ORAL ARGUMENT NOT YET SCHEDULED

No. 18-5214

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellant,

v.

AT&T INC.; DIRECTV GROUP HOLDINGS, LLC;
AND TIME WARNER INC.,

Defendants-Appellees.

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

PROOF BRIEF OF *AMICI* PROFESSOR WILLIAM P. ROGERSON AND AMERICAN CABLE ASSOCIATION IN SUPPORT OF APPELLANT

Ross J. Lieberman
AMERICAN CABLE ASSOCIATION
2415 39th Place, N.W.
Washington, D.C. 20007
(202) 494-5661 (telephone)

Jeffrey A. Lamken
Counsel of Record
Rayiner I. Hashem
MOLO LAMKEN LLP
The Watergate, Suite 660
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 556-2000 (telephone)
(202) 556-2001 (fax)
jlamken@mololamken.com

Counsel for William P. Rogerson and American Cable Association

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), *amici curiae* state as follows:

Parties and *Amici*. Except for *amici curiae* listed on this brief, all parties, intervenors, and *amici* appearing before the district court and this Court are listed in the Opening Brief of Petitioner United States of America.

Rulings Under Review. The rulings under review are listed in the Opening Brief of Petitioner United States of America.

Related Cases. There are no related cases of which *amici curiae* are aware.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1 and D.C. Circuit Rule 26.1, *amicus curiae* American Cable Association ("ACA") states as follows:

ACA has no parent corporation, and no publicly held corporation owns 10 percent or more of its stock, pays 10 percent or more of its dues, or possesses or exercises 10 percent or more of the voting control of ACA.

As relevant to this litigation, ACA is a trade association of small and medium-sized cable companies. ACA is principally engaged in representing the interests of its members before Congress and regulatory agencies.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES AND RULES

OTHER AUTHORITIES

<u>INTEREST OF *AMICI CURIAE*</u>

William P. Rogerson is the Charles E. and Emma H. Morrison Professor of Economics at Northwestern University. Among his roles, he serves as the Research Director for Competition, Antitrust, and Regulation at the Searle Center on Law, Regulation, and Economic Growth. He was formerly Chief Economist at the Federal Communications Commission ("FCC"). He was the Senior Economist supervising the FCC's economic analysis of the Comcast/Time Warner Cable, AT&T/DirecTV, and Charter/Time Warner Cable mergers. He also served as the outside economics expert for the Federal Trade Commission in connection with the AOL/Time Warner merger, and as the economics expert for the National Association of Attorneys General in connection with the DirecTV/EchoStar merger. His research encompasses antitrust, industrial organization, regulation, and telecommunications.[1]

A leading expert in the field of antitrust economics—and one of the pioneers in using the economic theories at issue here to analyze vertical mergers in the telecommunications industry—Professor Rogerson has a unique and uniquely balanced interest in this case. In the decision below, the district court rejected the argument that the proposed merger between AT&T Inc. ("AT&T") and Time

---

[1] Pursuant to Federal Rule of Appellate Procedure 29(c)(5), *amici* certify that no counsel for any party authored this brief in whole or in part and that no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this *amicus* brief.

Warner Inc. ("Time Warner") might raise the cost of television programming to multi-channel video program distributors ("MVPDs") and lessen competition. In doing so, the district court rejected two important economic principles: Nash bargaining theory, which holds that the terms of a negotiated exchange will depend on, among other things, the parties' alternatives to reaching an agreement, and the principle that firms seek to maximize firm-wide profits rather than the profits of a particular division. Professor Rogerson respectfully submits this brief to address inconsistencies in the district court's reasoning with respect to those principles—inconsistencies that do not merely require correction, but also cast doubt on the district court's economic reasoning. Professor Rogerson is a retained expert of the American Cable Association. This brief is based on a paper he wrote. *See* William P. Rogerson, *Two Economic Errors in the AT&T/Time Warner Decision* (Aug. 3, 2018), http://faculty.wcas.northwestern.edu/~wpr603/two-errors.pdf.

The American Cable Association ("ACA") is a nonprofit trade association representing approximately 750 small and medium-sized cable operators. ACA members provide television, broadband Internet, and phone service to nearly seven million subscribers, in all 50 States. ACA members range from family-owned companies serving small cities and rural areas to multiple system operators serving urban areas. The median number of subscribers for an ACA member company is about 1,000 households and businesses. Most ACA member companies operate with ten or fewer employees.

ACA and its members have a significant interest in this case. Most ACA members are MVPDs who must negotiate (individually or in a group) licenses with Time Warner and other content producers to purchase programing for their subscribers. Virtually all of them, moreover, compete with AT&T DirecTV, and many compete with AT&T U-verse as well. ACA members will be directly affected by any price increases for programming or other effects flowing from the merger under review. ACA thus has a strong interest in ensuring that, for this merger and others like it, courts analyze any potential anticompetitive effects by consistently applying sound economic principles.

