DOJ v. AT&T Looms Over U.S. Business

WSJ 3-16-18 P.A1

Trial over Time Warner deal has broad ramifications for antitrust enforcement across industries

By Brent Kendall and Drew FitzGerald

WASHINGTON—The government accuses the company's chief executive of behaving like the disingenuous Captain Renault in the film "Casablanca." The company likens the government's case to a shaved Persian cat, "pale and thin."

A federal judge in Washington, D.C., next week will hear a case that may settle one of the biggest antitrust issues of modern times.

The face-off, between the Justice Department and AT&T Inc. over the company's $85 billion agreement to buy media giant Time Warner Inc., has broad ramifications for media, technology and other industries as well as for the government's powers to deter large-scale corporate consolidation.

It could determine whether antitrust enforcers will have real practical authority to challenge so-called vertical mergers involving two complementary companies that operate at different levels of the same industry. Typically, the government challenges unions of direct competitors that sell similar products and services, or horizontal mergers.

The ruling could affect major pending health-care mergers and may have ramifications for the tech economy. If the deal is allowed, AT&T argues, it could act as a bulwark against the power of digital media giants such as Alphabet Inc.'s Google and Facebook Inc. Or it could create an entertainment behemoth that holds consumers hostage, as the government insists.

The outcome could also affect how strongly the Trump administration, with its rival populist and pro-business factions, pursues the kind of vigorous antitrust enforcement that was a hallmark of the Obama administration.

The battle is unusual because AT&T and Time Warner aren't head-to-head competitors. They want to combine AT&T's video-distribution network with Time Warner's content—from HBO's "Game of Thrones" to the NCAA basketball tournament—in a move to integrate different links in the same supply chain.

"This will be the first court decision on a vertical merger in a very long time," said Wayne State University law professor Stephen Calkins, "and what the court says will be terribly important."

The case is a pivotal moment in a recurring clash between merger mania and government enforcement, and the drama has produced two lead actors: AT&T boss Randall Stephenson and U.S. antitrust chief Makan Delrahim.

Mr. Stephenson has come to personify the hard-charging executive whose approach to guiding a corporate titan through a rapidly changing landscape is to get bigger. Mr. Delrahim emerged last year as a surprising foil, a Republican antitrust enforcer who moved swiftly to file suit against the deal—the type of merger challenge some liberal officials longed to bring but never did.

The case comes as viewers are demanding more ways to watch video programming at lower prices. Millions have abandoned cable and satellite-TV contracts for other options. Some have turned to cheaper packages online. Others have dropped traditional programming entirely, finding their entertainment on Netflix Inc., Amazon.com Inc., Hulu and Alphabet Inc.'s YouTube. Younger customers increasingly watch video on phones, tablets and laptops.

The upheaval has left the pay-TV industry scrambling. Mr. Stephenson made a $49 billion play for video distribution by acquiring DirecTV, the top U.S. pay-TV satellite service, in 2015. He's now trying to make the company's wireless and video bundles more attractive to viewers and investors by adding Time Warner news, sports and entertainment assets to the package.

Given Mr. Delrahim's objections, the deal has been pending for 17 months, creating something of an industry chessboard frozen in time, with competitors uncertain of their next play.

If AT&T wins, it could embolden rivals such as Comcast and Verizon Communications Inc. and clear the way for a market dominated by internet-media hybrids. A loss could leave the media industry wide open as programmers and distributors search for ways to adapt to changing consumer tastes.

The case raises this central question: If AT&T buys Time Warner, would it lead to substantially less competition? Both sides lay out their arguments in court papers filed in the case.

Mr. Delrahim's team says yes. The deal would mean higher prices and sluggish innovation, the department says in the filings, and "American consumers will end up paying hundreds of millions of dollars more than they do now to watch their favorite programs on TV."

Pay-TV ecosystem

The department acknowledges AT&T and Time Warner aren't direct rivals, but argues the deal could broadly harm the public because the merged firm would have too much power in the pay-TV ecosystem. It says Time Warner's content, especially the Turner networks—including TBS, TNT, CNN, Cartoon Network and truTV—are competitively significant, with consumers expecting pay-TV packages will include those channels.

