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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In The Matter of	)	
	)	
Evaluation of the Syndication and Financial Interest Rules	)	MM Docket No. 90-162
	)	

Comment of the Staff of the Bureau of Economics of the Federal Trade Commission*

September 5, 1990

* This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner. Inquiries regarding this comment should be directed to Bruce Kobayashi (202-326-3363) of the FTC's Bureau of Economics.

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Executive Summary

The staff of the Federal Trade Commission have submitted the attached comment in response to the Federal Communications Commission's notice of proposed rulemaking to evaluate the financial interest and syndication rules. The Commission's Financial Interest and Syndication ("Fin-Syn") Rules limit broadcast networks' ability to integrate vertically into the sale and distribution of syndicated programming. Specifically, the rules prohibit the networks from engaging in the domestic syndication of any program or the foreign syndication of any independently-produced (i.e., nonnetwork produced) programs. The rules also prohibit the networks from obtaining any financial interest, or proprietary right or interest, in the exhibition, distribution, or use of programs produced by others, except for the exclusive right to network exhibition in the United States. The rules were originally intended to constrain the broadcast networks' ability, individually or collectively, to act as monopsonists in the purchase of programs from independent producers. More recent concerns have suggested that the rules may also prevent the broadcast networks from acting as monopolists in the sale of "newly produced-off-network" programs (i.e., programs that originally aired on a network that are resold as re-runs in the syndication market) to independent television stations.

In 1983, the FTC staff submitted a comment and a reply comment on a similar proposed rulemaking. In those comments, the staff expressed doubts that the Fin-Syn rules had affected the networks' ability to exercise monopsony power in the purchase of programs, and questioned the existence of monopoly power in the sale of off-network programs. The staff, noting the growing importance of alternative broadcast media such as cable, multipoint distribution systems, etc., suggested that the arguments against retaining the rules would apply *a fortiori* in the future. Finally, it was suggested that the

rules likely would reduce efficiency in the market for new programming. Accordingly, the staff recommended that the FCC repeal the rules.

The attached comment re-examines the issues addressed in the 1983 FTC staff comments in light of changes in the market since 1983. Three substantive issues are addressed. First, we re-examine the rules' impact on the efficiency of the market for new programming. The 1983 FTC staff comments suggested that the rules interfered with the efficient sharing of risk between the networks and the producer of the program. The attached comment examines other ways in which the rules, by restricting the ability of the networks to integrate vertically, may decrease the efficiency of the market for new programming. Specifically, we examine the impact of the Fin-Syn rules on the networks' willingness to make program specific investments. Because the rules may prevent the networks from using the least cost arrangement to prevent opportunistic behavior on the part of the program producers, they may be less willing to make value-creating investments in activities such as program promotion or scheduling.

Second, we re-examine the monopsony issue. Our findings are consistent with the predictions of the 1983 FTC staff comment with respect to the emergence of alternative distribution outlets for programming (e.g., cable, the fourth network Fox, and the growth in independent television stations and video). Thus, whatever the degree of monopsony power existing at the time of the rules' promulgation or at the time of the 1983 comments (and existing evidence does not support such a claim), such power has likely declined. Moreover, to the extent that monopsony power is present, prohibiting or restricting the extent of vertical integration by the monopsonists (i.e., the networks) exacerbates, rather than diminishes, the attendant welfare losses. Under these circumstances, allowing a monopsonist to integrate vertically may, however, result in reduced profits for the input suppliers (program producers)

who remain independent. Such an outcome, although efficient, could conflict with the FCC's stated goal of improving the profitability of the program producers *vis-a-vis* the networks.

Finally, we examine the monopoly issue. We examine in detail the argument that the networks, by acquiring small financial interests in the syndication revenue of the programs, can monopolize the off-network syndication market. We observe that the monopolization issue does not arise unless one can defend an antitrust market defined as "newly-produced-off-network programs." The threat of monopolization would be considerably less credible if older off-network programs (since nonnetwork syndicators currently hold a large stock of such programs) or first run syndicated programs (which make up a growing share of the total market for syndicated programs) are part of the relevant antitrust market. Even if this restrictive market definition can be defended, however, the existing (albeit scarce) empirical evidence is not suggestive of actual or attempted network monopolization of syndication rights.

Overall, the comment concludes that a compelling economic case does not exist for continuing to impose a *per se* ban on the networks' acquisition of certain broadcast rights to newly-produced television programs. Competition would be better served by removing the restrictions, and addressing instances of alleged monopolization through application of conventional antitrust enforcement powers.

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Comment of the Staff of the Bureau of Economics of the Federal Trade Commission[1]

I. Introduction

The staff of the Federal Trade Commission appreciates this opportunity to submit a comment in response to the Federal Communication Commission's Notice of Proposed Rulemaking (NPRM) to evaluate the financial interest and syndication ("Fin-Syn") rules.[2] The FCC is seeking comment on a variety of proposals to modify the existing Fin-Syn rules. Our comment addresses issues relating to economic efficiency, competition, and the enforcement of the antitrust laws. It does not discuss other policy considerations that may be of relevance to the FCC.[3]

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[1] This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner. Inquiries regarding this comment should be directed to Bruce Kobayashi (202-326-3363) of the FTC's Bureau of Economics.

[2] *See Notice of Proposed Rulemaking* In the Matter of the Syndication and Financial Interest Rules, MM Docket No. 90-162, issued March 14, 1990.

[3] Our comment is based on positive economic analysis and therefore does not explicitly address normative concerns falling outside the scope of such an analysis (e.g., the potential that changing the rules will re-distribute rents from one of the interested parties to another). These and other concerns not explicitly addressed in this comment should be considered separately.

Section II summarizes the expertise of the staff of the Federal Trade Commission. Section III reviews the history of the current NPRM. The remainder of the comment addresses a number of the issues raised in the NPRM. Section IV summarizes the economic issues addressed in this comment. In Section V, we re-consider the analysis of the rules' impact on efficient risk-sharing and articulate in greater detail the conditions under which the rules will create inefficient risk allocations. We focus on the unique informational position of the networks and on the potential for opportunism when transaction-specific assets create market power after contracts are signed. The use of vertical integration as a solution to such problems is discussed in this section.

This comment also examines, from a more general theoretical perspective, the implications of vertical integration for economic welfare. Section VI examines the impact of vertical integration if the networks could collectively exercise market (i.e., monopsony) power over competitive programmers. It is shown that in this case, allowing vertical integration by the networks will likely increase the efficiency with which programs are produced and distributed, and likely increase programming output. Thus, to the extent that the networks collectively exercise monopsony power (and existing evidence does not support such a claim) vertical integration may reduce any welfare losses attributable to monopsony. Under these circumstances, allowing a monopsonist to integrate vertically may, however, result in reduced profits for the input suppliers (program producers) who remain independent. Such an outcome, although efficient, could conflict with the FCC's stated goal of improving the profitability of the program producers *vis-a-vis* the networks.

Finally, Section VII explores issues relating to the acquisition and exercise of market (monopoly) power in the sale of "off-network" programs to a competitive independent television station industry. This section examines

the extent to which an antitrust market for "newly-produced off-network programs" can be defined. We examine the networks' behavior in the period preceding the adoption of the Fin-Syn rules in an attempt to discern whether this behavior was consistent with a successful effort to acquire and exercise market power. Although such an examination cannot yield conclusive findings, the networks' activities in the pre-1970 period do not appear to have been consistent with an attempt to monopolize the market for "off-network" programs. We also discuss the economic analysis supporting the retention of the Fin-Syn rules. Although the possibility of program market monopolization cannot be ruled out, we do not find compelling evidence that such an outcome is likely, nor do we find evidence to support the *per se* ban on the acquisition of certain broadcast rights imposed by the Fin-Syn rules.

II. Expertise of the Staff of the Federal Trade Commission

The FTC is an independent regulatory agency responsible for maintaining competition and safeguarding the interests of consumers.[4] In response to requests by federal, state, and local government bodies, the staff of the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy. In the course of this work, as well as in antitrust and consumer protection research, nonpublic investigations, and litigation, the staff applies established principles and recent developments in economic theory to competition and consumer protection issues, including efficiency rationales for rate and entry regulation.[5]

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[4] 15 U.S.C. §§ 41 - 59.

[5] *See, e.g.*. Mathios and Rogers, *The Impact of State Price and Entry Regulation on Intrastate Long Distance Telephone Rates*, Bureau of Economics Staff Report to the Federal Trade Commission, November 1988.

The FTC staff previously has issued a comment and a reply comment to the FCC on the Fin-Syn rules.[6] The FTC staff also has commented on a variety of other issues before the FCC, including: (1) issues concerning competition, rate deregulation and the FCC's policies relating to the provision of cable television service;[7] (2) elimination of the prohibition on common ownership of cable television systems and national television networks;[8] (3) rules relating to whether cable television systems "must carry" television broadcast signals;[9] and (4) the FCC requirement that broadcast licenses be held for at least three years before being transferred.[10]

III. Background of the Current NPRM

A. History of the Current NPRM

On January 30, 1990, Fox Broadcasting Company ("Fox") filed a Petition for Resumption of Rulemaking and Request for Relief ("Petition") in BC Docket No. 82-345. Fox sought: (i) a temporary waiver to avoid application of the Fin-Syn and prime time access rules to the Fox television network and its affiliates; and (ii) a resumption of the FCC's consideration of the proposed changes in the Fin-Syn rules, 47 C.F.R. § 73.685(J)(1)(i) and (ii). Subsection (j)

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[6] *See Comments of the Bureaus of Consumer Protection, Economics, and Competition of the Federal Trade Commission* In the Matter of Amendment of 47 CFR §73.658(j) (The Syndication and Financial Interest Rule), January 27, 1983; and *Reply Comments of the Bureaus of Consumer Protection, Economics, and Competition of the Federal Trade Commission*, In the Matter of Amendment of 47 CFR §73.658(j) (The Syndication and Financial Interest Rule), April 26, 1983.

[7] *See Comment of the Staff of the Bureau of Economics and the San Francisco Regional Office of the Federal Trade Commission* In the Matter of Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, April 20, 1990.

[8] CT Docket No. 82-434.

[9] MM Docket No. 85-349.

[10] BC Docket No. 81-897.