INTRODUCTION

Antitrust law is unique in the degree to which it relies on economic theory. The antitrust statutes are addressed in broad strokes to protecting competition to enhance public welfare. To effectuate those statutes, however, courts by necessity must invoke sound economic principles, applying them to the facts and evidence before them to evaluate likely effects on consumers and the marketplace.

To produce reliable analysis and results, those principles must be applied consistently. A decision that applies a basic economic principle at one point but then rejects precisely that same principle at another—without reconciling the divergence—is not merely inconsistent with principles of judicial reasoning; it is also inconsistent with basic economics. The laws of supply and demand, bargaining principles, and theories about firm behavior should not be banished from one part of the analysis of a merger but reappear without explanation, apparition-like, in another.

Regrettably, the decision below is marred by that sort of inconsistency—not just in one respect, but two. The first instance concerns a basic economic principle about how prices are set through bargaining. In economics, it is generally accepted that an increase in the cost of providing a good (whether increased opportunity costs or otherwise) will ordinarily cause a provider to demand more compensation for the good and increase the price as a result. At one point in the decision below, the district court rejected that principle. But at another point, it accepted exactly that same principle, without recognizing the contradiction or making any effort to explain it.

The second instance concerns a foundational question about firm behavior. In general, economic theory assumes that firms act to maximize the profits of the firm as a whole. When evaluating potential anticompetitive effects, the district court rejected that theory. In its view, the Time Warner unit of the merged company would seek to maximize only its divisional profits. But later in the opinion, when analyzing pro-competitive efficiencies, the district court took the opposite approach. Without explanation, it assumed that the firm would maximize its profits as a whole.

As a formal matter, those inconsistencies require reversal and a remand for reconsideration by the district court. As a practical matter, they cast serious doubt on the correctness of the district court's reasoning, which departs substantially from standard economic theory. This brief will not dwell on the economic theory. The Government addresses that at length. This brief instead focuses on the internal contradictions in the district court's application of economic principles—contradictions that preclude affirmance.

SUMMARY OF ARGUMENT

I. The district court's treatment of Nash bargaining—and how changes in costs result in changes in programming prices—is internally contradictory. Nash bargaining predicts, all other things being equal, that increasing costs will increase prices in bargaining outcomes, and that lowering costs will lower prices. To demonstrate that the merger was likely to increase programming prices for MVPDs, the Government urged that the merger would increase Time Warner's "cost" of licensing programming to competitors. In particular, licensing an MVPD would cost the merged firm all of the profits AT&T could have earned if, absent that license, some of the MVPD's customers switched to AT&T. Under Nash bargaining theory, that increased cost—an increased opportunity cost—would change the outcome of negotiations between Time Warner and MVPDs, producing higher prices. The district court dismissed that theory as "implausible." According to the court, the Government had not provided "real-world evidence" to show that Nash bargaining operates in the context of programmer-MVPD license negotiations.

But other testimony from defendants' executives showed that it does—testimony that the district court credited. In connection with efforts to show merger-related benefits, defendants' executives testified that advertising revenues had been falling because of competition from digital advertising; that reduction in advertising revenues, they asserted, had caused negotiated license fees to rise. The district court accepted that contention, calling it a "predictable result." But that is precisely an example of Nash bargaining in the context of MVPD-programmer negotiations. Reduced advertising revenues for programming are equivalent to an increase in net costs that must be recovered. That increase in net costs leads to an increase in the negotiated price of programming—just as Nash bargaining predicts. Defendants' executives so testified. The court so ruled. The evidence the court itself accepted as a "predictable result" is exactly the "real-world evidence" the court deemed lacking. Nowhere in its opinion did the district court distinguish between the two situations to explain why Nash bargaining is an accurate predictor of behavior in one instance—producing the "predictable result"—but not in the other.

II. The district court likewise contradicted itself when it concluded that, post-merger, AT&T Time Warner's individual divisions would maximize individual unit profits rather than the profits of the whole firm. It was unbelievable, the district court found, that Time Warner would do anything to jeopardize licensing revenue to benefit AT&T's subscription revenue, even if that would maximize overall profits. But elsewhere the district court assumed the merged company would do just that. It accepted defendants' argument that elimination of double marginalization ("EDM") would result in hundreds of millions of dollars in cost reductions being passed on to consumers. But EDM presupposes that corporate divisions act to maximize firm-wide profits, not individual divisional profits.

III. Resting a judgment on reasoning that is internally contradictory is an abuse of discretion. This Court routinely reverses in the face of such errors. This Court should, moreover, remand for a retrial. The district court's evidentiary rulings reflect the district court's faulty and inconsistent reasoning regarding applicable economic principles.

