To the contrary, the government *expressly* identified this error and explained that the court's criticism made no sense. *See* Gov't Br. 64-65 & n.6. Professor Shapiro recognized and accounted for uncertainty about the parameters (for example, the subscriber loss rate) in his model by using conservative numbers. JA \_\_, \_\_-\_\_, \_\_-\_\_ (Tr. 2233:14-16, 2238:15-2239:9, 2243:1-2246:19). The observation of these values did not involve sampling and therefore did not lend itself to statistical testing.

AT&T additionally argues, incorrectly, that the government forfeited a challenge to the district court's conclusion that Professor Shapiro's model lacked probative value because the predicted harm would not manifest immediately. *See* AT&T Br. 56, 58. The court did no more than conclude that the existence of long-term contracts

“[f]urther [u]ndermines [the model’s] [p]robative [v]alue,” JA\_\_ (Op. 146), however, and the government’s argument that the court required a degree of certainty inconsistent with Section 7 encompasses the court’s concern that “the predictions of harm are not ‘sufficiently probable and imminent,’” JA\_\_ (Op. 148). Indeed, the government cited the court’s faulty conclusion on this issue as evidence that the court applied an erroneously high standard in finding “no probative value in Professor Shapiro’s predictions.” Gov’t Br. 65 (citing JA\_\_ (Op. 149)).

On the merits, AT&T wrongly asserts that the district court held that the government “had no plausible basis for speculating about price effects in 2021 and beyond.” AT&T Br. 56. The court held only that Professor Shapiro sensibly acknowledged that prediction “gets harder” past 2021. JA\_\_ (Op. 147). Neither the court nor AT&T claims that this is a ground to reject the government’s showing.

Moreover, the presence of long-term contracts does not vitiate Section 7’s application; when competition for a long-term contract has already occurred, the analysis shifts to competition outside or after the contract. *See United States v. El Paso Nat. Gas Co.*, 376 U.S. 651, 662 (1964) (although long-term contracts meant “there is no competition . . .

except as respects the incremental needs,” Section 7 still applied).

Section 7 “requires a prognosis of the probable *future* effect of the merger,” see *Brown Shoe Co. v. United States*, 370 U.S. 294, 332 (1962), and “[t]he proper timeframe for evaluating the effects of the merger on future competition must be ‘functionally viewed, in the context of its particular industry,’” *Aetna*, 240 F. Supp. 3d at 79 (quoting *Brown Shoe*, 370 U.S. at 321-22). Professor Shapiro’s model supplied the required “prognosis,” predicting how the merger is likely to harm consumers going forward. See JA\_\_ (Op. 146). His analysis was consistent with Section 7; the court’s was erroneous.

**B. AT&T Does Not Refute The Government’s Showing That The District Court Clearly Erred In Rejecting Professor Shapiro’s Reasonable Inputs**

**1. Subscriber Loss Rate**

AT&T’s defense of the district court’s rejection of Professor Shapiro’s specific inputs fails. AT&T again claims waiver, inaccurately asserting that the government “never argued and Professor Shapiro never testified that subscriber-loss figures should be calculated on the basis of each distributor’s own ‘subjective understanding.’” AT&T Br. 49. To the contrary, the government presented industry witnesses

at trial for this reason, and Professor Shapiro explained how subjective understanding affects bargaining leverage, JA\_\_ (Tr. 2195:19-21); *see also* Gov't Br. 66-67.

Additionally, AT&T erroneously criticizes Professor Shapiro for using a single subscriber loss rate for all distributors, oversimplifying his analysis. *See* AT&T Br. 49-50. Professor Shapiro identified a reasonable range of 9-14% based on a variety of industry sources, including the Altman analysis and [REDACTED].<sup>8</sup> He then used the bottom of the range as a reasonable estimate of what distributors were likely to determine their subscriber loss rates would be. *See* Gov't Br. 66-68. This conservative analysis satisfies Section 7's reasonable-probability standard.

There is nothing "dubious" about Professor Shapiro's use of the Altman analysis. *Contra* AT&T Br. 49. The relevant consideration is what Charter believed its subscriber loss rate would be. Charter commissioned the Altman analysis for that purpose, and Charter's negotiator testified that Altman's estimates were "helpful" in preparing

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<sup>8</sup> Contrary to AT&T's assertion, the government challenged the district court's failure to engage with Professor Shapiro's reliance on [REDACTED]. Gov't Br. 66-67; *see also, e.g.*, [REDACTED].

for recent negotiations. JA\_\_-\_\_ (Tr. 1347:22-1349:6). *Contra* AT&T Br. 50.

AT&T insinuates that the Altman numbers were inappropriately increased from 5% to 9%. *See* AT&T Br. 48. The truth is just the opposite. Altman used three different methodologies, initially generating rates of 5%, 14%, and 14%, JA\_\_-\_\_ (Tr. 1280:22-1281:22), and recommended Charter use 14%, JA\_\_ (Tr. 1281:23-1282:2). Altman, on its own initiative, later adjusted the 5% rate to 9% based on a quantitative analysis, JA\_\_-\_\_ (Tr. 1282:3-1283:6), and lowered its recommended rate from 14% to 9%, *id.*; JA\_\_ (1287:3-13). Contrary to AT&T's dubious claim, Altman did not "selectively raise[]" its recommendation, AT&T Br. 48, but rather *lowered* it.