If AT&T owns Time Warner, it could threaten to withhold the Turner channels from rivals of DirecTV unless they pay higher fees, a move that would ultimately lead to higher consumer cable bills, the department alleges. It says AT&T could limit the ability of rivals to offer promotions on Time Warner's HBO, the most popular premium television channel, as a way to add subscribers or retain customers.

On the innovation front, the department says an independent Time Warner has been eager to offer its channels as part of online packages that break from the traditional cable model but wouldn't be so willing under AT&T. "With the merger, Time Warner would turn from friend to foe," it says in filings.

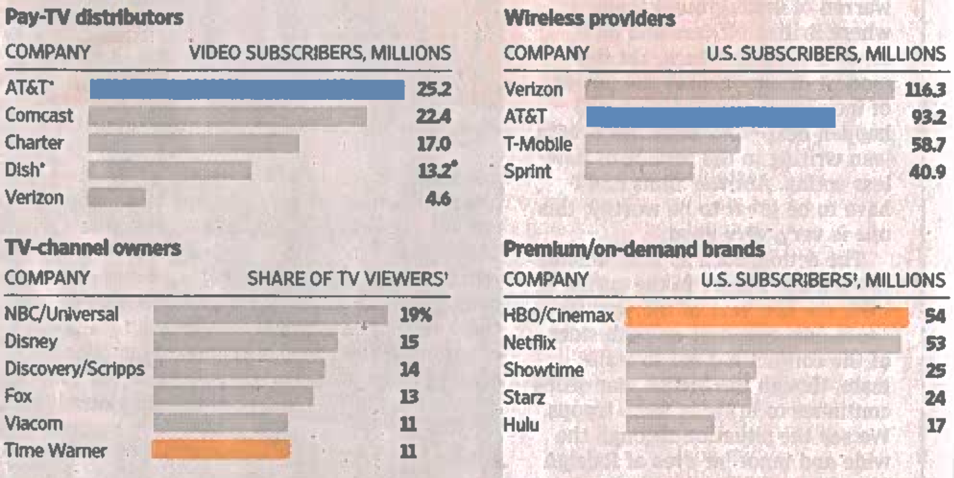
AT&T rival Comcast is likely to come up frequently in the case. An AT&T victory, the DOJ says, would give it and Comcast a stranglehold on the industry. But the department in 2011 allowed Comcast to take control of NBCUniversal, creating an integrated giant similar to what AT&T now wants to become.

The DOJ under Barack Obama allowed the Comcast deal after imposing restrictions

THE WALL STREET JOURNAL.

Industry Standing

AT&T and Time Warner already compete with different players in various markets. How they stack up:



*Includes 1.2M DirecTV Now connections and 2.2M Sling TV subscribers †Share of broadcast and cable programs watched live or within seven days for the current season (Sept. 25, 2017 - Feb. 25, 2018) ‡Estimates
Sources: Leichtman Research Group (pay TV); MoffettNathanson (TV channels); Kagan, S&P Global Market Intelligence (premium/on-demand TV); the companies

THE WALL STREET JOURNAL.

on Comcast's business tactics after the merger. DOJ leadership under Mr. Delrahim has made clear it opposes the approval of mergers based on those types of "behavioral" conditions.

AT&T and Time Warner say in court filings there is no valid legal argument for preventing the combination of complementary companies. They deny anyone's customers would pay more for TV and dispute the idea that anything they do will stop customers from cutting the cable cord. "AT&T and Time Warner aren't seeking to hold back the tide, as the government asserts, but to ride an irresistible wave," the companies say. AT&T says it would lose money withholding Time Warner programming from rival pay-TV distributors. As an assurance, the company offered rival video distributors the opportunity, for seven years, to let an arbitrator pick appropriate fees for the Turner channels if negotiations fail. The DOJ says the arbitration offer doesn't remedy the merger's harms to competition.