ARGUMENT

Economic principles play a powerful role in antitrust law, and in evaluating merger impacts in particular. The Government's brief explains at length why the decision below departs from fundamental economic principles. *Amici* submit this brief to address another flaw of the decision: its inconsistent—internally contradictory—treatment of those principles. This Court regularly overturns administrative agency decisions that are internally inconsistent. *See NRDC v. NRC*, 879 F.3d 1202, 1214 (D.C. Cir. 2018); *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1152-54 (D.C. Cir. 2011). The same result is required where district courts apply inconsistent reasoning as well. *See Westmoreland v. CBS, Inc.*, 770 F.2d 1168, 1177-78 (D.C. Cir. 1985). The use of "internally inconsistent" reasoning to support a decision is a classic abuse of discretion that warrants reversal. *United States v. Apfelbaum*, 445 U.S. 115, 126-27 (1980); *see FTC v. H.J. Heinz Co.*, 246 F.3d 708, 718 (D.C. Cir. 2001) ("inherent inconsistency in . . . logic" is fatal).

That requirement of internally consistent reasoning is critical in the antitrust context, where harms often are proven through the application of economic principles and statistical models. *See Heinz*, 246 F.3d at 711 (internally contradictory conclusions regarding a merger's effect on competition is an abuse of discretion); *United States v. W. Elec. Co.*, 993 F.2d 1572, 1581-82 (D.C. Cir. 1993) (similar). Consequently, courts should not purport to reject an economic principle at one point, but then embrace the identical principle at another, without reconciling (or even recognizing) the contradiction. Such internally contradictory reasoning undermines confidence in the outcome—not merely because it is formal error, but also because it often reflects more fundamental failure of analysis or understanding of relevant principles.

The decision below reflects that sort of internally contradictory analysis. *First*, in seeking to show that the merger would increase the prices paid by consumers, the Government relied on the theory of Nash bargaining. Nash bargaining predicts that, all else being equal, increasing one party's cost of providing a good—including opportunity costs—will increase the price of that good in bargaining negotiations; conversely, decreased costs will yield lower prices. In analyzing whether post-merger AT&T Time Warner would increase programming prices to MVPDs, the district court rejected that theory, calling it "implausible and inconsistent with record evidence." JA___(Op. 113). But it turned around and accepted testimony from defendants' executives showing precisely that occurs—that increases in costs result in increased prices for programming—calling it a "predictable result." (Point I, *infra*).

Second, the district court's analysis of profit-maximizing behavior is self-contradictory. Underlying most economic theory is the almost invariable assumption that firms are profit-maximizing—they seek to maximize the firm's profits as a whole, not the profits of internal divisions. The district court rejected that theory when addressing anticompetitive impacts. Each division of the combined firm, the district court asserted, would "separately maximize their respective revenues," including Time Warner when negotiating with AT&T's MVPD competitors. JA___(Op. 115). But the district court took the opposite approach when assessing whether the merger would result in substantial cost savings that would be passed on to consumers. In that context, it adopted the same theory of company-wide profit maximization that it rejected when looking at anticompetitive impacts. (Point II, *infra*). These contradictory findings regarding foundational issues in this case require reversal and remand. (Point III, *infra*).

I. The District Court's Treatment Of Nash Bargaining—And The Effect Of Increased Opportunity Costs On Bargaining Outcomes—Reflects Self-Contradictory Economic Analysis

To prevail in its suit to enjoin the merger, the Government had to show that the AT&T/Time Warner merger may have "the effect" of "substantially . . . lessen[ing] competition." 15 U.S.C. § 18. The Government urged that allowing Time Warner, which sells content and programming to MVPDs, to merge with a dominant MVPD like AT&T would increase the prices rival MVPDs pay Time Warner for programming. JA___(Op. 60). The increased programming costs confronted by AT&T's MVPD rivals, the Government contended, would make them less competitive against AT&T and reduce MVPD competition. *Id.*

The Government's position rested in large part on a well-accepted economic principle called "Nash bargaining." U.S. Br. 16-17. The Government explains why the district court's rejection of that principle is clear error. U.S. Br. 37-61. But there is another, even more basic, problem with the district court's analysis: It contradicts itself. In analyzing whether post-merger AT&T Time Warner would increase negotiated programming prices for MVPDs, the district court rejected Nash bargaining in that context, calling it "implausible and inconsistent with record evidence." JA__(Op. 113). But elsewhere it turned around and accepted testimony from defendants' executives about industry behavior—in the context of programmer-MVPD negotiations—that reflects Nash bargaining, characterizing it as the "predictable result." The district court thus rejected the premise that Nash bargaining accurately describes negotiations between programmers and distributors insofar as the Government invoked it to show economic *harm* from the merger. But the district court accepted and adopted assertions by defendants and their executives about benefits that reflect and require an indistinguishable application of Nash bargaining to the same programmer-MVPD negotiations.

A. Nash Bargaining Predicts That Increasing Costs for Sellers (Including Increasing Opportunity Costs) Will Alter and Increase Prices in Bargaining Outcomes

The Government's theory reflected a relatively straightforward application of Nash bargaining and common sense.