(1) (i) of the Fin-Syn rules forbids broadcast networks from engaging in the domestic syndication of any program or the foreign syndication of independently-produced (i.e., non-network produced) programs.[11] Subsection (j) (1) (ii) prohibits broadcast networks from obtaining any financial or proprietary right or interest in the exhibition, distribution, or use of programs produced by others except for the exclusive right to network exhibition in the United States.[12]

The second issue in the Fox petition re-opened a seven and a half year old FCC inquiry into whether the repeal of the Fin-Syn rules would be in the public interest. On March 14, 1990, Docket No. 82-345 was terminated, and in a separate order, MM Docket No. 90-162, a new rulemaking to evaluate the Fin-Syn rules was instituted. Fox's request for temporary relief, addressed in a separate non- docketed proceeding, was granted on May 4, 1990.[13]

B. Previous FTC Staff Comments on the Fin-Syn Rules

1. Constraining Networks' Monopsony Power

As mentioned above, in 1983 the FTC staff commented on a proposal to repeal the Fin-Syn Rules. In those comments, we expressed doubts that these rules served any of the goals sought by the FCC. In addition, our analysis

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[11] "Syndication" refers to the sale of programs on a market-by-market basis to independent television stations. There are two basic categories of syndicated programs, "first-run" and "off-network". First-run syndicated programs are shows produced specifically for the syndication market. Off-network programs are shows that originally ran on a network and are sold as re-runs in the syndication market.

[12] The rule bars only the acquisition of broadcast rights. The networks are allowed to acquire nonbroadcast (i.e., cable or pre-recorded video) rights. See 87 F.C.C. 2d. 30 (1981) and *Viacom Int. Inc. v. F.C.C.*, 672 F2d. 1034 (1982).

[13] The Fin- Syn rules apply to "interconnected program services" with 15 or more programming hours per week. The waiver, passed by a 4-0 vote, allows Fox up to 18.5 hours of programming. The waiver lasts for a period of one year.

suggested that the rules likely would reduce efficiency in the market for new programming. Accordingly, we recommended that the FCC repeal the rules.[14]

The rules' original purpose was to constrain the three major networks' (ABC, CBS, and NBC) ability, individually or collectively, to act as *monopsonists* in the purchase of programs from independent producers. By constraining the ability of the networks to exercise market power in the purchase of programs, the FCC hoped to increase the profitability of the programs' suppliers, to reduce "favoritism",[15] and to increase program diversity.

In 1983 the FTC staff concluded that the Fin-Syn rules did not promote these goals. This conclusion was based on three major propositions. First, since the rules did not address the source of any potential monopsony power (i.e., the structure of network broadcasting), it appeared unlikely that they would be effective in constraining such power. Second, the rules were unnecessary, since it appeared unlikely the networks could individually or collectively exercise market power in the purchase of programs. Third, the rules appeared likely to

[14] Shortly after the comments were filed, the FCC indicated an intention to repeal the rules in the near future. *See* Tentative Decision and Request for Further Comments, 94 F.C.C.2d 1019, 1027 (1983) (BC Docket 82-345). However, this action was never taken. The Fin-Syn rules obviously limit the extent to which the networks can integrate program production and distribution. The networks' ability to integrate vertically is also limited by Department of Justice consent decrees that limit in-house program production, and place restrictions on the length of option terms that the networks can negotiate. *See* 5 Trade Reg. Rep, CCH at 50,766 (1980) [ABC decree], 1980-81 Trade Cases at 63,594, [CBS Decree], 1978-1 Trade Cases, at 61, 855 [NBC Decree]. The provisions limiting in-house production will expire in November 1990. The restrictions on option length will expire in November 1995. However, the financial interest and syndication provisions of the decree are perpetual, and the networks will have to seek an order modification from the Department of Justice in order to engage in domestic syndication. *See* Comments of the U. S. Department of Justice in the Matter of Evaluation of the Syndication and Financial Interest Rules, MM Docket No. 90-162 (June 14, 1990), note 5. Thus, the repeal of the Fin-Syn rules is only a necessary, and not a sufficient, condition for the networks to engage in domestic syndication.

[15] The FCC wished to prevent networks from giving those programs in which they had acquired a financial interest preferential treatment (e.g., in terms of renewal, time slots, etc.). *See* 23 F.C.C. 2d 382, 392-99 (1970).

entail substantial costs by disrupting the market's ability to allocate risk efficiently.

Concerning the first proposition -- that the rules did not address or eliminate the source of the alleged network market power -- the FTC staff questioned whether rules affecting only a subset of broadcast programming rights could effectively constrain the exercise of such market power. Since the networks were left free to exploit any existing market power via the manipulation of the remaining contract terms (e.g., the fee for the initial broadcast rights), it appeared that the rules would, at most, simply alter the form through which any existing market power would be exercised.[16]

Concerning the second proposition, our 1983 comments questioned whether the networks were in fact likely to possess joint or unilateral market power in the purchase of programming. These doubts were based on the apparently increasing importance of alternative sources of program

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[16] Abstracting from other regulation-induced changes, it is unlikely that the Fin-Syn rules would have a major effect on the outcome of the bargaining process between a network and an independent producer. To the extent that networks are interested only in the initial broadcast rights, the rules are unlikely to have any effect. In the case where the networks would have purchased both the initial and syndication broadcast rights, a monopsonist network would reduce the purchase price paid to the program supplier by the amount of the expected value of the syndication broadcast rights. Thus, the bargaining position of the independent program supplier is not improved through the imposition of the rule. As we argue in Section VI, repeal of the rules and the subsequent entry by the networks into the production and sale of programming may make independent program suppliers worse off while simultaneously reducing the welfare losses associated with monopsony. Thus, contrary to the claim made in the economic comment submitted by the Coalition to Preserve the Financial Interest and Syndication Rule (the Coalition), this outcome is consistent with an increase in efficiency from removing the Fin-Syn rules and with the opposition to their removal by independent program suppliers. *See* F. R. Warren-Boulton, "Economic Analysis and Policy Implications of the Financial Interest and Syndication Rule," submitted by ICF Consulting Associates on Behalf of the Coalition to Preserve the Financial Interest and Syndication Rule, MM Docket No. 90-162 (June 14, 1990).

distribution,[17] and upon the difficulties that the networks might encounter if they attempted to establish and maintain a collusive agreement to exercise joint monopsony power. The increasing importance of alternative sources of program distribution would make the program supply faced by the networks more elastic, reducing the potential gain from any monopsony power the networks might have in the absence of these substitutes. If joint monopsony power is nonexistent, or prohibitively difficult to exercise, rules designed to constrain such power would be unnecessary and could reduce welfare if they prevent market participants from adopting efficient production and marketing arrangements.

Concerning the third proposition, our 1983 comments suggested that the rules were likely to entail substantial costs by preventing the efficient allocation of risks between networks and program producers. Assuming that the networks could more efficiently pool a larger number of programs than any individual program producer, the networks would be better able to offset the losses from unsuccessful programs with the gains from successful ones. By preventing the networks from assuming this risk, the Fin-Syn rules would force it upon program suppliers.[18] To the extent that the latter are relatively inefficient risk bearers, the cost of risk bearing would increase and the

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[17] Alternative delivery technologies discussed in the 1983 comments include cable, direct broadcast satellites, multipoint distribution systems, and low power television. *See* our 1983 comments, *supra* note 6, p. 10.

[18] The economic literature on principal-agent relationships has shown that contracts specifying that the contracting parties share the rewards from an uncertain output may help preserve an agent's incentives (in this case the program producer's incentives) to take actions that benefit a risk-neutral principal (in this case the network). By preventing the network from taking a share of the risky output from syndication, the rules may hinder efficient contracting, and may raise the costs of program production. *See*, e.g., Besen, Krattenmaker, Metzger, and Woodbury, *Misregulating Television (Network Dominance and the FCC)*. Chicago: University of Chicago Press, 1984, ch. 7.

propensity of producers to undertake risky ventures would fall. Thus, the rules could conceivably *reduce*, rather than increase, programming diversity.[19]

2. Constraining Networks' Monopoly Power

In 1983 the FCC also solicited comments regarding the effect of the Fin-Syn rules on the networks' ability to exercise market power in the sale of "off-network" programs to independent stations. "Off-network" programs are shows originally run on a network and then offered for sale as re-runs in the syndication market. In promulgating the Fin-Syn rules, the FCC reasoned that prohibiting the networks from syndicating programming would preclude them from acting as monopolists in the sale of "off-network" programs to independent stations.

It would seem clear that forbidding a firm from entering a market effectively precludes it from exercising market power in that market. Our 1983 comment argued, however, that such an extreme measure was unnecessary to constrain networks from acting as monopolists in the sale of programs to independent stations. Moreover, we argued that such action was probably unwise, given the potential costs of the Fin-Syn rules. The comment expressed considerable doubt whether any individual network could exercise market power in the sale of syndicated "off-network" programs, and we seriously questioned the likelihood of effective collusion between the networks. Moreover, even if such coordination could be achieved, the 1983 comment argued that competition from first-run syndicated shows, and from the large stock of "off-network" programs already in existence and held by non-network

[19] This argument is addressed in more detail in Section V of this comment. In general, we argue that the portfolio risk argument may be relatively unimportant when there are large publicly traded program suppliers. However, we argue that repeal of the rules may allow the networks to be able to reduce "systematic" risk; i.e., risk that cannot be diversified away through the stock market.

firms, would act as an effective competitive constraint on the networks' collusive market power. For similar reasons, we argued that a strategy whereby the networks "warehoused" programs, put forth in economic analysis supporting retention of the rules, would likely be unprofitable.[20]

IV. Economic Issues Addressed In the Present Comment

Section V of this comment analyzes the impact of the rules on efficient risk-sharing. Section VI examines the likely impact of vertical integration if the networks could collectively exercise market (i.e., monopsony) power over competitive programmers. Finally, Section VII explores issues relating to the acquisition and exercise of market (monopoly) power in the sale of "off-network" programs to a competitive independent television station industry.

V. Efficient Risk-Sharing in the Broadcast Industry

Various commenters have argued that the Fin-Syn rules reduce welfare by impeding the ability of the market to allocate risk to those best able to bear it.[21] Specifically, it has been argued that networks are more efficient risk-bearers than program producers, and that the rules prevent networks from assuming an efficient share of the risks of new program production.

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[20] The "warehousing" model, first suggested in the Comments of the Committee for Prudent Deregulation, 117-28 (1983), was developed by ICF Consulting Associates and submitted in BC docket No. 82-345. In the model, the networks, acting as a cartel, purchase the rights to off-network programs to prevent their release into the syndication market, and thus artificially restrict the supply of syndicated programs. The model was criticized in our 1983 reply comments, *supra* note 6. This model has been rejected in the latest ICF comments prepared by Dr. Warren-Boulton and submitted on behalf of the Coalition, *supra* note 16.