Where Mr. Delrahim and the government see a behemoth in the making, Mr. Stephenson and the companies envision the emergence of a streamlined rival ready to take on already-powerful competitors. The deal, they say in court filings, would give Time Warner access to AT&T's infrastructure for selling directly to consumers and, equally important, would provide Time Warner personalized data about AT&T customers' interests and preferences.

By joining forces, the companies have said publicly and in court documents, they can create a unique platform that allows advertisers to buy commercials targeted to specific viewers, creating an alternative to Google and Facebook, which have built businesses using consumer data to sell targeted ads.

High-stakes litigation always tends to produce bad blood, but the level of hostility in the AT&T case has been pronounced. Messrs. Stephenson and Delrahim have taken public shots at one another, even if rarely referring to each other by name.

'Shocked, shocked'

The two also have appeared to express fundamentally different recollections of their own face-to-face conversations. Mr. Stephenson has said publicly he never offered to sell CNN, a constant target of criticism by President Donald Trump, as a carrot to win DOJ approval.

Mr. Delrahim, in a sworn legal affidavit obtained by The Wall Street Journal under the Freedom of Information Act, said Mr. Stephenson indeed asked him whether the DOJ would approve the deal if AT&T sold CNN.

The DOJ in a brief last week mocked Mr. Stephenson's professed surprise at getting sued, noting the CEO previously said AT&T had been making litigation preparations from the outset. The government compared him to Captain Renault, the corrupt Vichy police prefect in the film "Casablanca," quoting his famous line, "I'm shocked, shocked to find that gambling is going on in here!"

If AT&T buys Time Warner, would it lead to substantially less competition?

People close to AT&T's management say the department's lawsuit surprised Mr. Stephenson, a lifelong Republican often vexed by Mr. Trump's unpredictable statements.

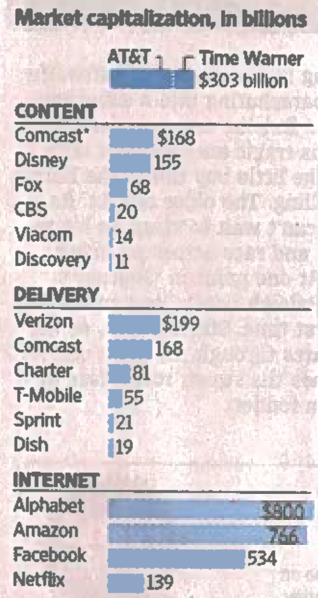
AT&T, in its own brief, said the department's legal arguments fell apart in trial preparations, writing: "Now, what remains of the government's case, 'like a Persian cat with its fur shaved, is alarmingly pale and thin,' " borrowing a turn of phrase from a 1992 case.

That choice of words raised eyebrows among some people close to Mr. Delrahim, who is of Persian descent.

U.S. District Judge Richard Leon will open the proceedings March 19. This isn't a jury trial. The judge alone, who oversaw the Comcast-NBCU settlement, will decide the merger's fate.

Giant Combination

A combined AT&T-Time Warner would dwarf traditional media firms but lag behind new internet players in market value.



*owns NBC/Universal
Note: As of March 14
Source: FactSet

THE WALL STREET JOURNAL.

FROM LEFT: ANDREW HARRER/BLOOMBERG NEWS; CLIFF OWEN/ASSOCIATED PRESS

AT&T CEO Randall Stephenson, left, is facing off with U.S. antitrust chief Makan Delrahim, right, over AT&T's Time Warner deal.

The DOJ presents its case first, with a roster of witnesses likely to include officials from rival companies.

AT&T and Time Warner will spend a good portion of their defense on testimony from their own executives, including Mr. Stephenson and Time Warner CEO Jeff Bewkes, about what they see as the deal's benefits.

Judge Leon, a George W. Bush appointee, is expected to rule in the next few months. The companies extended their merger agreement from April 22 to June 21 to give him more time.

Mr. Trump's comments hang over the case. After AT&T announced the deal in October 2016, Candidate Trump unequivocally said his administration would never allow the deal to be approved. After the department filed its lawsuit, Mr. Trump said he shouldn't comment on the litigation, then added: "Personally, I've always felt that that was a deal that's not good for the country. I think your pricing is going to go up."

