

A REASSESSMENT OF VERTICAL MERGERS WITHIN THE CONTEXT OF
ANTITRUST LAWS: THE TIME WARNER AND AT&T MERGER

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ABSTRACT

The development of Antitrust Laws in the United States has a direct correlation to the evolution of merger movements. These Antitrust Laws are still used today to challenge major corporations from consolidating in order to circumvent competition in the market. In June of 2018, AT&T, one of the largest providers of internet and cable, and Time Warner, one of the largest entertainment companies, merged to create Warner Media for \$85.4 billion. The merger was contested by the Department of Justice but was affirmed in Federal Court. In the wake of the pending appeal, this note presents the potential aftermath of the AT&T and Time Warner merger. This Note will provide background to the history of mergers, antitrust laws, and government influence on litigating these historically significant mergers. A review of the AT&T and Time Warner decision will give context to the challenges the DOJ will face in the appeals process and will evaluate the effects if the appeal is successful in overturning Judge Leon's decision. In addition, this Note will evaluate a new recommendation of policy concerning vertical mergers and discuss which standards are appropriate in prosecuting them.

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I. INTRODUCTION

On June 12, 2018 the AT&T and Time Warner Merger was affirmed by Judge Leon.¹ Powerful implications of potential transactional behavior follow such an opinion, however, the Department of Justice (“DOJ”) filed an appeal on July 13, 2018.² In order to understand why this vertical merger was so uncharacteristically challenged by the DOJ and how the outcome of the Court of Appeals will determine future potential merger transactions, a brief review of the history of mergers and antitrust laws, specifically the Clayton Act, would provide insight to this complicated situation and the charges the DOJ asserted. This Note will discuss the role government plays in choosing to litigate certain mergers and the effects government influence had on the AT&T and Time Warner prosecution. An overview of the case itself, including the legal standards that Judge Leon analyzed in order to come to his decision to sustain the merger, will be discussed. Finally, the Note will conclude with a proposal

*The Court of Appeals held that district court did not err in finding that government failed to show that the proposed merger would violate the Clayton Act, therefore the merger was upheld. *U.S. v. AT&T, Inc.*, 916 F.3d 1029, 1030 (D.C. Cir. 2019).

¹ See *U.S. v. AT&T, Inc.*, 310 F.Supp. 3d 161 (D.D.C. 2018), *aff’d sub nom. U.S. v. AT&T, Inc.*, 916 F.3d 1029 (D.C. Cir. 2019)(holding that the District Court did not err in finding that the government failed to show that proposed merger would violate the Clayton Act).

² *Id.*

for a new legal standard, specifically for vertical mergers, with specific elements that would eventuate a stable and growing economy with little threat of litigation.

II. HISTORY OF MERGERS/BACKGROUND

Mergers gained traction following the Civil War in the form of trusts, later known as cartels.³ Owners of companies formed the trusts to create a “series of interlocking companies” that appeared to be competitive in the market, but the trusts were in fact establishing monopolies.⁴ The first of which was Standard Oil in 1890, controlling all aspects of the industry resulting in the setting of whatever price they desired.⁵ The Companies that were circumventing market competition through these monopolies gave rise to antitrust laws enacted by Congress. The consolidation of ninety percent (90%) of the sugar industry in Philadelphia in 1895 was challenged by the U.S. government, but was struck down in a landmark decision. The opinion stated that manufacturing did not constitute “commerce” under the Sherman Act of the Antitrust Laws and thus did not apply.⁶ This gave rise to a wave of mergers from 1895 to 1904, resulting in a minority of trusts controlling the majority of manufacturing assets in the U.S.⁷ In 1904 the first successful antitrust prosecution known as the Northern Securities decision, the epicenter of President Theodore Roosevelt’s campaign, halted merger formations on a grand scale.⁸ Since this decision several subsequent Presidents have promised to strengthen antitrust law, which eventually translated into the development of the second major antitrust statute, the Clayton Act.⁹ Following the legislation of antitrust laws, merger transactions have ebbed and flowed with the economy and are still a healthy constant in the market today.

³ See C. Paul Rogers III, *A Concise History of Corporate Mergers and the Antitrust Laws in the United States*, 24 Nat’l L. Sch. India Rev. 10, 11 (2013).