[21] The inefficient allocation of risk has been the most commonly cited cost created by the Fin-Syn rules. *See*. e.g., our 1983 comments, *supra* note 6; Besen, Krattenmaker, Metzger, and Woodbury, *supra* note 18; and Summers, "The Economic Consequences of the Financial Interest and Syndication Rules Governing the Television Networks," submitted with the three Network Joint Comments, MM Docket No. 90-162, June 14, 1990.

The traditional explanation for networks' comparative advantage in bearing risks is based upon their ability to pool a large number of programs, which allows them to offset losses on projects that fail with gains from successful projects, thereby reducing the variance of the corresponding income stream. Program producers, it is argued, may be less able to bear this risk because their pool (or portfolio) of programs is smaller.[22]

This explanation is not completely satisfactory, however. The type of risk identified in previous comments represents risk that is unique to a particular company. Risk that is specific to a particular company is unlikely to be an important source of risk when there exist well-developed markets for the securities of different companies. This is because investors can protect themselves against company-specific risk simply by holding a diversified portfolio of stocks in a variety of firms (e.g., a collection of program producers). It is not necessary to combine the companies to obtain these benefits. Thus, to the extent that both networks and program producers are publicly traded, reducing the degree of diversifiable risk does not necessarily require program ownership by the networks.[23]

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[22] For a formal treatment of conditions under which the reallocation of risk-bearing is a valid reason for vertical integration, see Carlton, "Vertical Integration in Competitive Markets Under Uncertainty," 27 *Journal of Industrial Economics* 189 (1979).

[23] Publicly traded program producers traded on the New York Stock Exchange include Vestron, Unitrode, Paramount, Orion, MGM/UA, MCA Inc., Columbia Pictures Entertainment, and Blockbuster. In addition, other producers are traded on the AMEX, OTC and NASDAQ exchanges. The shifting of risk from the networks to the producers as under the Fin-Syn rules can change the value of the firms and increase their cost of capital if the shifting of risk changes the probability and cost of bankruptcy. *See* Evans and Rothschild, "The Impact of Divestiture on the Cost of Capital to the Bell System," in Evans, ed. *Breaking Up Bell*, New York: North-Holland (1983), esp. pp. 175-6. Whether expected bankruptcy costs will rise or fall with the Fin-Syn rules is *a priori* unclear. Although the probability of bankruptcy may be higher under the rule, the real costs arising from the bankruptcy of an independent program producer or a group of producers may be proportionately smaller than the real costs associated with the bankruptcy of a network.

The existence of large, publicly traded, diversified program producers has led others to conclude that the efficiency loss from nonoptimal risk pooling is small.[24] Thus, the risk-pooling argument would not seem to provide a compelling case for repeal of the rules, since the networks appear unlikely to be uniquely situated to bear this portfolio risk.

There exist, however, other types of risk that cannot be eliminated simply by reconfiguring an investment portfolio, but which can be reduced through vertical integration. Principal among these are risks arising from "behavioral uncertainty." Behavioral uncertainty arises when an economic relationship between two parties entails the creation of "relationship-specific" assets (i.e., assets whose value depends upon the continuation of the relationship between the two particular parties), and where the parties are unable to specify and enforce contracts that would govern their behavior under all possible contingencies.[25] Under such circumstances, the presence of relationship-specific assets may create the incentive for one of the contracting parties to attempt to "hold up" the other, and thereby expropriate some or all of the value of the asset. Firms recognize these risks, of course, but unless the parties can enter into arrangements that reduce the possibilities for such behavior, their incentives to make relationship-specific investments will be reduced, and economic welfare will be lower than it otherwise might be.

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[24] *See*, for example, the *Comments of the U. S. Department of Justice*, In the Matter of Amendment of 47 C.F.R. § 73.658(j) (the Syndication and Financial Interest Rule), BC Docket No. 82-345, January 26, 1983; and the Coalition's economic comments, *supra* note 16.

[25] The total value of a program (including the value of syndication rights) will depend upon several factors, including the program's overall quality, the time slot in which it is broadcast, the quality of the programs in adjacent time slots, the programs on other networks and independent stations, the promotional efforts made on behalf of the program, and the number of years the program runs. While some of these factors can be controlled by the network and/or the producer, the actions taken to control these factors are unlikely to be completely specifiable at the time of initial contract.

Transactions between the buyers and sellers of television programs likely entail the creation of relationship-specific investments. Perhaps most important among these are the network-provided, program-specific investments incurred in transforming an idea into a finished program.[26] If a network is to incur these costs, it must anticipate earning a stream of revenues that yields (at least) a competitive return on these investments. If the network perceives a risk that part of this income stream can be expropriated by opportunism on the part of program suppliers, the network's incentive to make these value-creating investments will be curtailed.

If high contracting costs or the existence of uncertainty make it difficult to resolve this problem contractually, joint ownership of the specific assets (i.e., backward integration by the networks) may be the least costly (and perhaps the only) solution to the hold-up problem.[27] The Fin-Syn rules, by preventing the networks from taking any ownership position in the syndication rights of a program, prevent the use of joint ownership as solution to this problem. If joint ownership or vertical integration is the most efficient method for reducing the networks' exposure to this form of behavioral risk, the

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[26] *See* Besen *et al.* (1984), *supra* note 18. Other network-provided specific investments include investments in scheduling programs in adjoining time slots due to audience flow considerations, and promotion of the program.

[27] *See* Klein, Crawford, and Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process," 21 *Journal of Law and Economics* (1978). In his submission on behalf of the Coalition, Warren-Boulton, *supra* note 16, discusses network and producer opportunism. The Coalition dismisses them as valid reasons for removal of the rules by asserting that contractual and reputational mechanisms are likely to mitigate such problems. However, it is not clear that this is a valid assumption. As pointed out in Klein, et. al., the costs of using explicit or implicit contractual mechanisms rise with the level of appropriable quasi-rents, while the costs of vertical integration do not. Thus, joint ownership or complete vertical integration can emerge as the lowest cost way in which hold-up of program specific investments can be avoided. Since they hinder the use of this organizational from, the Fin-Syn rules would increase the costs of avoiding hold-up problems under these circumstances.

attenuation of the networks' ability to integrate vertically may increase their exposure to behavioral risk, and thereby ultimately reduce welfare.[28]

This problem may become especially relevant if one considers that the networks possess potentially unique information about program value. This superior information stems from the networks' unique role as intermediaries between their affiliated stations and advertisers. Networks receive a constant stream of information about the sorts of programs advertisers and affiliated stations prefer, and the type of audience sought by advertisers. The networks also gain an informational advantage by collecting programs and organizing them into a schedule that takes advantage of the fact that two or more adjoining shows may complement each other.[29]

The existence of these advantages suggests that the networks may be best situated to decide what types of programs should be produced. However, their ability or willingness to make such investments may be attenuated by the Fin-

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[28] Because the program producers support retention of the rules, the Coalition, in their economic comments, *supra* note 16, reject this justification for eliminating the Fin-Syn rules. The Coalition argue that if the rules promote efficiency, the program producers would ultimately benefit from them, and thus should support their retention. However, program producers would not necessarily favor repeal of the Fin-Syn rules when this repeal increases efficiency. Suppose, for example, that removal of the Fin-Syn rules and other regulatory barriers would allow the networks completely to integrate vertically into program production. If this integration does not take place via merger with existing program producers, (e.g., through the expansion of in-house production by the networks) and if there are barriers to new network entry, removing the rules could create a class of more efficient competitors for any remaining non-integrated program producers. Thus, removing the rules could harm the studios and other producers, while increasing total welfare.

[29] Programs complement each other through "audience flow" considerations. Audience flow refers to the fact that *ceteris paribus*, a viewer watching, for example, an NBC program in the 8:00 time slot is more likely to view the NBC program in the 8:30 time slot than the ABC or CBS program in the 8:30 time slot. Thus having the time slot adjacent to an extremely successful show can significantly increase the ratings of even an otherwise mediocre program.

Syn rule.[30] Thus, the rule could result in less informed economic actors making investment decisions. If decision makers are less informed than they otherwise might be, the number of erroneous decisions, and thus total programming costs, could increase.[31]

The networks' position as "schedule gatekeepers" suggests a second problem created by the Fin-Syn rules. This problem arises because the rules reduce the networks' incentives to make scheduling decisions that maximize the value of the syndication rights of a program.[32] By separating those who make

[30] In the Coalition's economic comments, *supra* note 16, they suggest that the networks should be willing to freely give away such information. However, once their assumption of perfect collusion between the networks is dropped, this conclusion does not follow. If networks compete both with each other and with other distribution systems, there exists a possibility that these competitors, in conjunction with the program producers, may free-ride on the networks' investments in scheduling (for example, by copying a successful format). To the extent that production of such information by the networks is costly, free-riding on such investments may reduce a network's willingness to invest in scheduling, unless (i) the network can benefit from the increased value of programs favored by the scheduling, and/or (ii) the network can control the extent to which this information is released publicly. The first objective can be attained by the networks through the holding of a profit share of the programs affected by the information. This strategy is directly prohibited by the Fin-Syn rules. The second objective can be attained by keeping the information within the network. This strategy is also affected by the Fin-Syn rules, since they hinder the networks' ability to integrate vertically and keep this information within the "firm". For a general discussion of the incentives to obtain and release information, *see* Hirshleifer, "The Private and Social Value of Information, 61 *American Economic Review* 561 (1971).

[31] Owen and Wildman show that a larger percentage of shows failed after their first year during the period 1972-81 than during the period 1960-71. See Owen and Wildman, *Video Economics*, forthcoming (Harvard University Press (1991)). See also Crandall, "The Economic Case Against the FCC's Television Network Financial Interest and Syndication Rules," Appendix D, submitted as part of the three networks' joint comments in MM Docket No. 90-162, June 14, 1989.