There is no shortage of observers who believe Mr. Trump's position was motivated not by antitrust principles but by his distaste for CNN, whose news coverage he has criticized fiercely. Mr. Stephenson has called the tensions between Mr. Trump and CNN the "elephant in the room" when it comes to deciphering why the DOJ sued.

Mr. Delrahim has publicly said Mr. Trump and the White House didn't influence his decision to sue AT&T. The telecom giant laid the groundwork to make Mr. Trump's comments an issue in the trial, but Judge Leon denied AT&T's request to access certain internal government communications about the deal. The company hadn't shown it had been especially singled out for disfavored treatment, the judge concluded.

Judge Leon's ruling could be a career-defining moment for Messrs. Delrahim and Stephenson. Both, in a sense, have pushed all of their poker chips to the middle of the table.

The AT&T head has made clear the Time Warner acquisition is integral to his vision for the company—and equally clear he believes the government is treating AT&T unfairly. The bespectacled Oklahoman has spent his 35-year career at AT&T and its predecessor companies. His tenure as CEO includes a 2011 loss to the DOJ that scuttled a $39 billion bid for wireless rival T-Mobile, a failure that cost AT&T more than $4 billion.

Mr. Delrahim previously served in the department's antitrust division in the George W. Bush administration. With the AT&T case, he brought one of the most consequential merger lawsuits in a generation within weeks of taking office last fall, under highly unusual circumstances because of Mr. Trump's comments about the deal.

The DOJ has been riding a decade's momentum in court, with Obama antitrust enforcers succeeding in blocking several deals in which major rivals sought to merge.

Mr. Delrahim's opening act could either take that momentum to historical heights or deliver a painful blow to the department at a time when a new wave of deal making could be on the horizon.

The Antitrust Case Against America's Technology Behemoths

WSJ 1-17-18 p. A1

Amazon, Google and Facebook are as dominant as Ma Bell once was. Are consumers harmed?

By Greg Ip

Standard Oil Co. and American Telephone and Telegraph Co. were the technological titans of their day, commanding more than 80% of their markets.

Today's tech giants are just as dominant: In the U.S., Alphabet Inc.'s Google drives 89% of internet search; 95% of young adults on the internet use a Facebook Inc. product; and Amazon.com Inc. now accounts for 75% of electronic book sales. Those firms that aren't monopolists are duopolists: Google and Facebook absorbed 63% of online ad spending last year; Google and Apple Inc. provide 99% of mobile phone operating systems; while Apple and Microsoft Corp. supply 95% of desktop operating systems.

A growing number of critics think these tech giants need to be broken up or regulated as Standard Oil and AT&T once were. Their alleged sins run the gamut from disseminating fake news and fostering addiction to laying waste to small towns' shopping districts. But antitrust regulators have a narrow test: Does their size leave consumers worse off?

By that standard, there isn't a clear case for going after big tech—at least for now. They are driving down prices and rolling out new and often improved products and services every week.

That may not be true in the future: If market dominance means fewer competitors and less innovation, consumers will be worse off than if those companies had been restrained. "The impact on innovation can be the most important competitive effect" in an antitrust case, says Fiona Scott Morton, a Yale University economist who served in the Justice Department's antitrust division under Barack Obama.

Google which has spent the past eight years in the sights of European and American antitrust authorities, is hardly a price gouger. Most of its products are free to consumers and the price advertisers pay Google per click has fallen by a third the past three years. The company remains an innovation powerhouse, investing in new products such as its voice-activated assistant Google Home.

Key differences

Yet Google's monopoly means some features and prices that competitors offered never made it in front of customers. Yelp Inc., which in 2004 began aggregating detailed information and user reviews of local services, such as restaurants and stores, claims Google altered its search results to hurt Yelp and help its own competing service. While Yelp survived, it has retreated from Europe, and several similar local search services have faded.

"Forty percent of Google search is local," says Luther Lowe, the company's head of public policy. "There should be hundreds of Yelps. There's not. No one is pitching investors to build a service that relies on discovery through Facebook or Google to grow, because venture capitalists think it's a poor bet."