⁴ *Id.* at 11.

⁵ *Id.* at 11.

⁶ *Id.* at 11.

⁷ *Id.* at 11.

⁸ *Id.* at 12.

⁹ ROBERT W. HAMILTON & RICHARD A. BOOTH, *BUSINESS BASICS FOR LAW STUDENTS* 393 (Vicki Been, et al. eds., 4th ed. 2006).

III. ANTITRUST LAWS UNDER THE CLAYTON ACT

The first enacted antitrust legislation was the Interstate Commerce Act of 1887, then the Sherman Act of 1890, and finally the Clayton Act of 1914.¹⁰ The Federal Trade Commission was established that same year in order to enforce federal antitrust laws. The Sherman Act was introduced in order to regulate oppressive business practices associated with cartels and to prevent monopolies. The Sherman Antitrust Act is a federal law prohibiting any contract, trust, or conspiracy in restraint of interstate or foreign trade. The Clayton Act was passed in order to strengthen and clarify the provisions of the Sherman Act, while introducing new regulation regarding price fixing, price discrimination and other unfair business practices. For the purposes of this paper a further analysis of only the Clayton Act is pertinent to the Time Warner merger.

The purpose of antitrust laws is to regulate companies to ensure deceptive trade practices are not used, and ultimately to prevent monopolies from circumventing competition. The Clayton Act identifies acquisitions that have the effect of substantially lessening competition or those that tend to create a monopoly.¹¹ In the 1912 presidential election, all three candidates stood on the platform that Congress was too lenient on corporations within the bounds of the Sherman Act.¹² After elected, Woodrow Wilson enacted Congress to draft legislation that would strengthen the antitrust laws, which lead to the creation of the Clayton Act.¹³ The purpose of the Clayton Act is in direct contention with how Congress treats horizontal and vertical mergers alike and with similar scrutiny. The effects of vertical mergers are far less disruptive to the market than horizontal mergers and are considered competitively neutral by many economic specialists.¹⁴

In the AT&T and Time Warner merger, the Court had to analyze whether the merger violated the Clayton Act by encouraging post-merger coordinated interaction amongst corporations within the relevant entertainment market. The Court determined that looking at whether the corporation could wield anticompetitive power by utilizing their shared

¹⁰ See <http://legalcareerpath.com/antitrust-law/> (last visited November 19, 2018).

¹¹ 15 U.S.C.A. § 18 (West, February 8, 1996).

¹² <https://antitrustlaws.org/clayton-act.html> (last visited November 19, 2018).

¹³ *Id.*

¹⁴ See Michael H. Riordan and Steven C. Salop, Evaluating Vertical Mergers: A Post-Chicago Approach, 63 Antitrust L.J. 513, 516 (1995).

economic interest within the market with respect to “price and output decisions” would be the determining factor in analyzing a Clayton Act violation.¹⁵ Section 7 of the Clayton Act “prohibits acquisitions, including mergers, ‘where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition.’”¹⁶ In order for the Court to assess the Government’s Section 7 case, an investigation into a ‘comprehensive inquiry’ of the ‘future competitive conditions in a given market,’ must be completed within the context of the Clayton Act, in that it protects ‘competition,’ rather than any particular competitor.¹⁷ In other words, the Clayton Act requires the Court to make a prediction of future market effects in order to rule accurately in the present position, an important shortcoming of the Act in the judiciary system.

IV. GOVERNMENT INFLUENCE

For a number of mergers, “acquirers and/or targets are constituents of U.S. Senators and House Representatives that serve on the U.S. congressional committees charged with oversight of U.S. antitrust regulators. The two committees are the House Judiciary Committee and the Senate Committee on the Judiciary....”¹⁸ Judiciary committees are motivated, and in the most opportunistic position, to influence antitrust outcomes.¹⁹ Government influence as a means of motivation to challenge the merger was raised and dismissed by Judge Leon in his opinion.

AT&T and Time Warner participated in oral argument alleging that the opposition to the merger was politically influenced. Judge Leon refused the request for White House communications with the DOJ. The lawsuit reflected President Trump’s opposition to the merger, more specifically his outrage toward Time Warner’s CNN.²⁰ Judge Leon ruled that “Defendants have fallen far short of establishing that this enforcement action was selective,” in order to obtain the communications with the

¹⁵ *Supra* note 1.