[32] The literature on the theory of the firm has suggested that the alignment of incentives between those receiving the profits and those making decisions is an important consideration in determining the ownership structure of the firm. See Coase, "The Nature of the Firm," n.s. 4 *Economica* 386-405 (1937); Demsetz and Lehn, "The Structure of Corporate Ownership: Causes and Consequences," 93 *Journal of Political Economy* 1155 (1985); and Grossman and Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration," 94 *Journal of Political Economy* 691 (1986).

such decisions from the associated rewards, the rule could create so-called "agency" problems in scheduling. Specifically, by not allowing the networks to benefit from the long-term financial gains from syndication, the rule could reduce networks' incentives to consider separately the impact of their scheduling decisions on the syndication value of the programs. Since the value of a program in syndication is directly related to its success and longevity during its initial network run, the networks, through their control over the schedule, can greatly affect the value of a program in syndication.[33]

While this separation of incentives may reduce "favoritism,"[34] it may also reduce the welfare of the program producers by reducing the value of syndicated shows. Allowing networks to increase the extent to which they participate in syndication can increase efficiency by aligning the incentives of the network as the initial program distributor with those of the program producer.[35]

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[33] A network's decision to renew a program can greatly affect the value of a program in syndication. A long run on the network serves as a signal of the program's audience appeal, and creates a larger number (and thus a greater variety) of episodes available for distribution. The network decision to renew a series for a fourth season is a critical determinant of the syndication value of a program. In general, approximately 80 to 100 episodes are required for a program to be able to cover the costs of distribution with its syndication revenue. This minimum threshold is attained during a program's fourth year of production. See Crandall, "FCC Regulation, Monopsony, and Network Television Program Costs," 3 *Bell Journal of Economics* 483 (1972), and Warren-Boulton's submission on behalf of the Coalition, *supra* note 16, pp. 38-41. Other network decisions can affect the value of a program in syndication. The scheduling and promotion of a program in earlier years will affect the program's ratings, and will thus affect the probability that the program will be renewed.

[34] In contrast, the economic comment of the Coalition, *supra* note 16, suggests that the networks will discriminate *against* programs in which they take a financial interest. This model is discussed in more detail below.

[35] By contrast, the Coalition's economic analysis, *supra* note 16, assumes that only program producers make syndication-specific investments. Since the networks do not influence the probability of syndication in the Coalition's model, there is no incentive-aligning effect, and no efficiency rationale for the networks to have an ownership share. If, however, both the program producer and the networks make syndication-specific investments, the case for vertical (continued...)

Overall, we believe the most persuasive rationale for repeal of the rule stems not from the networks' superior ability to pool risk, but instead from their ability to *pool and use information.* The rules, by separating the networks from the rewards from using this information, can distort incentives (i.e., hold-up by the program producers, nonoptimal scheduling by the networks) and may tend to increase the amount of nondiversifiable (systematic) risk faced by the firms bearing these costs.[36]

VI. Vertical Integration and Networks' Monopsony Power

As noted above, our 1983 comment suggested that networks were unlikely to possess joint or unilateral monopsony power. This view enjoyed some empirical support from studies of network-programmer relationships, which suggested that prior to adoption of the rules, the networks compensated program producers for syndication rights, and these up front payments approximated the estimated market value of these rights in the syndication market.[37] The networks voluntarily renegotiated contract terms upward to

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[35](...continued)
integration as a solution to the problem of opportunistic behavior becomes stronger. See Klein, Crawford, and Alchian (1978), *supra* note 27. As noted in footnote 28, the fact that, on average, the program producers will be better off if the Fin-Syn rules are repealed does not suggest that the current set of program producers will benefit from removal of the rule. Specifically, anticipation that most of these rents will be transferred to those who successfully integrate production and distribution of programming will cause those who anticipate being left out to oppose the repeal of the rules. The implications of this and other assumptions in the Coalition's economic analysis are discussed in Section VII of this comment, *infra.*

[36] Spiller, "On Vertical Mergers," 2 *Journal of Law, Economics, and Organization* 285 (1985), and Helfat and Teece, "Vertical Integration and Risk Reduction," 3 *Journal of Law, Economics, and Organization* 47 (1987).

[37] *See*, for example, Crandall, *supra* note 33.

reflect favorable program performance, and total network payments were on average significantly higher than the production costs of the program.[38]

Whatever the degree of monopsony power held by the networks in 1970 or 1983, such power has likely diminished over time. At the time the Fin-Syn rules were adopted in 1970, the networks' share of the "prime time" viewing audience was over 90 percent. By 1983, this share had fallen to less than 80 percent, and by 1988 stood at less than 70 percent.[39] A similar pattern is seen in the networks' share of national television advertising expenditures. The networks' share of national television advertising revenues has decreased from over 60 percent in the late 1970's, to less than 50 percent in 1989.[40] The three network share of total broadcast and cable television advertising revenue has fallen from 48 percent to 32 percent over the same time period.[41]

This apparent decline in the position of the networks has been paralleled by the growth of other media. Cable television revenues have more than doubled since 1983, and the cable "penetration rate" (i.e., percent of households with televisions that are cable subscribers) has increased steadily from 7.6 percent in 1970 to about 34 percent in 1983, and to about 56 percent in 1989.[42] Revenues in the home video market, nonexistent in 1970, rose to $2.1 million in

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[38] *See* Woodbury, Besen, and Fournier, "The Determinants of Network Television Program Prices: Implicit Contracts, Regulation and Bargaining Power," 14 *Bell Journal of Economics* 351 (1983).

[39] *See* the three network joint comment in MM Docket 90-162, p. 110, June 14, 1990.

[40] *See* the Kagan Media Index, *Paul Kagan Associates, Inc.*, April 27, 1990, p. 10. Although network advertising revenue has increased steadily over this time period, revenues from spot, barter and cable all have increased at a faster rate.

[41] *See* the three networks' joint submission in MM Docket No. 90-162, *supra* note 39.

[42] *See* the Kagan Media Index, *supra* note 40.

1983, and to over $60 million in 1989.[43] The networks' position has also been eroded by the growth in the number of independent television stations,[44] and by the emergence of Fox as a fourth broadcast network.

The growth of alternative purchasers of programming causes the program supply facing the networks to become more elastic, reducing any potential gain from the networks, individually or jointly, exercising market power when they purchase programs. Thus, to the extent any monopsony power existed prior to the enactment of the Fin-Syn rules in 1970, any such power has certainly diminished over time.

While the limited amount of available empirical evidence does not suggest that monopsony power is (or was) a problem in this industry, and the growth in alternatives to networks has likely diminished any monopsony power held by the networks that might have existed, we cannot rule out, theoretically, the possibility that some monopsony power might exist or remain. Thus, to the extent that monopsony power held by the networks is a concern, one relevant policy issue then is whether vertical integration would tend to magnify or reduce the welfare losses associated with monopsony power.[45]

Monopsony power is said to exist when the purchaser (or a group of purchasers acting collusively) of a product (in this case, an input), faces an upward-sloping, rather than flat, supply curve for the product or input. A welfare loss from monopsony occurs because a profit-maximizing monopsonist

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[43] *See* the three networks' joint comment in Docket No. 90-162, *supra* note 39.

[44] According to the three networks joint submission, *id.*. the number of independent television stations has grown from 90 in 1970 to 339 in 1989.

[45] The effects of vertical integration discussed in this section depend upon the assumption that the potential for the exercise of monopsony power by the networks is a relevant concern. To the extent that empirical evidence suggests that this possibility may be remote and can be discounted, the analysis and the implied effects on welfare from vertical integration discussed in this section should also be discounted.

will take into account the increasing price he must pay to the inframarginal (i.e., lower cost) product or input suppliers when deciding whether to elicit an addition to supply at the margin.[46] Thus, the "marginal factor cost" facing a monopsonist, which equals the cost of the marginal unit *plus* the increase in revenues paid for the inframarginal supply, exceeds the cost of the marginal unit. Because the marginal factor cost to the monopsonist is greater than the cost of the marginal unit, the monopsonist purchases less of the product or input than would be socially efficient.

The monopsony distortion is thus attributable to a divergence between marginal factor cost (to the monopsonist) and the (social) cost of the marginal factor or product that arises from payments (known as economic "rents") to inframarginal suppliers.[47] Complete vertical integration eliminates this divergence. With vertical integration the rents otherwise paid on the inframarginal supplies are now collected by the monopsonist, and thus no longer represent a cost to the monopsonist. By eliminating any monopsony distortion, the monopsonist is induced to purchase the socially efficient quantity of the product or input. Accordingly, vertical integration by a monopsonist is likely to increase total welfare.[48] In fact, *complete* backward

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[46] This is analogous to an output market *monopolist*, which (absent the ability to price discriminate) must cut price to *all* consumers of his good to sell an additional unit of output to the marginal consumer. This accounts for the familiar result that a monopolist's marginal revenue will be less than his price.

[47] An economic rent is payment to a factor of production that exceeds that factor's social opportunity cost.

[48] *See* McGee and Basset, "Vertical Integration Revisited," *Journal of Law and Economics* (1976), and Perry, "Vertical Integration: The Monopsony Case," 68 *American Economic Review* (1978). Our comment does not explicitly address the case where the program production market is not perfectly competitive. Although the networks (in their joint submission, *supra* note 39) suggest that there has been increasing supplier concentration, there appears to be general agreement that programs are produced competitively (for example, *see* the 1983 Department of Justice comments, *supra* note 24, and the Appendix to this comment, Table A1). If programs are not currently produced competitively, however, the welfare implications of vertical integration are less clear cut; (continued...)

integration by a monopsonist totally eliminates any efficiency loss from monopsonistic behavior. The monopsonist gains because vertical integration allows it to capture the gains from a more efficient use of inputs without affecting his ability to exercise market power in the product market.

However, even in the case of monopsony, complete backward integration may not occur because vertical integration is costly. The degree of integration will be greater the lower the cost of vertically integrating. The greater the degree of backward integration, the greater will be the monopsonist's employment of the input or product. This, in turn, increases the monopsonist's *output*, which benefits consumers of the final good.[49]

Increasing the degree of backward integration may, however, result in reduced earnings for those input suppliers (program producers) that remain independent. This is because the integrated network monopsonist will utilize the inputs more intensively than if they were independently owned. Thus, the monopsonist's purchases from the remaining independent suppliers will be reduced.[50]

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[48](...continued)
downstream output may rise or fall, depending upon the characteristics of downstream production technology, and the elasticity of downstream demand (*see*, e.g., Salinger, "Vertical Mergers and Market Foreclosure," 103 *Quarterly Journal of Economics* 335 (1988)).

[49] *See* Perry (1978), *supra* note 48.

[50] The network will internalize the rents paid to inframarginal units it owns. Thus, it will operate on the marginal cost, not the marginal factor cost curve, for internally supplied inputs, resulting in increased utilization of these internally supplied inputs. The increased utilization of network-owned inputs will reduce the demand for nonnetwork-owned inputs, and decrease both the price and the rents paid to the inframarginal nonnetwork-owned inputs. The result derived in our 1983 comments, *supra* note 6, that the Fin-Syn rules were neutral with respect to the monopsony issue, did not examine this aspect of vertical integration. Our earlier comments only examined how changing the terms of the initial contract between the network and the program producer would not substantively change the bargaining outcome.