As for AT&T's arguments about other values that Professor Shapiro should have used, AT&T is wrong that the court made any finding of "the correct value." *See id.* at 47. The court noted the existence of other values, JA\_\_-\_\_ (Op. 129-30), but made no findings about their relevance or accuracy. It also referenced subscriber losses from Turner's short-term blackouts, JA\_\_ (Op. 137 n.45), but the undisputed metric in Professor Shapiro's model is the subscriber loss

rate for long-term blackouts. *See, e.g.*, JA\_\_-\_\_ (Tr. 2578:15-2479:14) (Carlton).

## 2. Diversion Rate

AT&T's arguments concerning the diversion rate also fail to justify the district court's erroneous rejection of an input derived from the Altman analysis. *See* AT&T Br. 51-53. The study's projections were sufficient for Charter to use in real-world negotiations, and they comported with Section 7's reasonable-probability standard.

To be clear, neither AT&T nor the court found any flaw in the baseline diversion figure that Professor Shapiro calculated, which used AT&T's market share to estimate the number of customers AT&T stood to gain from a long-term Turner blackout with a rival distributor. *See* JA\_\_-\_\_ (Op. 137-38). AT&T challenges only a minor factor in Professor Shapiro's estimate of the diversion rate, nitpicking his use of a 10% discount from the baseline to account for the share of customers who would not go to any distributor (MVPD *or* virtual MVPD), but instead would "cut the cord" entirely.

The court misstepped in rejecting the Altman discount based on Professor Carlton's opinion, the SNL Kagan data, and AT&T surveys.

AT&T claims that the court “did not need to” rely on those sources, but effectively concedes the court did. AT&T Br. 52 (quoting the court’s conclusion that the lack of explanation regarding the Altman analysis “coupled with” AT&T’s evidence left the court “with little confidence” in the 10% figure). AT&T tries to minimize the role of those sources, but they misled the court and are insufficient bases to reject the 10% discount rate.

AT&T misleadingly states that “20% of households are cord-cutters” and that Professor Shapiro “slash[ed] the cord-cutting number in half.” *Id.* at 51. Professor Carlton’s and SNL Kagan’s 20% figure identified the percentage of households that do not *currently* have any MVPD or virtual MVPD service, not the percentage that would *discontinue* their MVPD service in the event of a Turner blackout and not switch to another MVPD or virtual MVPD. A person dropping an MVPD due to a Turner blackout obviously values Turner programming more than one electing not to subscribe to any MVPD or virtual MVPD service in the first place. *See, e.g.*, JA\_\_-\_\_ (Tr. 3807:10-3808:21). This is an important distinction.

Likewise, AT&T's survey of customers departing from DirecTV for "cord cutting" did not measure the relevant fraction. *See* JA\_\_ (Tr. 2506:19-24). Its figure identified neither the number of customers who would leave due to a Turner blackout, nor clearly excluded customers who would go on to sign up for a *virtual* MVPD (and thus customers who are not a part of the discount rate). *See id.*

### 3. DirecTV's Margin

Unmentioned in AT&T's argument that Professor Shapiro used "outdated and inflated margins," AT&T Br. 53, is that, even using its late-produced 2017 margin data, the model predicts significant consumer harm from increased carriage fees. Using an average from the 2017 data provided, MVPDs would pay an extra \$98 million per year for Turner programming, and every customer would pay an extra \$0.13 per month for service. JA\_\_ (Op. 144). Even using the *lowest*, outlier monthly figure that AT&T produced (June 2017), MVPDs would pay about \$30 million more. JA\_\_, \_\_ (Tr. 3811:8-18, 3850:6-19). Professor Shapiro prepared additional estimates of harm using the 2017 data, but the district court wrongly limited the government's rebuttal case and excluded this evidence. Gov't Br. 71.

Professor Shapiro's 2016 margin estimate was reliable, subject to the inherent, and agreed upon, limitations of litigation. AT&T reiterates the court's erroneous claim that the underlying 2017 margin data was available to Professor Shapiro when he submitted his rebuttal report on February 28, 2018. AT&T Br. 53. It was not. One DirecTV executive mentioned the June 2017 margin *figure* in a February 14, 2018, deposition. JA\_\_ (Op. 143 & n.48). The underlying *data* were first produced with Professor Carlton's rebuttal report on February 28—and, even then, included only the January, April, and June 2017 margins.

There is also no good reason to find the June 2017 figure—on which Professor Carlton solely relied—reliable. It shows about a 40% decline from 2016 figures. JA\_\_ (Op. 142). Professor Carlton could not explain the curious drop in the June 2017 figure, nor the absence of data for February, March, or May 2017, shrugging, "I didn't do an investigation." JA\_\_, \_\_ (Tr. 2579:7-21, 2581:14).

\* \* \*

Given the district court's illogical conclusion that the merger will lead to no change in bargaining leverage, and its erroneous finding of no consumer harm, a remand is necessary.

### CONCLUSION

The judgment below should be vacated, and the case remanded.

Respectfully submitted.

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October 11, 2018

## CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limit of Fed. R. App. P. 32(a)(7)(B) because, excluding the parts exempted by Fed. R. App. P. 32(f), the brief contains 6,492 words.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(b) because the brief has been prepared in Microsoft Word 2010, using 14-point New Century Schoolbook font, a proportionally spaced typeface.

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**CERTIFICATE OF SERVICE**

I certify that on October 11, 2018, I caused the public, redacted version of the foregoing brief to be filed through this Court's CM/ECF system, which will serve a notice of electronic filing on all registered users, including counsel for Defendants-Appellees. In addition, I caused two paper copies of the public, redacted version of the brief and two paper copies of the sealed, unredacted version of the brief to be hand delivered, as instructed by counsel for Defendants-Appellees, on:

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