¹⁶ *Supra* note 1 at 190.

¹⁷ *Supra* note 1 at 190.

¹⁸ Mehta, Mihir N. and Srinivasan, Suraj and Zhao, Wanli, *Political Influence and Merger Antitrust Reviews* 1,2 (September 13, 2017). Available at SSRN: <https://ssrn.com/abstract=2945020> or <http://dx.doi.org/10.2139/ssrn.2945020>.

¹⁹ *Id.* at 2.

²⁰ Shannon Bond, Judge Refuses AT&T Requests for White House Communications Financial Times (Feb. 20, 2018) <https://www.ft.com/content/fc713c60-1681-11e8-9e9c-25c814761640>.

White House.²¹ Historically, democratic administrations in the White House have more frequently opposed mergers than republican administrations. “Vertical merger enforcement is less common than horizontal enforcement. It also varies more from one administration to another. According to our count, there have been forty-six vertical enforcement actions in the 1994–2013 period of twenty years. The DOJ and FTC brought about thirty-one enforcement challenges during the two Clinton administration terms. During the two G.W. Bush administration terms, the two agencies brought only seven enforcement actions. And, through 2013 of the Obama administration, the two agencies have brought eight enforcement actions.”²² It is so uncommon for a republican administration to influence the DOJ to pursue litigation against a merger, and even more rare for the litigation to be aimed at a vertical merger, that the enforcement against the merger is riddled with a “selective” undertone. These actions by the DOJ are especially suspicious given that the DOJ just approved a similar acquisition in late June between Disney and 21st Century Fox with the minor stipulation that Fox spin off its regional sports network.²³ President Trump has a positive relationship with conservative news station Fox, despite his overall scrutiny of journalism, which in turn propagates selective litigation efforts against Warner Media. These were similar mergers in terms of market share and effect, however one is prosecuted and the other is left unhindered.

V. BRIEF HISTORY OF U.S. v. AT&T INC.

The case of U.S. v. AT&T Inc. was highly publicized and was the first challenge to a vertical merger in decades. Judge Leon discussed the burden of proof the government was required to meet in order to enjoin the merger. A further discussion on the effects of Judge Leon’s decision is discussed in order to illustrate the precedential influence on future vertical mergers and could change the way litigators present their economic analysis to the court in future lawsuits.

²¹ *Id.*

²² Salop and Culley, *Potential Competitive Effects of Vertical Mergers: A How-To Guide for Practitioners*, 1, 4 Georgetown L.J. (2014).

²³ Adi Robertson and Makena Kelly, Why yesterday’s AT&T and Time Warner merger appeal matters — and why it’s a long shot, *The Verge* (July 13, 2018, 11:01AM) <https://www.theverge.com/2018/7/13/17566326/justice-department-att-time-warner-merger-ruling-appeal-explainer>.

A. *Burden of Proof*

Judge Leon published his opinion stating that the Government had the burden of proof to demonstrate that the merger is likely to lessen competition substantially.²⁴ The prerequisite for an illegal acquisition or merger is based on the effect of that action, not the motivation or influences that lead to the merger. In order to satisfy the government's burden of proof that the merger would substantially lessen the competition, the government must show that the effect would be "sufficiently probable and imminent"²⁵. The burden of proving the effect would only shift to the Defendant if the government could establish a prima facie case, in which the defense would have to prove through sufficient evidence that the prima facie case "inaccurately predicts the relevant transaction's probable effect on future competition."²⁶

This burden is particularly hard for the government to overcome in the event of a vertical merger. A vertical merger consolidates together companies that operate in different parts of a production and distribution chain within the same market, as opposed to a horizontal merger that would combine direct competitors.²⁷ In the case of a vertical merger the Government can only overcome the burden by presenting a fact specific argument that the effect of the merger is likely to be anticompetitive.²⁸ The Government failed to provide evidence sufficient to meet this standard and Judge Leon ultimately ruled in favor of the merger.

