

MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
Fall 2025

Tuesdays and Thursdays, 3:30 pm – 5:30 pm
Dale Collins
wdc30@georgetown.edu
www.appliedantitrust.com

Class 22 (November 11): Vertical Mergers (Unit 11)

In Class 22, we will continue with the *AT&T/Time Warner* opinion. After finding the non-expert evidence insufficient, the court turned to the parties' expert economists: Professor Carl Shapiro for the government and Professor Dennis Carlton for the defendants. Shapiro's Nash bargaining model attempted to quantify predicted harm, while Carlton's empirical analysis examined what actually happened in prior vertical mergers in this industry. We will see why the court rejected Shapiro's predictions but credited Carlton's real-world evidence. As you read the district court opinion, focus on: (1) how the Shapiro model quantifies harm; (2) why the court finds it unreliable; (3) what Carlton's analysis shows, how the DOJ responded, and how the court weighed it; and (4) what this case teaches about the relative weight of theory vs. empirical evidence.

After finishing the opinion, we will turn to the DOJ's appeal to the D.C. Circuit. You have enough to read and I have not assigned the appellate decision, but in class, we will examine the government's appellate strategy, the standard of review challenges it faced, and why the appeal failed. Keep this in mind as you read the district court's opinion: If you were the DOJ appealing Judge Leon's decision, what would you argue and what obstacles would you face?

Expert evidence: The Shapiro Nash bargaining model (pp. 259-98). These pages contain the most technically demanding analysis in the opinion and require careful reading. In a raising rivals' costs framework, Shapiro employed a Nash bargaining model to quantify how the merger could increase the fees that rival MVPDs would pay for Turner programming. Shapiro also concluded that the merger would reduce DirecTV's costs through the elimination of double marginalization (EDM). To determine the net effect on competition, he compared his quantitative estimate of EDM savings at DirecTV with his estimate of affiliate fee increases at DirecTV's rival distributors. Shapiro determined that the cost increases to rivals outweighed the EDM savings at DirecTV, yielding a net reduction in total consumer surplus. On that basis, he concluded that the merger would reduce competition.

Shapiro estimated the elimination of double marginalization (EDM) effect by first calculating Turner's premerger markup on programming supplied to DirecTV. He then assumed the postmerger internal transfer price would fall to Turner's marginal cost of supply. This reduction in DirecTV's input costs would, given his assumption of full pass-through, lower DirecTV's retail prices. Using DirecTV's subscriber base and margins, Shapiro quantified the cost savings at approximately \$1.20 per subscriber per month. With roughly 24.4 million DirecTV subscribers receiving Turner content, this generated about \$29.3 million in monthly savings, or \$352 million annually. The merging parties did not dispute these estimates, and the court accepted them as a reasonable measure of EDM savings.

Next, within a raising rivals' costs framework, Shapiro used a Nash bargaining model to quantify how the merger could increase the fees that rival MVPDs would pay for Turner programming. The model assumes that equilibrium affiliate fees depend on the parties' relative disagreement payoffs (the value each side expects if negotiations break down). Postmerger, the merged firm's disagreement payoff rises because subscribers who would lose Turner programming during a blackout at a rival MVPD are predicted to switch to DirecTV, allowing the merged firm to capture the DirecTV margin on those diverted subscribers. This higher disagreement payoff increases the merged firm's bargaining leverage, leading to higher equilibrium affiliate fees for rival distributors.

Shapiro framed each Turner–distributor negotiation by specifying the parties' disagreement payoffs with and without the merger and then isolating how the merger changes those outside options. The payoffs turn on five inputs: (1) the subscriber loss rate at a rival MVPD if Turner goes dark; (2) the diversion share to DirecTV among those lost subscribers; (3) DirecTV's contribution margin on diverted subscribers; (4) distributor-side offsets (e.g., migration to substitute programming); and (5) the bargaining-weight parameter in the Nash bargaining solution. Rather than compute the two payoff levels explicitly, Shapiro focused on the *difference* between the disagreement payoffs with and without the merger. Under the Nash bargaining solution, this incremental change translates into a predicted increase in the negotiated affiliate fee. That is the model's mechanism for raising rivals' costs.