There are key differences between today's tech giants and monopolists of previous eras. Standard Oil and AT&T used trusts, regulations and patents to keep out or co-opt competitors. They were respected but unloved. By contrast, Google and Facebook give away their main product, while Amazon undercuts traditional retailers so aggressively it may be holding down inflation. None enjoys a government-sanctioned monopoly; all invest prodigiously in new products. Alphabet plows 16% of revenue back into research and development; for Facebook it's 21%—ratios far higher than other companies. All are among the public's most loved brands, according to polls by Morning Consult.

Yet there are also important parallels. The monopolies of old and of today were built on proprietary technology and physical networks that drove down costs while locking in customers, erecting formidable barriers to entry. Just as Standard Oil and AT&T were once critical to the nation's economic infrastructure, today's tech giants are gatekeepers to the internet economy. If they're imposing a cost, it may not be what customers pay but the products they never see.

In its youth Standard Oil was as revered for its technological and commercial brilliance as any big tech company today. John D. Rockefeller began with a single refinery in Cleveland in 1863 and over the next few decades acquired other, weaker refineries. Those that wouldn't sell, he underpriced and drove out of business. By 1904, companies controlled by Standard Oil produced 87% of refined oil output, according to Mike Scherer, a retired Harvard economist who has written extensively on antitrust.

This wasn't superficially bad for consumers. The price of kerosene, the principal refined product from oil, fell steadily as Standard Oil's market share expanded, thanks to falling crude oil prices and Standard Oil's economies of scale, bargaining power with suppliers such as railroads, and innovation, such as the Frasch-Burton process for deriving kerosene from high-sulfur oil in Ohio.

When the federal government sued to break up Standard Oil, the Supreme Court acknowledged business acumen was important to the company's early success, but concluded that was eventually supplanted by a single-minded determination to drive others out of the market.

In a 2005 paper, Mr. Scherer found that Standard Oil was indeed a prolific generator of patents in its early years, but that slowed once it achieved dominance. Around 1909 Standard's Indiana unit invented "thermal cracking" to improve gasoline refining to meet nascent demand from automobiles, but the company's head office thought the technology too dangerous and refused to commercialize it. After the Indiana unit was spun off when the company was broken up in 1911, it commercialized the technology to enormous success, Mr. Scherer wrote.

The story of AT&T is similar. It owed its early growth and dominant market position to Alexander Graham Bell's 1876 patent for the telephone. After the related patents expired in the 1890s, new exchanges sprung up in countless cities to compete.

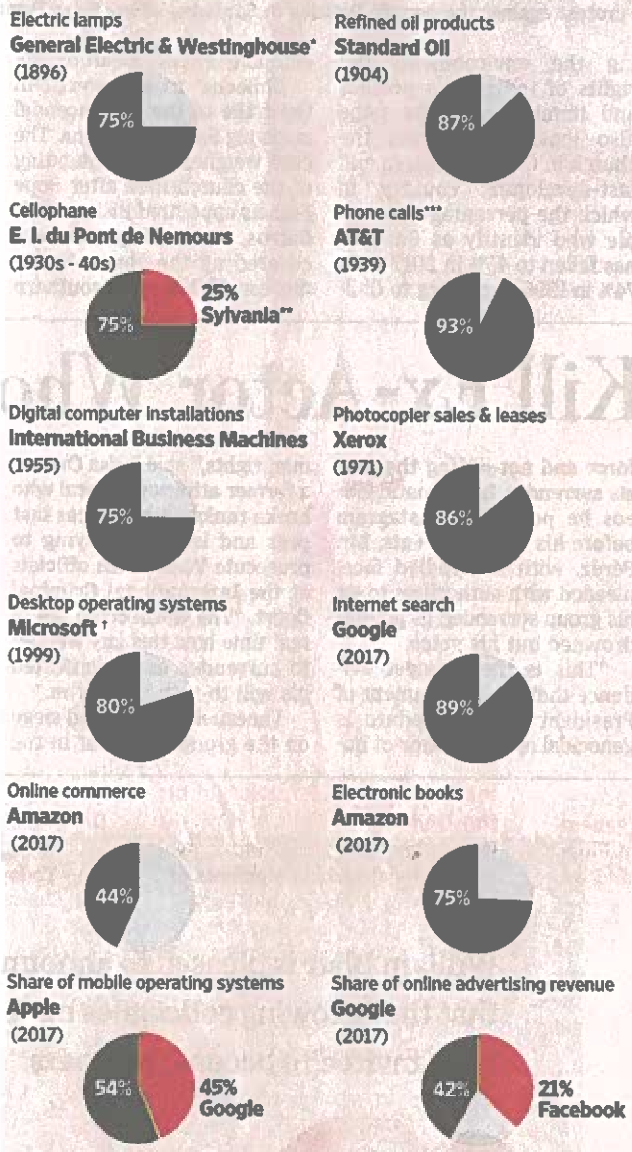
Competition was a powerful prod to innovation: Independent companies, by installing twisted copper lines and automatic switching, forced AT&T to do the same. But AT&T, like today's tech giants, had "network effects" on its side.