B. *Effect of Decision*

After careful analysis, Judge Leon attributed his decision to the elimination of double marginalization.²⁹ Two different firms in the same

²⁴ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 165 (D.D.C. 2018) (opinion of Honorable Richard J. Leon).

²⁵ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 190 (D.D.C. 2018) (quoting *F.T.C. v. Arch Coal, Inc.*, 329 F.Supp. 2d 109, 115 (D.D.C. 2004)(internal citations omitted).

²⁶ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 191 (D.D.C. 2018) (quoting *United States v. Anthem, Inc.*, 855 F.3d 345, 349 (D.C. Cir. 2017)(internal citations omitted).

²⁷ *Supra* note 20.

²⁸ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 192 (D.D.C. 2018).

²⁹ *See U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 197 (D.D.C. 2018).

industry merge and effectively decrease their price markups by eliminating their stacked margins, which is ultimately passed on to consumers.³⁰

Fortunately, Judge Leon's decision will presumptively have a significant impact on future deals, specifically vertical transactions. "[J]udge Leon's decision is a welcome reminder of the importance of evidence-based antitrust and a triumph of the role of economic analysis in antitrust law."³¹ The thorough economic analysis the Court relied on will influence litigators in the future on how they present their evidence and how their expert witnesses will provide insight in future merger cases. Judge Leon's decision to approve the merger encourages other companies within vertical merger stances to bid on other companies.³² Vertical mergers are seen for what they are after this highly publicized litigation, efficient and pro-competitive.

VI. APPEAL OF U.S. V. AT&T

If the Justice Department successfully appeals the merger, AT&T and Time Warner would be forced to split off the new subsidiary "Warner Media". The Court could fast-track the case and hear it within a few months, which would prevent further integration of the companies.³³ AT&T and Time Warner would be required to pay a break up fee of \$500 million if the merger was overturned.³⁴ The Court of Appeals is unlikely to reverse the merger given the integration of the companies. "Courts are even more reluctant to grant divestiture today and, further, a private litigant faces an uphill battle to prove money damages since it must establish causation between the unlawful merger and its loss of revenue or profits."³⁵ Warner Media has already begun offering consumers bundled entertainment packages and are driving new customers to sign up for its phone plans.³⁶ De-integration of the company would have an adverse affect on consumers that are already benefitting from the merger and since

³⁰ *Id.* at 197.

³¹ Joshua D. Wright and Jan Martin Rybnicek, *AT&T/Time Warner Decision: The Triumph of Economic Analysis*, (June 27, 2018) <https://fedsoc.org/commentary/blog-posts/at-t-time-warner-decision-the-triumph-of-economic-analysis>.

³² David Dayen, *The AT&T – Time Warner Merger Is Already What the Government Feared*, THE NEW REPUBLIC MAG. (June 22, 2018), <https://newrepublic.com/article/149305/at-time-warner-merger-already-government-feared>.

³³ *See Id.*

³⁴ *Supra* note 1 at 165.

³⁵ *Supra* note 3 at 28.

³⁶ *See supra* note 32.

antitrust laws are enforced based on consumer welfare, a successful appeal seems unlikely.

Recent developments of Warner Media's behavior regarding pricing of current customer packages could hurt their case. "Judge Leon's ruling argued that AT&T and Time Warner could offer better and cheaper options to customers by merging."³⁷ However, immediately following Judge Leon's ruling AT&T increased their price for DirectTV Now Service, pushing consumers to downgrade their service for bundled packages.³⁸ The main objective of antitrust laws is to regulate the market, which ultimately protects the consumers from price gouging. A decrease in price of DirectTV was specifically stated in the opinion as a reason for merger approval.³⁹ This may provide the appeals court with the "meaningful real world evidence" the Government needed to meet their burden of proof to enjoin the merger.⁴⁰ Such behavior of Warner Media implies that the Government was correct in surmising that the merger would not benefit consumers and price increasing would likely occur. Another issue that was not present in the initial trial but may become a problem in the future is the price increase of the unlimited data plans for the phone services Warner Media is selling.⁴¹ By utilizing the new and exclusive entertainment packages available after the merger to drive their phone plan prices up through data allowances, the DOJ may be able to show "real world evidence" that the merger had an anticompetitive effect.