Applying his model, Shapiro reported positive predicted increases in affiliate fees for major rival MVPDs. Using his inputs for subscriber loss, diversion to DirecTV, and DirecTV margins, the model yielded a fee increase of \$0.76 per subscriber per month in a representative Turner–distributor negotiation. Aggregated across third-party MVPDs licensing Turner content, Shapiro calculated \$48.9 million per month—or \$586.6 million per year—in additional programming costs to rival distributors. Assuming partial pass-through to retail prices, he translated those higher affiliate fees into \$9.8 million to \$23.9 million per month—or \$117.6 million to \$286.8 million per year—in increased costs borne by rival MVPD subscribers, depending on the pass-through rate.

Shapiro compared his estimated EDM savings of approximately \$352 million per year to the \$586.6 million per year in additional affiliate fees his Nash bargaining model predicted for rival MVPDs. While acknowledging the merger's efficiencies from EDM as real, he determined they were outweighed by the competitive harm from increased programming prices to rival distributors. Because the predicted cost increases to rivals substantially exceeded the cost savings to DirecTV, Shapiro concluded the merger would produce a net reduction in consumer welfare and, on that basis, would lessen competition.

The court's evaluation of the Shapiro approach. Judge Leon was not convinced that the Nash bargaining model applied to the AT&T/Time Warner merger. He characterized the model as a “Rube Goldberg” theoretical construct whose predictions turn mechanically on parameter choices rather than observed bargaining behavior. Shapiro's own concessions on cross-examination—that “bargaining is a dark art” that may turn on “unpredictable factors,” including “personalities” and other “hairly stuff”—undercut the claim that the Nash solution reliably maps real-world negotiations into higher affiliate fees.

The court also had serious concerns about the reliability of the model's key inputs. The opinion singled out the subscriber loss rate for scrutiny. Shapiro used 9 percent, the number reported in a

Charter analysis provided during the DOJ investigation. However, when the same analysis was presented to Charter's board, it reported a 5 percent loss rate—an inconsistency Shapiro was unaware of at trial and could not reconcile. Shapiro agreed that, using a 5 percent subscriber loss rate, EDM savings would exceed the predicted cost increases to rivals under his framework.

Finally, the court found that the model's probative value was further undermined because it did not incorporate Turner's long-term affiliate agreements. Those multi-year contracts—many extending well into the future—fixed affiliate fees and renewal mechanics and therefore limited when any postmerger price effects could plausibly occur. The omission resulted in the model overstating near-term effects and failing to reflect the real-world timing constraints established by the evidence accurately.

In light of these criticisms—both the model's lack of grounding in observed bargaining behavior and the unreliability of its key inputs, compounded by its failure to account for binding contract coverage—Judge Leon held that Shapiro's Nash-bargaining model lacked credibility as a predictor of Time Warner's postmerger licensing outcomes. He therefore could not credit Shapiro's model or conclude from Shapiro's testimony that prices to rival distributors would increase as a result of the transaction.

By the end of this class, you will have seen why Judge Leon rejected the DOJ's economic case. Shapiro's Nash-bargaining model failed both empirically and conceptually, leaving the government without a credible quantitative showing of harm. The next class turns to the defense case, where Professor Carlton and industry witnesses offered real-world evidence drawn from prior vertical integrations. Their testimony provides the court with a factual counterweight to Shapiro's theoretical model and sets the stage for Judge Leon's ultimate conclusion that the government failed at Step 1 of *Baker Hughes*. We will also briefly cover vertical mergers that create anticompetitive information conduits.

Enjoy the reading. As always, if you have any questions, please send me an email.