CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
October 2011 (2)

DOJ's Attempt to Block the AT&T/T-Mobile Merger Places the Horizontal Merger Guidelines on Trial

Benjamin D. Brown
Cohen Milstein LLP

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2011© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

DOJ's Attempt to Block the AT&T/T-Mobile Merger Places the Horizontal Merger Guidelines on Trial

Benjamin D. Brown[1]

The competitive landscape of the telecommunications industry is under perpetual scrutiny, due to its extremely high entry barriers and unique history of a forced transition from the monopoly once known as "Ma Bell." In recent years, despite regional entrenchment of the nation's largest incumbent landline telephone carriers, competition has been robust in telecommunications services due to the operation of four large national wireless providers, Verizon, AT&T, Sprint, & T-Mobile. Still, speculation had been percolating that a merger would be announced at some point between two of the so-called "Big Four." On March 20, 2011, AT&T and T-Mobile finally announced their intent to marry.

In the U.S. antitrust merger enforcement community, many believed that the Department of Justice ("DOJ") would sue to enjoin any attempt to further consolidate among the Big Four, especially any combination that would involve either of the biggest two networks, Verizon and AT&T, eliminating one of their smaller competitors. It therefore was not unforeseen when DOJ announced, on August 31, 2011, that it would indeed seek an injunction to prevent consummation of the deal. Few gave credence to AT&T's public statements that they had been somehow blindsided by the Antitrust Division. What many in the competition policy world did not realize at the time the Division announced the suit was that this case will likely result in a trial of the Division's litigation mettle and the Horizontal Merger Guidelines themselves.

Under the Horizontal Merger Guidelines—the official public guidance issued by both the DOJ's Antitrust Division and the Federal Trade Commission ("FTC") to the business community about how the agencies interpret the Clayton Act—the Division had little choice but to sue. The Guidelines' basic approach is to first assess whether the merger will result in a significant increase in market power. If so, then it needs to assess whether the specific industry dynamics support the view that this increased market power will lead to higher prices or reductions in quality or quantity of goods or services.

The AT&T/T-Mobile merger would greatly concentrate market share on a nationwide basis. The post-merger Herfindahl-Hirschman Index ("HHI") (the most commonly-used measure of industry concentration) for mobile telecommunications services would increase by a whopping 700 points, which far exceeds the standard for a presumption of enhanced market power. Moreover, there is clear evidence that competition among the Big Four is benefiting American consumers. Each of the Big Four races to bring out the fastest and most reliable networks, the most advanced handsets, and the cheapest monthly plans. Meanwhile, the networks take not-so-subtle shots at each other's networks, services and prices in advertisements.

These public indicia of competition were reinforced by internal documents reviewed during the DOJ's investigation and publicized in the resulting complaint. AT&T documents

[1] Benjamin D. Brown is an antitrust partner in the Washington, D.C. office of Cohen Milstein. Prior to joining Cohen Milstein in 2005, Mr. Brown spent four years as a trial attorney with the Antitrust Division of the United States Department of Justice.

explained how T-Mobile's network upgrades had forced it to add services to their own offerings to remain competitive. T-Mobile documents revealed a strategy of "disruptive pricing" specifically aimed at stealing AT&T and Verizon customers. Industry "churn" statistics, which track specific customers' migration between wireless companies, revealed that T-Mobile and AT&T are actively fighting over many of the same customers, driving intense competition on price and quality metrics. In the face of these real-world market dynamics and share statistics, DOJ had to challenge the merger.

Moreover, for all of the publicity and buzz in the antitrust community surrounding the 2010 revisions to the Merger Guidelines, the decision to block AT&T/T-Mobile was not based on any sort of "nouveau" analysis. This was not a situation where the Division had to abandon market definition and rely primarily on direct evidence of competition. There was no need to resort to the new "Upward Pricing Pressure" theory of effects because of differentiated products, and the Division's theory of injury does not rely on the controversial "reduction of product variety." This is instead a merger that is presumptively anticompetitive under any iteration of the Guidelines via a straightforward application of market definition and share calculations, as supported by direct evidence of competition on price and quality. In the merger enforcement world, this is meat and potatoes rather than experimental cuisine.

Historically, telecommunications merger decisions by DOJ have not been challenged in court. One widely held view has been that, since the FCC must also approve telecommunications mergers and because that agency also factors competition-related concerns into its analysis, a court victory against DOJ would be Pyrrhic because the FCC would use a subsequent administrative hearing to accomplish the same result. In practice, however, a federal court's holding that a merger does not violate the Clayton Act would likely be given significant deference, even if it does not technically have a preclusive effect. In this case, where the rumored break-up fee is between three and six billion dollars, AT&T and T-Mobile have ample incentive to test conventional beliefs about the wisdom of laying down after an Antitrust Division merger challenge in the telecommunications industry.