"In antitrust parlance, this is known as "tying." As the U.S. Federal Trade Commission notes, "The law on tying is changing. Although the Supreme Court has treated some tie-ins as per se illegal in the past, lower courts have started to apply the more flexible 'rule of reason' to assess the competitive effects of tied sales." But using HBO to drive cell phone subscriptions, when rivals can't do the same, should face legal scrutiny."⁴²

³⁷ Adi Robertson and Makena Kelly, Why yesterday's AT&T and Time Warner merger appeal matters — and why it's a long shot, THE VERGE (July 13, 2018, 11:01AM) <https://www.theverge.com/2018/7/13/17566326/justice-department-att-time-warner-merger-ruling-appeal-explainer>.

³⁸ *Id.*

³⁹ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 198 (D.D.C. 2018).

⁴⁰ *Id.* at 199.

⁴¹ *Supra* note 37.

⁴² *Supra* note 37.

This legal argument cannot be introduced at the Court of Appeals, as this is new evidence that was not presented at the initial trial, however it is hard to ignore the behavior of Warner Media in the aftermath of the merger. These actions can present a problem for Warner Media in proving the DOJ's arguments were not without weight, especially in support of their theory of their probable harm argument. The Court can subjectively look at the price increase as non-significant and can show that consumers are getting more for what they were paying for, given the advanced content that wasn't available before, with bundled packages including phone services. Judge Leon relied heavily on the economic analysis presented by experts in Court. "Judge Leon concluded that Dr. Carlton's analysis, which definitively showed that prior instances of vertical integration in this industry have had no statistically significant effect on content prices, could be afforded probative weight in predicting the potential pricing effects of the AT&T/Time Warner transaction."⁴³ The Appeals Court will likely side with Judge Leon given the substantial amount of economic analysis based on prior transactional history that the vertical merger is unlikely to reduce competition in the market.⁴⁴

VII. RECOMMENDATION OF POLICY

Vertical mergers are less likely to cause market disruption in the form of anticompetitive effects, especially in an oligopolistic market. This ideology should be reflected in the policies and legal standards that govern vertical mergers specifically, instead of utilizing the same legal standards as horizontal mergers.

It is important to note, however, that while some vertical mergers may facilitate oligopolistic coordination, firms may also vertically integrate or merge in order to evade oligopolistic coordination or cheat on a collusive agreement. One example is provided by the wave of acquisitions by cement companies of concrete firms in the 1970s, a merger wave that set off concerns at the FTC that these mergers were facilitating coordination or even collusion, or perhaps foreclosure. On closer examination, however, it appears that cement firms were acquiring concrete companies in order to evade oligopolistic discipline in

⁴³ See *supra* note 31.

⁴⁴ The Court of Appeals affirmed the decision in the District Court stating that the District Court did not abuse its discretion in denying injunctive relief. *U.S. v. AT&T, Inc.*, 916 F.3d 1029, 1046 (D.C. Cir. 2019).

maintaining cement prices. It is hard to think of a clearer example of the cost of false positives.⁴⁵

Further, the 1984 Vertical Merger Guidelines included quasi-safe harbor provisions for specific oligopolies but broader safe harbor provisions should be reassessed during Guideline revision.⁴⁶ The technology sector has expanded so greatly since the adoption of these Guidelines that incentives to integrate, especially in the telecommunications market, greatly motivate vertical mergers today.⁴⁷

Currently, the DOJ has authority to pursue litigation against mergers by benefitting from a presumption of illegality when said merger threatens to create an undue concentration in the market.⁴⁸ A merger presents an undue concentration in the market when the surviving corporation will control thirty percent (30%) or more of the total market share, within the proscription of the Clayton Act.⁴⁹ Fortunately, the DOJ did not have the benefit of the presumption because the vertical merger did not increase market concentration due to the verticality of the deal. Therefore, the DOJ was required to present evidence of antitrust violations that would substantially lessen competition without the market share evidence to reinforce their argument, which likely changed the outcome of the case.