This analysis suggests that, to the extent that monopsony is (or was) a problem in this industry, the Fin-Syn rules might have successfully achieved one of its goals: increasing the profitability of independent program suppliers. However, this increase in profitability cannot be, in this case, attributed to an increase in the "bargaining power" of the program suppliers, but rather to the fact that the rules prevent an efficient set of competitors (i.e., the vertically integrated networks) from competing against the remaining independent program suppliers. Thus, with the caveat that one assumes that network monopsony power is an empirically relevant concern, the above analysis suggests that increasing the profits of independent programmers may have come at the cost of a reduction in total welfare.[51]

VII. The Networks as Input Market Monopolists

While adoption of the Fin-Syn rules appears to have been motivated principally by concerns about the exercise of network monopsony power, the FCC also was apprehensive about the possibility that the networks might exercise *monopoly* power in the sale of "newly-produced off-network" syndication rights to independent broadcast stations. Thus, if the Fin-Syn rules are repealed, the networks might emerge as holders of a large share of the syndication rights to newly-produced programs. To the extent that a relevant antitrust market consisting of "newly-produced off-network syndicated

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[51] The possibility that independent suppliers would be made worse-off by repeal of the rules might help explain their opposition to proposals to repeal of the Fin-Syn rules. Even in the absence of the monopsony problem, the observation that the independent suppliers might be harmed by repeal of the rules does not necessarily imply the existence of a competitive problem. The repeal of the Fin-Syn rules may remove an important "barrier to entry" that currently protects existing program suppliers and syndicators from competition from a more efficient set of competitors -- the vertically integrated networks.

programs" can be defended,[52] the emergence of the networks as holders of a large share of the syndication rights to these programs would result in a high level of market concentration, suggesting the possible existence of market power in that market.

A. Evidence on the Relevant Antitrust Market

The networks' ability to acquire market power in programming markets is diminished if the relevant antitrust market includes first-run syndication programs not controlled by the networks in addition to off-network programs. At the time the rules were first adopted, "off-network" programs attracted over 75 percent of the total syndicated program audience. The holders of a large share of the rights to "off-network" programs would thus have had (at least potentially) a large share of a relevant market containing both off-network and first-run syndicated programs. However, by 1988, the share of the total syndicated program audience watching off-network programs had declined to 31 percent.[53]

The networks' ability to acquire market power in programming markets also would be diminished if the stock of older "off-network" syndicated shows cannot be excluded from the relevant antitrust market. The current existence of a large stock of "off-network" programs controlled by non-network third parties suggests that the networks now might find it difficult to acquire and exercise market power even in a narrowly defined antitrust market limited to

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[52] The method by which an antitrust market is defined is described in the U.S. Department of Justice Merger Guidelines June 14, 1984, *reprinted in* 4 Trade Reg. Rep. (CCH) para. 13,103. Unless an antitrust market consisting of "newly-produced off-network syndicated programs" can be defended using the principles articulated in the *Merger Guidelines*, acquisition of even 100 percent of the syndication rights to all such programs by a single network (or a network cartel) may have no significant adverse impact on consumer welfare.

[53] *See* the three network joint submission, MM Docket No. 90-162, *supra* note 39.

only "off-network" programs. Because the networks currently own none of the rights to "off-network" programs (all in nonnetwork hands under the Fin-Syn rules), acquisition of market power through internal production of network shows, or through the purchase of syndication rights at the time initial network broadcast rights are purchased, would require the networks to obtain a large proportion of these rights, most likely for many years in the future.[54] Of course, any attempt by a network to acquire a sufficiently large share of the rights to existing off-network programs to facilitate the exercise of market power would be subject to review, and possible enforcement actions, by the Federal Trade Commission and the Department of Justice.[55]

If the value of "off-network" programs rapidly depreciates, the existence of older off-network programs may not constrain an anticompetitive price increase by a monopolist (or colluding oligopolists) holding the rights to a large share of "newly-produced off-network" programs. Thus, the extent to which newer "off-network" programs compete with older programs will help determine whether "new off-network syndicated programs" are a relevant market. In Section D of the Appendix, we present evidence showing that a substantial

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[54] With positive interest rates, any potential harm may be small in present value terms. In addition, the rapid growth of alternative distribution systems, and the falling probability that off-network programs constitute an antitrust market may also make the gains from an attempt to monopolize future off-network programs small or even negative.

[55] For a recent example of a similar enforcement action, see the U. S. Department of Justice's opposition to the sale of gates at the Philadelphia Airport by Eastern to USAir, 56 *Antitrust Trade and Regulation Report*, 834 (June 8, 1989) and 887 (June 22, 1989). The transfer of these gates from Eastern to USAir would have given USAir control over 47% of the gates at the Philadelphia Airport. The transaction was abandoned after the Justice Department announced its intent to block the transaction.

The costs of purchasing the rights to a large group of older programs for monopoly may also be prohibitive. The profitability of a network attempt to purchase the rights to older programs for purposes of monopoly would be reduced by individual program producers "holding out" for larger shares of the monopoly profits. *See* Lewis, "Preemption, Divestiture, and Forward Contracting in a Market Dominated by a Single Firm," 73 *American Economic Review* (1983).

share of off-network programming shown on independent television stations consists of "older" programs. In Table A3, we show that programs ten years or older make up 27 percent of the audience viewing off-network syndicated programming. Programs five years or older make up 43 percent of this audience. Consequently, an effort by the networks to raise the price of "newly-produced off-network" programs may be defeated by increases in the supply of older programs offered, of which there is a significant stock uncontrolled by the networks.

Because the rules currently prevent the networks from owning syndication rights, a conventional antitrust analysis based on the current market shares of the networks in the market for syndicated programs is impractical. Some insights into the current likelihood of program market monopolization in the absence of the rules can be obtained, however, by examining the networks' behavior prior to the imposition of the Fin-Syn rules. In addition, we argue that the networks' current behavior with respect to use of exclusivity clauses also suggests that the potential for network acquisition of market power may be small.

Examination of the pre-1970 behavior of the networks is not suggestive of actual or attempted network monopolization of syndication rights. According to the FCC Network Staff Report,[56] the networks collectively had only 18.5 percent of syndicated program sales by hours.

The pre-1970 experience does not suggest that the networks attempted to purchase a large share of the syndication rights for programs exhibited on their network. Kahn (1983) examined the extent to which CBS acquired the

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[56] Network Inquiry Special Staff Report, *An Analysis of Television Program Production, Acquisition, and Distribution*, Docket No. 21049 (1980).

syndication rights to new "prime time" series from 1963 to 1971.[57] Overall, CBS purchased these rights to domestic syndication 36 percent (25 out of 69 instances) of the time.[58] From a set of producers that included the large studios, in only in 1 case (out of a possible 22) did CBS acquire these rights. Given the declining importance of small independent producers and the growing importance of large Motion Picture Association of America (MPAA) studios, it is not clear that one should expect a higher rate of rights acquisition, should the Fin-Syn rules be repealed; one might expect, if anything, the same (or perhaps a lower) rate.[59]

The networks' current behavior regarding the purchase of "exclusivity clauses" also suggests a diminished potential for anticompetitive "warehousing"

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[57] *See* Kahn, "Comments on the Federal Communications Commission's Financial Interest and Syndication Rules," January 25, 1983.

[58] CBS did acquire profit shares in a larger number of cases. However, these profit shares averaged 32 percent for those series where CBS acquired a profit share. *See* Kahn, *id.* Given that these shares represent a minority interest on average, it is unlikely that the network's holding of these noncontrolling ownership interests could result in the program producer holding the majority profit share agreeing to warehouse the program and forego his majority profit. The potential for anticompetitive behavior from the networks acquiring small shares of the *gross syndication revenue* has been posited by the Coalition in their economic submission, *supra* note 16, and is further discussed in subsection B of this Section. However, evidence suggests that prior to the imposition of the Fin-Syn rules, contracts between the networks and independent program producers did not take the form posited in the Coalition's economic model. That is, contracts written prior to the imposition of the Fin-Syn rules specified that the networks receive shares of the net profit, not the gross revenue. *See* Arthur D. Little, Inc., *Television Program Production, Procurement, Distribution and Scheduling,* Data Relating to Proposals for Rule Making in Federal Communications Commission Docket No. 12782, Including Data Supplemental to the 1966 Arthur D. Little, Inc. Study, *Television Program Production, Procurement and Syndication* (1970).

[59] During the 1969-70 season, CBS was supplied by 22 outside independent studios and three MPAA studios. In contrast, in 1981-82, CBS was supplied by 16 studios, nine of which were independents. Of these nine, five have been involved in a merger. The number of suppliers selling programs to CBS has dropped to twelve for the 1989-90 season.

of programming.[60] Purchases of exclusivity clauses permit the networks to keep programs out of syndication as long as the programs remain in first-run production.[61] However, the networks often have not purchased and exercised available exclusivity clauses.[62]

That the networks have allowed independent television stations access to newer shows even when such access can be denied (through enforcement of the exclusivity clause, or through the purchase of the exclusive broadcast rights) raises doubts that "warehousing" of off-network programs has been or will be an empirically important phenomenon.[63]

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[60] For an explanation of the efficiency properties of exclusivity clauses, see Klein and Murphy, "Vertical Restraints as Contract Enforcement Mechanisms," 21 *Journal of Law and Economics*, and Marvel, "Exclusive Dealing," 25 *Journal of Law Economics* (1982). With respect to the syndication market, the networks provide a sorting function by providing information about the popularity of programs. The exclusivity clause allows networks to earn a normal return on their investment in producing this information. Absent exclusivity, the independent stations, in conjunction with the program suppliers, could select only the successful programs or lineups for exhibition, free-riding on the networks' investments in information.

[61] The exclusivity clause is regulated by the Justice Department's consent decrees. The decrees prohibit networks from acquiring an exclusive right of exhibition beyond the term of the contract defining the network's right to network exhibition. The networks remain free to acquire exclusive exhibition rights to a series for each broadcast year for which such series is ordered, and are free to purchase the rights to once weekly exhibition and "stripping" (i.e., the broadcast of a program more than once a week after the series has been exhibited).

[62] See Besen *et al.*, *supra* note 18. There are many examples of shows that were in production and shown as first-run, on-network series in 1989 that also had earlier episodes simultaneously released to the domestic syndication market. Examples include, but are not limited to, *Cosby* (1987), *Cheers* (1987), *Dallas* (1984), *Dynasty* (1985), *Family Ties* (1987), *Highway to Heaven* (1988), *Kate and Allie* (1988), *Knots Landing* (1986), *Newhart* (1987), *Night Court* (1988), *Simon and Simon* (1987), *Who's the Boss?* (1987). *See Television Programming Source Books, Volume III*, BIB Channels (1989).