1. At the highest level of generality, the Government simply compared the economic incentives faced by Time Warner absent a merger (under pre-merger conditions), and by AT&T Time Warner post-merger. Absent the merger, Time Warner had every incentive to reach a deal with and provide programming to an MVPD. If negotiations failed, Time Warner would lose valuable licensing fees

and advertising revenue. More important, a failed negotiation would gain nothing. There was no "silver lining" from not selling programming to MVPDs. Distributing its programming did not result in opportunity costs to Time Warner—*i.e.*, the cost of a lost opportunity to gain revenue some other way.

The merger, the Government explained, would change that calculus. Post-merger, the company *would* see a gain from failed negotiations. A successful deal thus would impose an *opportunity cost*. In particular, if the Time Warner side of the company failed to reach a deal with an MVPD, the AT&T side of the company could see a gain in subscribership. The competing MVPD's subscribers, disappointed by the absence of Time-Warner content, could switch to AT&T to gain access. Increased subscribership would mean not only increased subscription fees, but also increased advertising revenues.

In that circumstance, the Government urged, a merged AT&T Time Warner would charge MVPDs *more* for programming than Time Warner would have charged absent the merger. Post-merger, the cost of providing programming to an MVPD would include a new opportunity cost—the cost of forgone profits that AT&T could have earned if the failure to reach a licensing agreement drove some of the MVPD's customers to AT&T instead. Because AT&T Time Warner would confront an additional cost in providing programming to competing MVPDs, it would charge competing MVPDs a greater price for Time Warner programming than Time Warner would charge, standing alone, absent the merger.

2. Nash bargaining predicts that common-sense outcome. Developed by the Nobel Prize-winning economist John Nash, Nash bargaining provides a useful framework for analyzing bargaining behavior. U.S. Br. 18-19; *see* Jonathan B. Baker, *Comcast/NBCU: The FCC Provides a Roadmap for Vertical Merger Analysis*, 25 ANTITRUST 36, 40 (2011). Among other things, Nash's theory explains how parties split the gains from trade—*i.e.*, how parties allocate amongst themselves the net gain of a transaction. JA____(Tr. 2193); Baker, *supra*, at 40; Kevin M. Murphy, *Economic Analysis of the Impact of the Proposed Comcast/NBCU Transaction on the Cost to MVPDs of Obtaining Access to NBCU Programming*, *Applications of Comcast Corp.*, FCC MB Docket No. 10-56, at 18 (filed June 21, 2010).

Nash's theory explains that parties engage in a transaction when the transaction is mutually beneficial—it results in a net gain to both parties. *See* Baker, *supra*, at 40. But the terms of the bargain—*e.g.*, the price of an item—depends on the costs and benefits of the transaction to each party. *Id.* Among other things, parties negotiate against their fallback position—"what would happen if there were no deal." JA____(Tr. 2193); *see* U.S. Br. 19-20; Murphy, *supra*, at 18-19. Typically, parties will agree to terms where each party receives *at least* as much value as it would in its fallback scenario, *plus* some share of the net gain resulting from the transaction. JA____-____(Tr. 2194-2195); Murphy, *supra*, at 19. In other words, where parties negotiate terms for a transaction—such as the licenses at issue here—the resulting terms will reflect those parties' costs from the transaction (including the fallback position they give up by transacting). Changing the costs (or strengthening one party's fallback position) will change the equilibrium of the negotiation and correspondingly change the negotiated terms.

At trial, the Government's expert, Professor Shapiro, used the example of someone selling a car to illustrate Nash bargaining. If the buyer is willing to pay up to $10,000 for the car, and the seller values the car at $5,000, Nash bargaining predicts that the negotiated price will be somewhere between $5,000 and $10,000. (Nash bargaining predicts a price at the mid-point, or $7,500, if one assumes that both parties have equal bargaining strength.) *See* JA____-____(Tr. 2211-2212); Murphy, *supra*, at 19. If the seller discovers, however, that he can earn $1,000 using the car to drive for Uber or Lyft, his bargaining position will shift—he will ask relatively more for the car, because he will give up more by selling it. Nash bargaining predicts that the bargaining outcome will change as well. *See* JA____(Tr. 2212); Murphy, *supra*, at 19; Baker, *supra*, at 37. The price will go up, with the precise amount of increase depending on the relative bargaining strength of each party. JA____(Tr. 2212).

The same principles would ordinarily apply here. Post-merger, the combined AT&T Time Warner would have a more valuable fallback position than pre-merger Time Warner. U.S. Br. 19-20, 33-34; JA____-____(Tr. 2215-2216); *see* Murphy, *supra*, at 19-20; Baker, *supra*, at 37. Pre-merger and post-merger, a failed negotiation prevents the MVPD from showing Time-Warner content to its subscribers; but Time Warner loses out on the subscription fees and advertising revenue it otherwise would have received. *Id.* Post-merger, however, the failed negotiation also provides a benefit: If a competing MVPD cannot offer its subscribers Time Warner content, some of those subscribers may switch to an AT&T service such as U-verse or DirecTV, increasing revenues. U.S. Br. 33-34; JA____-____(Tr. 2216-2218); Baker, *supra*, at 37. In that way, the merger strengthens Time Warner's fallback position; a failed negotiation at least has the benefit of driving the MVPD's subscribers to AT&T.