At first glance, the Division's case against the merger seems strong. The deal appears to be precisely the sort of combination the Horizontal Merger Guidelines counsels against. Despite this fact, some observers believe the Division will have a difficult time at trial. AT&T trumpets supposed efficiencies and posits that the elimination of a sizeable competitor will lead to more, not less, competition. Specifically, it argues that T-Mobile is a hopelessly weak competitor, and that by adding T-Mobile's wireless spectrum to its own, it will be able to greatly improve its network and offer quality and service offerings that neither competitor could hope to achieve on their own. However, many who favor AT&T's odds at trial do so not because of AT&T's arguments for merger-specific efficiencies, but from fundamental concerns about DOJ's inability to match AT&T's massive public relations campaign, or the persuasiveness of the Horizontal Merger Guidelines, or the Division's effectiveness at trial. These doubts are not unfounded.

One field in which DOJ is plainly outgunned is public relations. From the day the suit was announced by DOJ, commentators flooded the airwaves and internet with AT&T talking points. Because job creation and a stalling economy are the issues commanding the attention of the nation, the message centered on supposed new jobs and additional investment that would result from the merging of the spectrum and enhancement of the network. Throughout the months of September and October, Americans—specifically those living inside the Washington Beltway—were bombarded by the message that this merger would be a step toward American

financial recovery, if only the DOJ would get out of the way. AT&T engaged in innovative mechanisms to get its message out, including negotiating with large unions to persuade them to come out publicly against the DOJ's lawsuit and even persuading 15 House Democrats to sign a public letter to President Obama urging him to persuade the DOJ to settle and end the litigation—an unprecedented intervention by legislative branch officials into an ongoing antitrust law enforcement action.

While AT&T launched its sophisticated full-court press, DOJ lacked any mechanism to respond. Beyond issuing press releases, the Antitrust Division does not engage in public relations campaigns and does not authorize anyone to appear on its behalf in the press. This approach does not result from naïveté, but from a lack of authority to openly lobby government or the court of public opinion.

Fortunately for DOJ, the ultimate determination will not be made by Congress or by a jury, but by a federal judge—likely with a copy of the Horizontal Merger Guidelines on her desk. The Guidelines are often used as persuasive authority by courts evaluating acquisitions. In fact, some courts have gone so far to describe the Guidelines as a "benchmark of legality" when it comes to proposed mergers. At the same time, the judiciary is quick to point out that the Merger Guidelines do not bind it and that the Guidelines reflect only the DOJ and FTC's judgment about how the Clayton Act ought to be applied and interpreted with regard to mergers.

There are no guarantees that the government will be given the benefit of the doubt by the court in interpreting the Clayton Act. One certainty at trial is that AT&T will not be ceding ground. AT&T will argue that the Guidelines' presumption of anticompetitive effects flowing from increased market share is ill-founded and that the Guidelines' treatment of anticipated efficiencies is too miserly. Make no mistake: however innocuously these arguments may seem, they aim straight at the heart of modern merger enforcement policy.

The last time DOJ was forced to try a case in court to block a merger approaching the size of the AT&T/T-Mobile deal was in 2004, when DOJ ultimately failed to prevent the merger of Oracle and PeopleSoft. Since then, DOJ has endured uncharacteristic losses in criminal antitrust trials across the country, while seemingly avoiding civil trials. The Antitrust Division surprised many competition lawyers when it permitted the mergers of Maytag and Whirlpool in 2006 and Sirius and XM in 2008. In both cases, the Division was persuaded that market dynamics and company assurances would prevent prices from increasing post-merger. Many quietly whispered that the Antitrust Division was clearing anticompetitive mergers due to being gun shy in the wake of Oracle/PeopleSoft. Those criticisms have only gained credence with recent public analyses concluding that both deals have indeed substantially increased consumer prices in the relevant markets.

In the wake of these decisions, and on the heels of the Revised Horizontal Guidelines, the DOJ had to move to block AT&T/T-Mobile. Unlike Oracle/PeopleSoft, there are no overly complicated issues involving market definition. Mobile telephone service is a clean and clear market. A failure to bring suit against AT&T/T-Mobile would have wholly abandoned the guidance the competition agencies endorsed just last year, when they left presumptions of enhanced market power based on HHI in the Guidelines, tweaking only the numerical thresholds.

Much is at stake for the government in this trial. A defeat would not only portend a further loss of respect for the Antitrust Division's trial competencies, but it could undermine

acceptance of the Horizontal Merger Guidelines and usher in an era of uncertainty about modern application of the Clayton Act. The DOJ is taking no chances with its trial team. The Antitrust Division directly placed Assistant Attorney General Joseph Wayland, a respected antitrust trial attorney who joined the Obama administration from the law firm of Simpson Thatcher, in charge of the trial team. Moreover, the Division recently made the somewhat unusual move of reaching out to add an additional "hired gun" to bolster the team—Glenn Pomerantz, a top trial lawyer at Munger Tolles and Olson. Pomerantz will join Division trial team veterans Claude Scott, Larry Frankel and Hillary Burchuk in taking on a well-heeled AT&T team staffed by lawyers from many of Washington D.C.'s leading law firms.

In the upcoming trial, Washington and the nation's antitrust community will witness a clash of titans. Many of the nation's most skilled antitrust trial lawyers will be engaged as the DOJ's Antitrust Division attempts to block this major strategic initiative from one of America's largest companies, with nothing less than the continuing vitality of modern merger enforcement policy on the line. If merger enforcement can ever be equated with "high drama," this is such a time.