"Just like people joined Facebook because everyone else was on Facebook, the biggest competitive advantage AT&T had was that it was interconnected," says Milton Mueller, a professor at the Georgia Institute of Technology.

Early in the 20th century, AT&T began buying up local competitors and refusing to connect independent exchanges to its long-distance lines, arousing antitrust complaints. By the 1920s, it was allowed to become a monopoly in exchange for univ...

A Century of Techopoly

Today's tech companies enjoy market shares similar to monopolies of earlier eras.



*GE cross-licensed its patents with Westinghouse **Sylvania was licensed by du Pont
***Market share among carriers reporting to the Federal Communications Commission
†Federal district court put Microsoft's share of Intel and Mac-based desktop operating systems at 'well above 80%'

Sources: Michael Scherer, Harvard University; Federal district court; Statcounter; eMarketer; Global Web Index; Codex Group.

THE WALL STREET JOURNAL.

vice in the communities it served. By 1939, the company carried more than 90% of calls.

Though AT&T's research unit, Bell Labs, became synonymous with groundbreaking discoveries, in telephone innovation AT&T was a laggard. To protect its own lucrative equipment business it prohibited innovative devices such as the Hush-a-Phone, which kept others from overhearing calls, from connecting to its network.

After AT&T was broken up into separate local and long-distance companies in 1982, telecommunication innovation blossomed, spreading to digital switching, fiber optics, cellphones—and the internet.

Just as AT&T decided what equipment could be used on the nation's telephone systems, Google's search algorithms determine who can be found on the internet. If you searched for a toaster online in the mid 2000s, Google would probably have taken you to comparison shopping sites such as Nextag. They pioneered features such as showing consumer ratings in search results, how popular a product was and how prices had changed over time, recalls Gary Reback, an antitrust lawyer who represented several competitors against Google.

But when Google launched its own comparison business, Google Shopping, those sites found themselves dropping deeper into Google's search results. They accused Google of changing its algorithm to favor its own results. The company responded that its algorithm was designed to give customers the results they want. "If consumers don't like the answer that Google Search provides, they can switch to another search engine with just one click," Executive Chairman Eric Schmidt told Congress in 2011.

At that same hearing Jeffrey Katz, then the chief executive of Nextag, responded, "That is like saying move to Panama if you don't like the tax rate in America. It's a fake choice because no one has Google's scope or capabilities and consumers won't, don't, and in fact can't jump."

In 2013 the U.S. Federal Trade Commission concluded that even if Google had hurt competitors, it was to serve consumers better, and declined to bring a case. Since then, comparison sites such as Nextag have largely faded.

European model

Last year the European Commission went in the other direction and fined the company $2.9 billion and ordered it to change its search results.

The different outcomes hinge in part on different approaches. European regulators are more likely to see a shrinking pool of competitors as inherently bad for both competition and consumers. American regulators are more open to the possibility that it could be natural and benign.