Put differently, the merged AT&T Time Warner faces an additional *cost* from a successful transaction. The benefit from reaching agreement on a license remains the same. The merged entity gains subscription fees and advertising revenue (just as our hypothetical car seller gets the cash price). But a successful negotiation means that the merged entity incurs an opportunity cost: It loses the revenue it could have earned if, absent an agreement, some of the MVPD's customers switched to AT&T (just as our car seller incurs an opportunity cost in not being able to drive for Uber). As Professor Shapiro explained at trial, the post-merger Time Warner thus has "a higher cost" for agreeing to license its content; it will be somewhat "less inclined to license" its programming because that would mean for-going an increase in AT&T's subscriber base and revenues. JA____(Tr. 2203). Time Warner will "have more leverage in the negotiations, because they're less keen to cut a deal." *Id.*

Traditional Nash bargaining principles predict that those differences will change bargaining outcomes and increase prices. Because the merged entity faces increased opportunity costs for licensing its content—it now gives up its content and also some AT&T revenue—it will demand (and get) more for the license. JA____(Tr. 2195). Under Nash bargaining theory, those increased costs will translate to higher programming prices. U.S. Br. 33-34; JA____-____(Tr. 2213-2214); Baker, *supra*, at 37. That will, in turn, increase consumer prices and weaken AT&T's competition by raising the cost of a key business input—programming. U.S. Br. 35-36; Baker, *supra*, at 37.

The use of such a framework for analyzing the competitive effects of vertical mergers is hardly novel. *Amicus* Professor Rogerson used that analysis in 2004 to evaluate the merger between News Corp. and DirecTV. *See* William P. Rogerson, *An Economic Analysis of the Competitive Effects of the Takeover of DirecTV by News Corp., General Motors Corp.*, FCC MB Docket No. 03-124 (filed June

16, 2003); William P. Rogerson, *A Further Economic Analysis of the Competitive Effects of the Takeover of DirecTV by News Corp.*, *General Motors Corp.*, FCC MB Docket No. 03-124 (filed Aug. 4, 2003). The bargaining theory framework played a central role in shaping the FCC's analysis of the Comcast/NBC Universal merger in 2011, including the FCC's decision to require mitigation measures. *See* Memorandum Opinion and Order, *Applications of Comcast Corp.*, 26 FCC Rcd. 4238 (released Jan. 20, 2011); Baker, *supra*, at 36-37; William P. Rogerson, *Economic Analysis of the Competitive Harms of the Proposed Comcast-NBCU Transaction*, *Applications of Comcast Corp.*, FCC MB Docket No. 10-56 (filed June 21, 2010); William P. Rogerson, *A Further Economic Analysis of the Proposed Comcast-NBCU Transaction*, *Applications of Comcast Corp.*, FCC MB Docket No. 10-56 (filed Aug. 19, 2010); William P. Rogerson, *A Vertical Merger in the Video Programming and Distribution Industry: Comcast-NBCU (2011)*, THE ANTITRUST REVOLUTION 534-75 (6th ed. 2014).

B. The District Court's Treatment of Nash Bargaining Is Internally Inconsistent

The district court, however, rejected the Government's theory, along with the underlying economic precepts. The district court found that "the evidence is insufficient to support Professor Shapiro's conclusion that this Nash bargaining theory will accurately predict an increase in [Time Warner's] post-merger bargaining leverage." JA___(Op. 111); *see* JA___-___(Op. 109-110). It deemed

Professor Shapiro's "assumptions" "implausible and inconsistent with record evidence." JA___(Op. 113). The court took particular exception to the idea that a change to the strength of Time Warner's fallback position—a blackout with an MVPD—could somehow affect Time Warner's negotiating behavior. JA___-___(Op. 116-117). The "Government's increased-leverage theory," the district court asserted, "does not make sense as a matter of logic," JA___(Op. 117), and contradicts the "real-world . . . experiences" of defendants' negotiators, JA___-___(Op. 84-85).

The district court thought the benefit to AT&T from a blackout—the ability to obtain customers from MVPD competitors—was irrelevant because, "even post-merger," a blackout "would cause [Time Warner] to lose more in affiliate fee and advertising revenues than the merged entity would gain." JA___(Op. 116). Because blackouts were unlikely, the court reasoned, Time Warner could not "drive up prices by *threatening* distributors with long-term blackouts." JA___(Op. 116); *see* JA___(Op. 117) (it "does not make sense as a matter of logic" that Time Warner "would gain increased leverage").

The Government cogently explains (at 41-44) why that reasoning is incorrect as a matter of economic principles. Simply put, the relative costs of a failed negotiation—and the opportunity costs of a successful one—*do* influence bargaining leverage and outcomes.[2] But there is a more straightforward problem with the district court's analysis: It is internally contradictory. The district court dismissed the Government's application of Nash bargaining to affiliate fee negotiations as "implausible," and stated that it contradicted the "real-world . . . experiences" of defendants' negotiators. JA___-___, ___(Op. 84-85, 113). But in other testimony, defendants' executives described "real-world" behavior that reflects precisely the Nash bargaining the court rejected as "implausible." And the district court readily accepted that behavior as "predictable." JA___, ___(Op. 27, 39).