[63] A network's choice not to purchase the once weekly or the "stripping" (i.e., more than once weekly) broadcast rights is identical to the choice of selling these same rights for syndication if it owned the syndication rights. The opportunity cost of retaining these rights, whether they are incurred in the form of additional payments to program producers, or whether they are incurred as lost profits, are identical. *See* Demsetz, "Barriers to Entry," 72 *American Economic Review* 47 (1982).

B. **Monopolization of the Input Market Without a Large Network Participation in the Market -- The Coalition's Economic Model**

Economic analysis supporting the retention of the Fin-Syn rules has been prepared by Dr. F. R. Warren-Boulton and submitted on behalf of the "Coalition to Preserve the Financial Interest and Syndication Rules."[64] The analysis in the Coalition's economic comments examines the ability of the networks to act as monopolists in the sale of newly-produced off-network syndicated programs.[65]

The Coalition's economic comments contain a model that compares the behavior of a hypothetical network monopolist constrained by the Fin-Syn rules to its behavior absent such constraints. They argue that if the rules were repealed, the networks could effect a monopolistic reduction in the number of

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[64] *See* note 16, *supra*. The Coalition consists of independent program producers, a set of independent television stations, major studios, and various public interest groups.

[65] The monopsony issue is not addressed in the Coalition's comment. Also, the Coalition reject the "warehousing" story presented in the 1983 ICF report prepared on behalf of the "Committee for Prudent Deregulation" (a predecessor of the Coalition). The earlier "warehousing" story cannot account for the position taken by producers in support of the rules. *See* the Coalition's economic comments, *supra* note 16, p. 23. In addition to the Coalition's comments, a set of independent television stations filed separate comments. The concerns expressed in these comments bear little resemblance to those put forward in the Coalition's economic submission. For example, the independent television stations express concern that the networks may *favor* programs in which they hold a financial interest. They argue that the network may "continue a network run of a marginal series beyond the time it would otherwise be dropped so that the program will generate more syndication revenues for the network." *See* the *Comments of Independent Stations*, MM Docket No. 90-162 (1990), p. 33. In contrast, the Coalition's economic analysis suggests that the networks will attempt to *disfavor* programs in which they hold a financial interest in order to prevent the marginal series from reaching syndication. While the Coalition's economic submission rejects the warehousing theory or the suggestion that infra-marginal programs would be affected, the independent television stations suggest that the networks would "withhold programs from syndication, delay syndication of the most popular off-network series ... ." *Id.*, p. 32. In addition, the independent television stations express concern that the networks will "prefer their affiliates to their independent competitors in the syndication process." For evidence that this argument may not be an empirically important phenomenon, see the discussion surrounding footnotes 60 to 63, *supra*.

syndicable programs by "taxing" producer investments in syndicability. This tax is placed on the program producer though the network purchase of a small financial interest in the syndication revenues of the program.[66]

The Coalition's model assumes that (i) the three networks act as a perfect cartel, (ii) the program producer market is perfectly competitive, and (iii) first-run sales on the networks are an essential part of producing syndicated shows. Assumption (iii), that the initial network run is an essential facility, is critical to the analysis. Under this condition, the network cartel receives any and all gains from the monopolization of the off-network syndication market in the form of lower network license fees.[67]

The Coalition maintain that their model correctly predicts the positions of major groups affected by the Fin-Syn rules. They also suggest, by example, that the model predicts that consumer welfare would fall, and that the price of off-network programming would rise, should the Fin-Syn rules be terminated. Although eliminating the rules (in the Coalition's example) causes the price of network programming to fall, the corresponding increase in welfare is not sufficient to offset the decrease in welfare arising in the syndication market. Furthermore, they argue that the networks can gain from the monopolization of the market for newly-produced off-network programming without purchasing a large share of the rights in this market.[68]

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[66] For a general discussion of this strategy, and its possible equivalence to vertical integration in the "variable proportions" model, *see* Blair and Kaserman, *Law and Economics of Vertical Integration and Control* (1983), pp. 63-68.

[67] The costs are ultimately passed on to firms that advertise on independent television stations.

[68] The Coalition, in their economic comments, *supra* note 16, contend that "[h]igh network shares in the syndication market, or even a network presence, is unnecessary for the networks to be the ultimate recipients of at least some of the potential profits from a monopoly in that market, and only a relatively small direct participation in that market may be necessary for the networks to receive the maximum achievable monopoly profits from that market." In the model, the networks acquire the gains from monopolizing the syndication (continued...)

Below, we discuss the Coalition's analysis in greater detail. We conclude that the Coalition's analysis is unable to support general policy conclusions. The model's predictions about the competitive implications of removing the rules depend critically upon the values assigned to certain model parameters.[69] No empirical justification is offered, however, for the values used in the numerical example presented in the appendix to the Coalition's submission; nor does the Coalition's analysis examine the sensitivity of this particular set of results to the adoption of different assumptions about the values of these parameters. Notably, it appears that some of the model's assumptions are inconsistent with important aspects of broadcasting and programming markets.

To illustrate, the Coalition's model does not take into account the presence of a large stock of older off-network programs, or the existence of the large first-run syndicated program market. When the existence of these two types of substitutes are taken into account, the model may fail to predict correctly the position taken by the major studios and other program producers. In addition, the model assumes that the networks are unable to affect the probability that a program will be syndicable. If one takes into account the networks' ability to change this probability through their control over the renewal decision, the case for maintaining the rules is weakened. Each of these points is discussed in greater detail, below.

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[68](...continued)
market through lower network license fees (i.e., the fees paid to producers for the right to exhibit the program on a network). Since they do not need to own the syndication rights to profit from monopolization of the syndication market, their participation in this market can be limited to controlling those programs they wish to keep out of syndication.

[69] The critical parameters are: the price elasticity of demand for network programming, the price elasticity of demand for syndicated programming, the cost of program production, producers' rate of time discount, and the elasticity of the probability of syndication with respect to expenditure per program.

1. The Model Does Not Provide a General Guide to Policy

The model presented in the Coalition's submission cannot be used to provide general policy conclusions about the desirability of the Fin-Syn rules. The welfare analysis derived from the numerical simulations presented in Appendix A depends upon the particular values assigned to certain model parameters. Assigning different (but equally plausible) values to these parameters can lead to different implications for consumer welfare from relaxing the rules.[70] At most, the analysis presented in the Coalition's submission provides an example of a situation where the profits of a network monopoly would rise, but total welfare would fall, upon repeal of the rules.

Unexplained are how the parameter values used in the Coalition's numerical simulation may have been chosen. Likewise, the Coalition do not discuss how different welfare results might have been obtained had alternative parameter values been selected for use in the numerical simulations. As they note on p. 9 of Appendix A, "total consumer surplus may rise or fall when monopoly is extended . . . [the total welfare] result is even less generalizable . . .". Overall, it is doubtful that one can ascertain the desirability of the Fin-Syn rules from a single simulation of a model lacking general predictive power.

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[70] For example, the example assumes that the discount rate is zero. Since the welfare losses from the syndication market occur later than the welfare gains from the original network run, a more realistic positive discount rate could reverse the total welfare result in the Coalition's model. Prior to undertaking such a sensitivity analysis, we note that there seems to be a missing discount factor in equation (14).

2. The Existence of Older Off-Network Programs

The Coalition state that "critical assumptions of the model appear consistent with the available stylized facts." One of these "stylized facts" is the proposition that "off-network" programs are an antitrust market as defined by the Department of Justice *Merger Guidelines*. While the validity of this proposition has not been established empirically, it should be noted that the Coalition's analysis actually applies only to a much narrower market -- the market for *newer* off-network programs.[71] That is, the model does not take into account the large existing stock of off-network programs currently in the hands of the program producers. If the market includes this stock of programs, the corresponding network market share would be considerably smaller than the network share of the more restrictive market definition.

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[71] Some empirical evidence is presented in the Coalition's reply comments. *See* the *Reply Comments Submitted on Behalf of the Coalition to Preserve the Financial Interest and Syndication Rule*, MM Docket No. 90-162 (August 1, 1990). As noted in the Coalition's reply comments, "product market definition depends upon the elasticity of demand facing a hypothetical monopolist ("own price elasticity")". The Coalition's reply comments contain anecdotal evidence (consisting of quotations from trade press articles) about the elasticity of demand for recent off-network syndicated programs. While these articles suggest that the price paid for off-network programming has changed as the number of newer programs has changed, the articles also suggest other plausible reasons that price has fluctuated (e.g., quality differences, changing demand conditions, and changing expectations of the independent television stations). *See* "Sitcoms in Syndication: Too Much of a Good Thing?," *Broadcasting*, May 29, 1989. In addition, this same article suggests that significant supply side substitution exists. For example, the article notes that "[t]o counter the impending shortage of off-network series... syndicators are finding innovative ways to package and recycle product already in their library. And in what programmers regard as potentially the most promising recent development . . . a number of distributors are now releasing theatricals which have never had broadcast network exposure . . ." *Id*., p. 58.

Absent adjustments for changes in the quality of the programs, or for possible shifts in demand, strong inferences about the elasticity of demand cannot be made from the observation that price and quantity are negatively correlated. The econometric evidence presented in the Coalition's reply comment does have variables to adjust for these two types of changes. However, the Coalition do not attempt to measure the elasticity of demand for newer off network syndicated programs in these regressions. Instead they attempt to estimate the change in price due to shifts in demand, i.e., they attempt to estimate a *supply* elasticity.

The Coalition's analysis also does not take into account the presence of potentially good substitutes for the programs not syndicated because of the "financial interest tax." This tax would affect the syndication of marginal programs, and likely would not prevent the syndication of popular shows. Thus, even if popular shows reaching the end of their network runs, and older, off-network shows, compete in different antitrust markets, the large stock of older off-network programs already available for syndication is likely to be a much closer substitute for a marginally profitable, newly-produced off-network show. Some of the regression analysis presented in the Appendix to this comment (*see* column 4 of Table A5) suggests that older programs may provide significant competition for this set of newly-produced programs.[72]

3. The Growing Importance of First-Run Syndicated Programming

The Coalition's analysis does not take account of the substitution possibilities between first-run syndicated programming and new off-network syndicated programming. The rapid growth in the number of first-run syndicated programs calls into question the model's assumption that "first-run sales on the networks are an essential part of producing syndicated shows." In Table A2 in the Appendix to our comment, we show that the absolute number, as well as the share, of households viewing off-network syndicated programming has fallen vis-a-vis first-run syndicated programming (*see* figure

[72] Other regression results presented in Table A5 of the Appendix (*see* columns 1-3) suggest that older off-network programs are viewed by smaller audiences than are newer off-network programs. This difference in audience size is consistent with newer and older off-network programs competing in separate antitrust markets. However, as is explained in greater detail in § (d) of the Appendix, this evidence, by itself, cannot establish the existence of a separate antitrust market for newly-produced off-network programs. This would require evidence on the pricing of programs in relation to audience size, and evidence on how buyers would respond to changes in the relative prices of newer and older off-network programs.