This can be analyzed in two different ways. One, mergers that result in a surviving corporation that controls less than thirty percent (30%) of the total market share cannot satisfy the requisite standard of illegality of antitrust laws. Two, all vertical mergers are not subject to violation of antitrust laws due to their lack of disruptiveness on the market. A vertical merger that involves elements of a horizontal merger, such as a merger of firms producing complementary products, could avoid needless litigation by offering conditions on the merger.⁵⁰

⁴⁵ Frederick R. Warren-Boulton, *The Contribution of the Merger Guidelines to the Analysis of Non-Horizontal Mergers*, <https://www.justice.gov/sites/default/files/atr/legacy/2007/07/11/11709.pdf> at 6.

⁴⁶ Salop and Culley, *Potential Competitive Effects of Vertical Mergers: A How-To Guide for Practitioners*, GEORGETOWN L.J. (2014).

⁴⁷ *See supra* note 44 at 7.

⁴⁸ *See U.S. v. Philadelphia Nat. Bank*, 374 U.S. 321 (1963).

⁴⁹ *Id.* at 1.

⁵⁰ *See supra* note 45 at 5.

Ultimately a more realistic approach to avoid needless litigation would be to apply a new standard solely to vertical mergers:

1. Vertical mergers should be given the least stringent scrutiny in the review process under Antitrust Laws given their non-disruptive effect on the market.⁵¹
 - a) The Burden of Proof should be placed on the Government to show substantial anticompetitive behavior.
 - b) A presumption of good faith should lie with the corporations and the structural presumption should automatically apply.⁵²
 - c) *Note:* A review and revision of the Clayton Act could adapt this new standard.
2. Elements
 - a) Vertical merger must lack substantial horizontal merger elements; and
 - b) Result in minimal anticompetitive effects on the current or immediate future of the market.

These proposed elements would counter wasteful litigation in the event of a routine vertical merger. Emerging markets, such as the technology sector, should be celebrated and advocated by the judicial system, not delayed and countered due to political influence and frivolous concerns of monopolizing markets.⁵³ The elements would specifically address vertical mergers and how to proceed through them during a judicial review process, as opposed to relying on subjective interpretations of common law or borrowing outdated prose from the non-horizontal merger guidelines. The vertical guidelines should be revised and reviewed by the DOJ, not only by the companies, as their purpose is to “inform

⁵¹ *Contra* Michael H. Riordan and Steven C. Salop, Evaluating Vertical Mergers: A Post-Chicago Approach, 63 ANTITRUST L.J. 513, 516 (1995).

⁵² *Supra* note 31 (“The DOJ’s loss in AT&T/Time Warner is a reminder that the structural presumption is a powerful tool for the government and one that may be doing real harm if it allows the antitrust agencies to win merger challenges even when they cannot produce evidence sufficient to carry their burden of showing that the transaction is likely to harm consumers.”).

⁵³ *U.S. v. AT&T Inc.*, 310 F.Supp. 3d 161, 193 (D.D.C. 2018).

parties which economic scenarios the Agencies will take seriously when considering potential anticompetitive effects (e.g., raising entry barriers, collusion, regulatory evasion) or efficiencies (e.g., counteracting the incentive to free ride).⁵⁴ Further, the DOJ should only pursue litigation of mergers that have been subject to investigation and show elements of horizontal merger concerns. The DOJ should not be influenced by political motivations and government insistence to pursue vertical mergers. Once a merger, subject to investigation, passes muster of the previously cited elements, the DOJ should not halt business transactions.

VIII. CONCLUSION

In conclusion, the Appeals Court will most likely affirm the decision approving the merger of AT&T and Time Warner. Businesses can take a cue from this likely outcome and focus on acquiring businesses that would satisfy a vertical merger in order to stay relevant in the evolving landscape of business. The Court should be wary of government influences of merger reviews beyond the “selective” standard currently in play in order to keep the markets healthy and competitive.⁵⁵ Reviewing vertical mergers under the standard of per se illegality is misguided and ignores the underlying economic opportunity costs. Therefore, a new standard should apply for vertical mergers that satisfy the proper characteristics of a non-threatening merger. Promoting business transactions with little resistance from potential litigation would protect companies and advocate for a growing stable economy. The Antitrust laws are better served when the consumer reaps the benefits from vertical integration, such as the AT&T and Time Warner merger.

⁵⁴ *Supra* note 45 at 8.

⁵⁵ *See supra* note 20.