That testimony concerned the effect of advertising revenues on programming prices. Typically, programmers receive revenue from licensing fees paid by MVPDs, and the sale of advertisement slots to advertisers. (There are 18 minutes of advertising per hour of programming; 2 of those are sold by the MVPD, and 16 minutes are sold by programming providers like Time Warner. JA___(Op. 10)). Defendants introduced evidence showing that, because of new market entrants, including competitors that provide access to viewers online, Time Warner had seen "declines in television advertising revenue." JA__(Op. 27).

That decreased advertising revenue, they explained, put "more pressure on affiliate fees, meaning that programmers will increase the fees charged for their

[2] While the court credited defendants' testimony that Time Warner negotiators never considered the leverage created by vertical integration in their negotiations with MVPDs, U.S. Br. 60, MVPDs testified that everyone accounts for the possibility of blackouts in negotiations, even though blackouts are rare, *id.* at 46-48.

content." JA___(Op. 27). Time Warner's CEO thus testified that decreased advertising revenue is "bad for consumers" because "the financial support for all this programming . . . gets pushed over toward subscription prices." JA____(Tr. 3089); *see* JA____-____(Tr. 610-611) (when "advertising revenue gets stressed" that "puts more stress on [affiliate fees]," and affiliate-fee increases "end up passing on to the consumer") (Turner CEO John Martin). The district court accepted that result as "predictable." JA___(Op. 27); *see* JA___(Op. 39).[3]

But that explanation is just an application of the Nash bargaining model the district court elsewhere rejected. Nash bargaining theory predicts that bargained outcomes depend on each party's costs and benefits from the transaction, and that outcomes will change as those costs and benefits change. *See* pp. 11-17, *supra*. For the programmer, receiving less advertising revenue is no different than facing a higher net cost for programming; the cost of providing that programming is no longer offset by advertising income. Nash bargaining predicts that, confronted with those increased costs—or lesser offsets to its costs—a programmer will demand, and obtain, more money for its programming in negotiations with MVPDs.

---

[3] Defendants introduced that testimony as part of their larger argument that the merger would generate pro-competitive benefits. The merger, "Time Warner and AT&T witnesses testified, will lead to higher ad revenues that will alleviate pressure on the programming side and lower the price of video distribution." JA___(Op. 39).

The district court's decision is thus marred by a double contradiction. Defendants' executives urged that "the economic theory of Nash bargaining" does not "accurately predict the dynamics and final fee structure of complex affiliate fee negotiations." JA___-___(Op. 109-110). But they themselves provided a powerful example showing that it does: They provided "real-world" evidence that cost changes result in changes in programming prices—higher costs yield increased prices in bargaining—precisely the "real-world" evidence the district court deemed lacking. JA___, ___(Op. 111, 113).

The district court indulged that same contradiction. It accepted AT&T's argument that higher net costs (from decreased advertising revenues) would increase programming prices, describing that outcome of Nash bargaining as intuitively "predictable" and reflecting an accurate description of licensing negotiations. JA___, ___(Op. 27, 37). But it reached exactly the opposite result in evaluating the Government's argument that increased costs—an increased opportunity cost—would result in increased programming prices. There, it called the application of Nash bargaining to licensing negotiations "implausible" and inconsistent with "real-world experience." JA___-___(Op. 113-14). That is the sort of "internally inconsistent" reasoning this Court is loath to accept. *Gen. Chem. Corp. v. United States*, 817 F.2d 844, 854 (D.C. Cir. 1987).

AT&T's and the district court's analysis of advertising-revenue impacts also defies the district court's rationale for rejecting the Government's Nash bargaining theory. The district court rejected the Government's theory that increasing the opportunity costs of a successful negotiation would increase prices, because that would not "flip" the "economics"—*i.e.*, it would not render a failed negotiation more profitable than a successful one. JA___(Op. 117). But the district court readily accepted the notion that the *decreased* advertising revenues Time Warner was suffering had *increased* programming fees without any suggestion that the decline in advertising revenues would "flip" programming licenses from profitable to unprofitable. Defendants did not claim, after all, that reduced advertising revenues made it *unprofitable* for them to offer programming at the old prices. Rather, programming prices increased because cost increases naturally translate into price increases—even if the change does not "flip" the economics by rendering previously unprofitable activity profitable.

The district court's reliance on a hypothetical posed by Time Warner's CEO, JA___(Op. 117), reflects the same mistake. The CEO urged that Time Warner's "fallback" of no license was "irrelevant":

> [If] we have a risk that a thousand-pound weight might fall on us – we hope it doesn't, but if that's always there, then if you said to me, well, don't worry; it might be a 950-pound weight instead of a thousand pounds, are you going to think about it differently, feel differently? Are you going to take more risk that any of that might happen to you? Absolutely not.