1 in the Appendix to this comment).[73] The declining importance of off-network programming casts doubt on the Coalition's assumption that networks are an essential part of producing programs that compete in an antitrust market that includes newer off-network programs.

4. The Position of the Program Producers is Not Correctly Predicted by the Coalition's Model

The Coalition suggest that their model, unlike those proposed by other intervenors, correctly predicts the positions of the major parties to this debate. Indeed, the Coalition characterize this as the principal virtue of their model relative to others, and they rule out alternative explanations because of their alleged inability to predict correctly the position of the various parties to this proceeding.[74] Their model does not predict correctly the position of the program producers, however. Rather, it shows that program producers should be *indifferent* to the presence or absence of the rules, since they make zero economic profits whether or not the rules apply. While the model correctly predicts that actors, writers, and other suppliers of labor to program production will oppose repeal, it does not explain why the employers of this talent (i.e., the major studios) should oppose repeal.

Moreover, because monopolization of the market for off-network programs would likely increase the profitability of older off-network shows currently owned by program producers, as well as increase the profits earned by these same producers when they sell programs for first-run syndication, the Coalition's economic model does not accurately predict the position of program producers. These firms would be the owners of the closest substitutes for the

[73] These figures are based on the Nielsen Station Index.

[74] We argue in Section VI that such out-of-hand rejection is not necessarily correct.

monopolized good, and thus would be the beneficiaries of increased prices if the networks successfully raised the price of newly-produced off-network programs. This suggests that they should welcome repeal of the rules if this repeal would facilitate the creation and exercise of market power.

5. Network Control over the Syndicability of the Program

The Coalition's model does not admit the possibility that the networks, through their control over the renewal decision, could reduce the syndicability of the marginal programs.[75] If the networks do have control over the syndicability of the marginal programs, repeal of the rules is not necessary for the networks to carry out the hypothetical reduction in the number of syndicable programs. The networks can reduce the number of syndicable shows simply by choosing not to renew a larger number of shows after the first, second, or third year of the network run. Since the lack of a large base of episodes reduces the syndicability of a series, the networks, through early termination of marginally profitable series, can reduce the number of newly-produced syndicable programs with the Fin-Syn rules in place. Incorporating this possibility into the model would introduce more ambiguity into the welfare analysis of the rules.

In addition, if producers' expenditures on programming increase the quality of a program during its *network* run (and not just during its *syndication* run, as assumed by the Coalition), then the Coalition's model will fail to capture accurately the impact of a network's purchase of a financial interest in a program. The effect on the quality of the program during its initial network

[75] The use of the renewal decision to change the syndication value of a program is discussed in the text of the Coalition's economic comments. *See* the Coalition's economic comments, *supra* note 16, pp. 38-9. However, they do not discuss the possibility that use of the renewal decision may be used by the networks as a substitute for the tax.

run will tend to align the networks' and program producers' preferred expenditures. In the case posited in Appendix B of the Coalition's economic submission (where the effect on the value of the program during its initial network run swamps the effect on the syndicability of the program), their model predicts that the networks will wish to *subsidize* rather than tax these expenditures. Under such circumstances, the purchase of the financial interest by the network cannot be explained as a tax on effort..

C. Summary and Discussion

While we cannot rule out the possibility of program market monopolization, the existing (albeit scarce) empirical evidence does not provide a great deal of support for the monopolization hypothesis. A concern remains, however, about the possibility of successful monopolization of the program market by networks should the Fin-Syn rules be repealed. It appears to us that a critical policy question is whether the risk of program market monopolization by a network cartel appears sufficiently high that consumer welfare would on balance be improved by continued enforcement of the Fin-Syn rules. This requires a comparison of the rules' benefits and costs. If there is a risk of program market monopolization, the benefit is that the attendant monopoly welfare losses are reduced without incurring the costs of case-by-case antitrust enforcement. The costs are the foregone efficiencies that have been described in preceding portions of this comment.

It is not possible for us to quantify these benefits and costs. However, we do not believe that a compelling case has been made for the perpetuation of the rules. It is not clear that the risk of program market monopolization is sufficiently great that enforcement measures beyond those provided by the antitrust laws are necessary. If, as we believe, the rules entail potentially substantial costs in the form of lost efficiencies, then a reasonable argument

can be made that consumers' interests would be best served by repeal of the rules.

We also suggest that the FCC's analysis of the rules take careful account of forthcoming changes in the legal constraints that now bind the networks' behavior. The Department of Justice's consent decrees against the networks currently impose restrictions on the amount of "in-house" program production that the latter may undertake. These restrictions will expire in November 1990. If it would be efficient for the networks to purchase the syndication rights to independently-produced programs, the retention of the Fin-Syn rules may induce the networks to opt for what may be a "second-best" alternative to this -- expanded in-house production. Not only might this entail a sacrifice of efficiencies (i.e., because the potentially most efficient relationship is proscribed by the rules), it could increase the extent to which the networks "favor" their own programs, which is contrary to one of the original purposes of the Fin-Syn rules.

VII. Conclusion

The best case for direct economic regulation of an industry's behavior arises when the procompetitive aspects of the proscribed behavior are minimal, while the anticompetitive aspects are substantial. Under such circumstances, *per se* bans on certain market arrangements can make sense, since they reduce the welfare losses of the anticompetitive conduct without incurring the potentially substantial costs associated with case-by-case assessment of dubious efficiency claims made on behalf of the behavior in question.

The Fin-Syn rules constitute a *per se* ban on the acquisition by networks of certain broadcast rights to newly-produced television programs. Whether these rules create greater net consumer benefits than would alternative policies (such as the application of conventional antitrust enforcement standards to the

networks) depends upon whether allowing networks to acquire these rights creates the risk of substantial welfare losses without offering the prospect of production or marketing efficiencies.

The principal justification for the Fin-Syn rules has been that they prevent the exercise of monopsony and monopoly power by the networks. Our analysis suggests that whatever the degree of monopsony power possessed by the networks, constraining the degree of vertical integration likely *increases*, rather than decreases, the attendant welfare losses. Concerning the monopolization issue, we cannot rule out, as a theoretical matter, the possibility that the networks might attempt to create market power in the market for off-network programming. However, available empirical evidence does not provide a compelling basis for believing that the risk of monopolization is sufficiently great that the structural safeguards embodied in the Fin-Syn rules are required. Taking into account the potential costs of the rules, which consist mainly of the foregone efficiencies from the prohibited arrangements, the justification for the continuation of the rules seems to us questionable.

Appendix

To assist in the preparation of our comment, the networks provided the Bureau of Economics with data on syndicated programs. Annual data were provided on the number of viewers captured by both off-network and first-run syndicated programs during November of each year. These figures were obtained from the Nielsen Station Index, which is a compilation of the average number of households in a given city or geographic location that viewed a half-hour segment of programming during the month of November.

The data allowed us to examine the current structure of the three antitrust markets suggested in the text as potentially at issue in this proceeding. First, we constructed concentration indexes for markets consisting of (1) all off-network programs, and (2) all syndicated first-run programs. Second, we compared the movement over time in the respective shares of total viewers captured by off-network and first-run programs. Third, we combined the network data with data taken from the *Television Programming Source Books* to examine the share of the total audience captured by newer versus older off-network programs.

(a) Concentration in the Market for Syndicated Programs

Table A1 shows the shares of program suppliers, by "audience" and "adjusted audience", of syndicated programs televised during November 1989.[76] In both the "off-network" and "first-run" segments, the Herfindahl index (HHI) (computed from the size of the audience captured by each supplier) is below

[76] The "adjusted" audience number takes into account the length of the program. To illustrate, suppose that *Star Trek* (a one-hour program) and *Cheers* (a half-hour program) are each watched by 1,000 households. The "adjusted audience" figure for *Star Trek* would be reported as 2,000, while the "audience" figure would be 1,000. For *Cheers*, both figures would equal 1,000.

1000, and would thus be classified as "unconcentrated" by the *Merger Guidelines.*[77]

TABLE A1 (FIRST RUN)
SYNDICATION SALES AND CONCENTRATION FOR FIRST-RUN PROGRAMS,
NOVEMBER 1989
number of households (in thousands)

SUPPLIER	AUD	SHARE(%)	HHI	ADJ AUD	SHARE	HHI
King World Productions	40,961	15	224	50,839	13	169
Paramount TV Sales	35,293	13	166	59,026	15	228
Warner Bros. Domestic TV Dist.	18,840	7	47	21,671	6	31
MCA Television	15,376	6	32	16,993	4	19
Tribune Entertainment	13,234	5	23	22,255	6	32
Buena Vista Television	12,815	5	22	22,218	6	32
Multimedia Entertainment	10,546	4	15	21,092	5	29
Viacom Enterprises	9,144	3	11	11,423	3	9
Fox Syndication	8,851	3	10	8,851	2	5
Teletrib	8,842	3	10	15,876	4	16
LBS Communications, Inc.	8,458	3	10	10,113	3	7
Group W Productions	7,167	3	7	9,710	2	6
Worldvision Enterprises Inc.	6,021	2	5	9,633	2	6
Genesis Entertainment	5,262	2	4	8,924	2	5
Claster Television Productions	4,617	2	3	5,840	1	2
GTG Marketing	3,713	1	2	4,873	1	2
Gaylord Syndicom	3,526	1	2	6,960	2	3
Turner Program Services	3,472	1	2	6,451	2	3
Qintex Entertainment	2,985	1	1	5,407	1	2
All American Television	2,712	1	1	2,712	1	0
Titan Sports	2,419	1	1	4,838	1	2
Raymond Horn	2,185	1	1	4,000	1	1
Samuel Goldwyn Television	2,037	1	1	4,074	1	1
Pro Sports Entertainment	1,831	1	0	1,831	0	0
D.L. Taffner/Limited	1,826	1	0	1,962	1	0
Blair Entertainment	1,668	1	0	1,767	0	0
Synchronal Research	1,589	1	0	1,775	0	0
DFS Dorland Program Exchange	1,510	1	0	3,020	1	1
MGM/UA Television	1,506	1	0	1,506	0	0
Contempo TV	1,426	1	0	1,426	0	0
MG/Perin Inc.	1,361	0	0	1,668	0	0
Orion Entertainment	1,349	0	0	1,349	0	0
Jefferson-Pilot Teleproduction	1,306	0	0	2,612	1	0
Select Media Communications	1,299	0	0	1,299	0	0
Orbis Communications Inc.	1,154	0	0	1,154	0	0
Fox/Lorber Associates Inc.	1,041	0	0	1,651	0	0
Williams TV Time	1,012	0	0	1,012	0	0
SNI Sports Network	928	0	0	1,856	0	0
Berl Rotfeld Prod. Inc.	916	0	0	916	0	0
Palladium Entertainment Inc.	886	0	0	886	0	0
ITC Entertainment	858	0	0	1,716	0	0
World Events Productions	838	0	0	1,676	0	0
Mercury Media	809	0	0	809	0	0
Don Lewis Advertising	781	0	0	781	0	0
Michael Krauss Syndication	778	0	0	1,556	0	0
New World Television	757	0	0	1,514	0	0
Johnson Publishing Co., Inc	718	0	0	718	0	0

[77] *See* the U. S. Department of Justice Merger Guidelines, *supra* note 52, Section 3.11(a).