In new industries, smaller players are frequently bought up or vanquished by deeper-pocketed, more-innovative rivals. Google's general counsel, Kent Walker, wrote in response to the European Commission decision that even as smaller sites have retreated, Amazon has grown to become a huge player in comparison shopping.

But a platform that confers monopoly in one market can be leveraged to dominate another. Facebook's existing user base enabled it to become the world's largest photo-sharing site through its purchase of Instagram in 2012 and the largest instant-messaging provider through its purchase of WhatsApp in 2014. It is also muscling into virtual reality through its acquisition of Oculus VR in 2014 and anonymous polling with its purchase of TBH last year.

What Facebook doesn't acquire, it copies. Snap Inc.'s Snapchat, a fast-disappearing photo and video sharing app hugely popular with teenagers, was widely seen as a challenger to Facebook. But in 2016, Facebook introduced its own Snapchat-like feature, Stories, on Instagram, which now has more users and advertisers than Snapchat. That has undercut Snap's growth and profits by reducing the number of new users "interested in trying Snap for the first time," says Peter Stabler, an analyst at Wells Fargo.

Copying Snapchat

There's nothing wrong with copying, especially if the copy is better than the original. Snapchat's app was originally difficult to use, says Mr. Stabler, and "you can't discount [Facebook's] quality of execution." Moreover, even as Facebook copies its competitors, it continues to expand and enhance its own services such as Pages, which 70 million businesses world-wide have used to design their own webpages on Facebook.

Amazon hasn't yet reached the same market share as Google or Facebook but its position is arguably even more impregnable because it enjoys both physical and technological barriers to entry. Its roughly 75 fulfillment centers and state-of-the art logistics (including robots) put it closer, in time and space, to customers than any other online retailer.

'There should be hundreds of Yelps,' a company official says. 'There's not.'

Google, Facebook and Amazon all boast overwhelming shares of some markets on their own, and Apple arguably qualifies as a duopolist.

The company says size makes it possible to deliver millions of items free of shipping charges to isolated communities with little retail presence. Amazon makes that network available to third-party merchants who pay a 15% commission and, typically, a $3 pick-pack-and ship-fee, says Greg Mercer, founder of Jungle Scout Inc. which advises third-party merchants how to sell on Amazon. "We have tons of examples of small entrepreneurial-type people who are really good at creating new inventions but have no idea how to distribute to the masses," he says. "They create products and Amazon can take care of the rest."

The probability of regulatory action—for now—looks low, largely because U.S. regulators have a relatively high bar to clear: Do consumers suffer?

"We think consumer welfare is the right standard," Bruce Hoffman, the FTC's acting director of the bureau of competition, recently told a panel on antitrust law and innovation. "We have tried other standards. They were dismal failures."

Still, Ms. Scott Morton notes, "the consumer welfare standard covers today and tomorrow," and the potential loss of innovation is something both the law and the courts can and have weighed in an antitrust case.

Antitrust Now and Future? Exercise

Read each article and respond to the questions that follow. Be sure responses are thorough and thoughtful for full credit. This assignment is worth up to 40 points. Please bring a print out of your responses to class on the due date.

DoJ v. AT&T article

1. Explain the difference between a horizontal and vertical merger. Include an example of each.
2. Does the DoJ or AT&T have the more persuasive argument? Explain your position.
3. In your opinion, would the merger of AT&T and Time Warner enhance or harm competition in the entertainment industry? Explain your response.
4. Would the same merger restrict innovation? Explain your response.
5. Are internet based firms a threat to traditional media firms and by attempting to merge with Time Warner, is AT&T preparing itself for competition from them?

Technology Behemoths article

1. In your opinion, which approach to antitrust do you think is best: the U.S. or E.U? Explain why.
2. Do you agree that dominant technology firms may harm consumers by preventing alternatives from being developed? Explain your response.
3. Do you agree that search firms may favor some results over others? For example, Google Shopping may favor its advertisers. Explain your response.
4. In your opinion, should the United States take legal action under the antitrust laws against dominant technology firms? Explain your response.
5. In your opinion, would consumers benefit if these firms are forced to break-up? Explain your response.