JA____-____(Tr. 3120-3121). He stressed that the repercussions of failing to reach a deal were so catastrophic (like being crushed by a thousand-pound weight) that the price would not change depending on whether that outcome was a little more or less "bad." The district court found that analogy "particularly persuasive." JA___(Op. 117). But the same hypothetical destroys the testimony, from the same executives, that lost advertising revenues result in "more pressure on affiliate fees," increasing prices. If the 1,000-pound-weight theory worked, Time Warner would never risk a deal by demanding higher programming fees to offset lost advertising revenue. But defendants told the court—and the court agreed—exactly that happens. JA___-___(Op. 27-28).

Far from reconciling these contradictions, the district court appears not to have recognized them. From an economic perspective, they are glaring. The court accepted the results of Nash bargaining as accurate when invoked by defendants to show that decreased advertising revenue will increase prices in bargaining outcomes—even absent proof that changes in advertising revenues had rendered existing prices unprofitable. But it rejected the results of Nash bargaining when invoked by the Government to show that increased opportunity costs will increase prices in bargaining outcomes, deeming it as "implausible" absent proof that the increased cost would render licensing unprofitable (compared to the alternative). Nowhere in its opinion did the court distinguish between the two situations to explain why Nash bargaining is an accurate predictor in one instance but not in the other. There is none. In both cases, increased costs (from lost advertising or the forgone opportunity to gain subscribers) translates into increased prices.

II. THE DISTRICT COURT'S TREATMENT OF FIRMS' INCENTIVES TO MAXIMIZE FIRM-WIDE PROFITS IS INTERNALLY CONTRADICTORY

The district court rejected the Government's theory for a second reason. It ruled that, even if the merged firm as a whole would confront an additional opportunity cost from licensing Time Warner programming to MVPDs, negotiators would ignore that additional opportunity cost. In particular, the district court rejected the idea that, post-merger, Time Warner would negotiate against the backdrop of the benefits to its AT&T division of not reaching a licensing deal with an MVPD. JA___-___(Op. 113-114). In the district court's view, that was equivalent to saying that "[Time Warner] will not do its own negotiations; AT&T will step in to do the negotiations for [Time Warner]." JA____(Tr. 2200). That premise, the court stated, was not "sufficiently grounded in the evidence," JA___(Op. 120), and was an "economist assumption," JA____-____(Tr. 2200-2201); *see* U.S. Br. 25. The district court did not dispute that "a firm with multiple divisions" generally "will act to maximize profits across them." JA___(Op. 114). Instead, it credited defendants' testimony that "the identity of a programmer's owner does not affect the negotiating dynamic." JA___(Op. 113). In the district court's view, the Time

Warner unit would maximize its own profits without regard to the impact on the profits of other units, such as AT&T. *Id.*

As the Government explains (at 50, 53-55), that treats a foundational precept of economics—that "parent corporations and their wholly owned subsidiaries act to maximize corporate-wide profits"—as a factual issue requiring record support. *See Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 770 (1984) ("there can be little doubt that the operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor"). But, once again, a more straightforward error plagues the district court's analysis—a failure of consistency. When considering anticompetitive impacts, the district court refused to credit the principle that firms seek to maximize corporate profits as a whole—not the profits of individual business units. But when considering pro-competitive impacts, the court accepted precisely that same principle.

In seeking to show pro-competitive benefits, defendants argued that the merger would lower consumer prices through the elimination of double marginalization ("EDM"). JA___-___(Op. 66-67). In an industry with vertical layers, like video distribution, companies at each layer seek a profit—a "margin." JA___(Op. 66). Before the merger, Time Warner would seek a profit on its license of content to AT&T, and AT&T would seek a profit when it included that programming in television packages sold to consumers. The merged firm would no longer do that.

It would seek a profit only once in the sale to the consumer. *Id.*; JA____(Tr. 2251). In theory, the elimination of double marginalization leads to lower prices. JA____-____, ____, ____(Tr. 2251-2252, 2438, 2446).

The district court embraced that argument. JA___(Op. 57). It repeatedly invoked the resulting theoretical price reductions. *Id.* ("EDM effect is generally accepted as a potential procompetitive benefit"); JA___(Op. 58) (considering "positive" impact from EDM); JA___(Op. 66) (EDM is "one standard benefit associated with vertical mergers"); JA___(Op. 109) (citing "$350 million in annual EDM savings").

In accepting the EDM theory, however, the district court accepted precisely the single-firm profit-maximization principle the Government had pressed, and that the district court had rejected in evaluating competitive harm. EDM is based on the idea that it is "in the interests of the *joint company*" to "shrink that total margin so there's one instead of two." JA____(Tr. 2252) (emphasis added); *see* U.S. Br. 55-56. EDM arises from the fact that, after the merger, the distribution division of the merged firm will have a greater incentive to lower prices and increase sales because it will consider the programming division's profit on license fees. Thus, it *presupposes* that the different divisions of the merged firm will change their behavior to maximize firm-wide profits. Put another way, EDM assumes that the "identity of a programmer's owner" *matters*—it yields cost savings to customers because entities formerly in different vertical layers change their behavior when they come into common ownership.

The district court accepted that result in evaluating defendants' EDM theory but rejected it in evaluating the Government's theory of harm. The district court offered no reason why Time Warner would account for its common ownership with AT&T in scenarios where that would lead to lower consumer prices, but would ignore that common ownership where it might lead to higher prices.

III. THE JUDGMENT MUST BE REVERSED AND THE CASE REMANDED FOR RETRIAL

A. The District Court's Internal Contradictions Require Reversal

The inconsistencies in the district court's decision warrant reversal. This Court has repeatedly recognized that inconsistent economic reasoning undermines the whole decision and justifies reversal. *See W. Elec.*, 993 F.2d at 1581-82 (noting "inconsistent" findings); *Heinz*, 246 F.3d at 711 (noting "internally contradictory" logic). That is true under the Administrative Procedure Act. *See NRDC v. NRC*, 879 F.3d at 1214 ("it would be arbitrary and capricious for the agency's decision making to be 'internally inconsistent' "); *Bus. Roundtable v. SEC*, 647 F.3d at 1152-54 (reasoning is "internally inconsistent and therefore arbitrary"); *Gen. Chem. Corp.*, 817 F.2d at 854 (the "Commission cannot have it both ways," rejecting certain evidence in one context but relying on it elsewhere). And it is true on review of district court decisions as well. *Heinz*, 246 F.3d at 711.

B. Retrial Is Warranted Because the District Court's Evidentiary Rulings Rest on Incorrect and Inconsistent Economic Analysis

A new trial is warranted. The district court's erroneous economic analysis infected the evidence it allowed the Government to present. U.S. Br. 22-23. As the Government explains (at 21), the "district court substantially constrained the government's presentation of evidence showing that the merged entity would have greater bargaining leverage." For example, at trial, the district court refused to admit an analysis prepared by *AT&T's* consultants about the potential effects of vertical integration on competition. JA____-____(Tr. 1762-1763); U.S. Br. 21-22. It also excluded reports prepared by DirecTV addressing effects programming blackouts would have in the event of failed negotiations, questioning whether that evidence was "relevant and probative." JA____-____(Tr. 1592-1593); U.S. Br. 22.

At trial, the district court also rejected the Government's attempts to question experts about a report Professor Kevin Murphy had prepared for defendant DirecTV in connection with the Comcast-NBCU merger. JA____(Tr. 2377); U.S. Br. 42. In that report, Professor Murphy had applied Nash bargaining to predict that the Comcast-NBCU merger would result in higher programming prices. JA____-____(Tr. 2377-2378); U.S. Br. 41-42; *see* Murphy at 13-28. And the district court also excluded, as irrelevant, other regulatory filings in which AT&T and DirecTV had endorsed the same Nash bargaining theory of harm that the Government invoked, but they opposed, here. U.S. Br. 22-23. Although the court later appeared to consider some evidence related to the past regulatory filings, it refused to allow their proper use at trial—as substantive evidence and potentially devastating impeachment—and directed the government not to use them in its closing. *Id.* The district court was "hesitant to assign any significant evidentiary value to those prior regulatory filings" because it failed to comprehend their economic significance. JA___-___(Op. 81-82).

It appears that those mistaken evidentiary rulings reflected the district court's faulty and inconsistent economic reasoning. The district court neither heard all the relevant evidence at trial, nor permitted its full use for purposes of impeachment and argument. Under the circumstances, a new trial for proper presentation of all relevant evidence is warranted.

CONCLUSION

The judgment should be reversed. The case should also be remanded for a new trial.

August 13, 2018

Respectfully submitted,

/s/ Jeffrey A. Lamken

Jeffrey A. Lamken
Counsel of Record
Rayiner I. Hashem
MOLO LAMKEN LLP
The Watergate, Suite 660
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 556-2000 (telephone)
(202) 556-2001 (fax)
jlamken@mololamken.com

Ross J. Lieberman
AMERICAN CABLE ASSOCIATION
2415 39th Place, N.W.
Washington, D.C. 20007
(202) 494-5661 (telephone)

Counsel for William P. Rogerson and American Cable Association

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

_x_ this brief contains 6,456 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f), or

___ this brief uses a monospaced typeface and contains ________ lines of text, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

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)(6) because:

_x_ this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14 point font, or

___ this brief has been prepared in a monospaced typeface using [state name and version of word processing program] with [state number of characters per inch and name of type style].

August 13, 2018 /s/ Jeffrey A. Lamken

CERTIFICATE OF SERVICE

I certify that today, August 13, 2018, I electronically filed the foregoing document with the Clerk of the Court for the U.S. Court of Appeals for the District of Columbia Circuit using the appellate CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

August 13, 2018 /s/ Jeffrey A. Lamken