KOVR-TV	712	0	0	712	0	0
Jalbert Productions	618	0	0	618	0	0
Clark National/Mercury Media	584	0	0	584	0	0
Raycom Sports	536	0	0	1,049	0	0
WPIX Inc.	536	0	0	536	0	0
Twin Star Productions	534	0	0	534	0	0
Wall Street Journal Television	531	0	0	531	0	0
Eclipse Entertainment	527	0	0	527	0	0
Various	520	0	0	956	0	0
Bristol Valley Communications	505	0	0	505	0	0
Media Arts International	498	0	0	498	0	0
Hawthorne Communications, Inc.	491	0	0	557	0	0
Electra Pictures, Inc.	472	0	0	681	0	0
King Features Entertainment	467	0	0	934	0	0
NU Day Marketing	460	0	0	460	0	0
Project Media	434	0	0	596	0	0
American Telecast	416	0	0	416	0	0
Silverach-Lazarus Group	388	0	0	776	0	0
Mediacast TV Entertainment	387	0	0	387	0	0
W.B. Doner	367	0	0	367	0	0
S & S Communications, Inc.	346	0	0	692	0	0
Medstar Communications	341	0	0	341	0	0
American Marketing Systems	331	0	0	331	0	0
Bohbot Communications	328	0	0	656	0	0
Sybervision Systems	323	0	0	323	0	0
WTTV-TV	321	0	0	321	0	0
Not Available	307	0	0	614	0	0
Andrews & Martin Syndication	295	0	0	590	0	0
Quantum Marketing	294	0	0	294	0	0
Fishing the West	265	0	0	265	0	0
Syndicast Services, Inc.	262	0	0	262	0	0
U.S. Chamber of Commerce	262	0	0	263	0	0
HMS Communications	259	0	0	259	0	0
PBS/Post Newsweek	254	0	0	254	0	0
Behrens Productions, Inc.	233	0	0	233	0	0
ABR Entertainment Company	179	0	0	358	0	0
Cowboys Football Club	136	0	0	136	0	0
Spectra Communications	128	0	0	128	0	0
Jim Owens/All American Television	111	0	0	111	0	0
Larry Harmon Pictures Corp.	108	0	0	216	0	0
Media Headquarters	103	0	0	103	0	0
Four Star Entertainment Corp.	101	0	0	101	0	0
Willie Wilson Productions	84	0	0	84	0	0
Florida State University	81	0	0	81	0	0
Hit Video USA	77	0	0	154	0	0
Georgia Tech. University	76	0	0	76	0	0
Total Communications	71	0	0	142	0	0
Fishing Texas	68	0	0	68	0	0
Metro Sports	65	0	0	130	0	0
University of Georgia	61	0	0	61	0	0
C.T.C. Sports	55	0	0	55	0	0
ABN Television, Inc.	49	0	0	49	0	0
New Sights	49	0	0	49	0	0
New Zoo Revue	48	0	0	48	0	0
Outdoor Trail Prod. Co.	48	0	0	48	0	0
Telstar, Inc.	48	0	0	96	0	0
Auburn University	42	0	0	42	0	0
Jimmy Houston Productions	42	0	0	42	0	0
Sportsman's Showcase	42	0	0	42	0	0
Paragon Adventures	41	0	0	41	0	0
University of Tennessee	41	0	0	41	0	0
West Virginia University	38	0	0	38	0	0
Frank White Productions	37	0	0	37	0	0
On Target Productions	36	0	0	36	0	0
California Pacific Research	34	0	0	34	0	0

U.S. Department of Agriculture	34	0	0	34	0	0
Program Syndication Services, Inc.	32	0	0	32	0	0
Granada TV Network	31	0	0	31	0	0
Manion Outdoors Company, Inc.	31	0	0	31	0	0
MBW Inc.	30	0	0	60	0	0
Dennis Smith	26	0	0	26	0	0
WGNO-TV	24	0	0	24	0	0
Home Shopping Network	23	0	0	46	0	0
Media Works	23	0	0	23	0	0
Multimedia Program Productions	21	0	0	21	0	0
Shearer Productions	21	0	0	21	0	0
Archie Phillips Productions	19	0	0	19	0	0
California Service Agency	16	0	0	32	0	0
COE Film Associates	15	0	0	15	0	0
M & M Syndications	14	0	0	14	0	0
Bulldog Sports Network	13	0	0	13	0	0
Creative Sports Marketing	12	0	0	12	0	0
WGGS-TV	10	0	0	10	0	0
Meridian Telecommunications	7	0	0	7	0	0
Crossroad Christian Communications	6	0	0	12	0	0
GLL Enterprises	6	0	0	6	0	0
TOTAL AUDIENCE FOR FIRST-RUN	**273,540**	**100**	**605**	**391,297**	**100**	**614**
TOP 5 SYNDICATORS	**123,704**	**45**	**493**	**170,784**	**44**	**478**
TOP 10 SYNDICATORS	**173,902**	**64**	**562**	**250,244**	**64**	**570**

Source: Nielsen Station Index.

TABLE A1 (OFF-NETWORK)
SYNDICATION SALES AND CONCENTRATION FOR OFF-NETWORK PROGRAMS,
NOVEMBER 1989
number of households (in thousands)

SUPPLIER	AUD	SHARE(%)	HHI	ADJ AUD	SHARE(%)	HHI
Viacom Enterprises	19,239	15	230	22,077	13	166
Columbia/Pictures Television	19,004	15	224	21,637	13	159
Paramount TV Sales	16,181	13	162	18,349	11	115
Warner Brothers Domestic TV Dist.	15,355	12	146	20,798	12	147
MCA Television	14,430	11	129	24,389	14	203
Fox Syndication	8,885	7	49	10,369	6	37
DFS Dorland Program Exchange	3,881	3	9	6,110	4	13
D.L. Taffner/Limited	3,835	3	9	3,835	2	5
MTM Distribution	3,637	3	8	4,992	3	8
Worldvision Enterprises Inc.	3,252	3	7	6,504	4	14
Genesis Entertainment	2,514	2	4	5,028	3	9
Buena Vista Television	2,305	2	3	4,610	3	7
Program Exchange, The	1,768	1	2	2,199	1	2
Televentures	1,602	1	2	3,204	2	3
LBS Communications, Inc.	1,570	1	2	2,741	2	3
Claster Television Productions	1,440	1	1	2,880	2	3
Qintex Entertainment	1,195	1	1	1,195	1	0
Republic Pictures	1,061	1	1	2,047	1	1
Turner Program Services	1,045	1	1	1,659	1	1
King World Productions	636	1	0	941	1	0
SFM Entertainment	483	0	0	966	1	0
Four Star Entertainment Corp.	459	0	0	837	0	0
Filmtel Int'l. Corp./DFS	425	0	0	850	0	0
KOST Broadcast Sales	404	0	0	404	0	0
New World Television	373	0	0	373	0	0
Orion Entertainment	360	0	0	360	0	0
Colex Enterprises	345	0	0	345	0	0
CB Distribution Company	334	0	0	334	0	0
Alan Enterprises, Inc.	220	0	0	440	0	0
Colbert TV Sales/Orion Entertainment	183	0	0	183	0	0
Republic of Texas Communication	142	0	0	142	0	0
Palladium Entertainment, Inc.	136	0	0	136	0	0
Independent Television Corp.	74	0	0	148	0	0
LBS/MGM Television	71	0	0	142	0	0
Orion Television	58	0	0	116	0	0
Blair Entertainment	37	0	0	37	0	0
TOTAL AUDIENCE FOR OFF-NET	**126,939**	**100**	**991**	**171,377**	**100**	**898**
TOP 5 SYNDICATORS	**84,209**	**66**	**892**	**107,250**	**63**	**790**
TOP 10 SYNDICATORS	**110,213**	**87**	**978**	**144,088**	**84**	**876**

Source: Nielsen Station Index.

(b) Evidence on the Relationship between Off-Network and First-Run Syndicated Programming

The data also allowed us to examine whether off-network programs have grown or declined in importance as a source of syndicated programming sales. Table A2 shows the audience captured by off-network and first-run syndicated programming over time. As these figures show, the importance of off-network programming has declined relative to first-run programming. These figures also show that both the overall size of the syndication market, as well as viewership of first-run syndicated programs, grew during this period. In contrast, viewership of off-network programs generally fell, both absolutely and as a percentage of total syndicated program viewership.

TABLE A2

THE RELATIVE IMPORTANCE OF OFF-NETWORK VERSUS FIRST RUN SYNDICATION.

BASED ON "UNADJUSTED" AUDIENCE
number of households (in thousands)

YEAR	OFF-NET AUDIENCE	FIRST-RUN AUDIENCE	TOTAL AUDIENCE	OFF-NET SHARE
1989	126939	273540	400479	31.7%
1988	126810	270399	397209	31.9%
1987	145812	273300	419112	34.8%
1986	160039	238366	398405	40.2%
1985	168382	199460	367842	45.8%
1984	174543	160131	334674	52.2%
1983	157155	132746	289901	54.2%
1971	186419	104703	291122	64.0%

BASED ON "ADJUSTED" AUDIENCE
number of households (in thousands)

YEAR	OFF-NET AUDIENCE	FIRST-RUN AUDIENCE	TOTAL AUDIENCE	OFF-NET SHARE
1989	171377	391297	562674	30.5%
1988	171737	387617	559354	30.7%
1987	203657	369164	572821	35.6%
1986	224477	325674	550151	40.8%
1985	238053	277290	515343	46.2%
1984	258253	220461	478714	53.9%
1983	225548	183540	409088	55.1%
1971	248402	136701	385103	64.5%

Source: Nielsen Station Index.

Figure 1 shows how the share of off-network syndicated programming has changed over the longer period, 1971-1989.

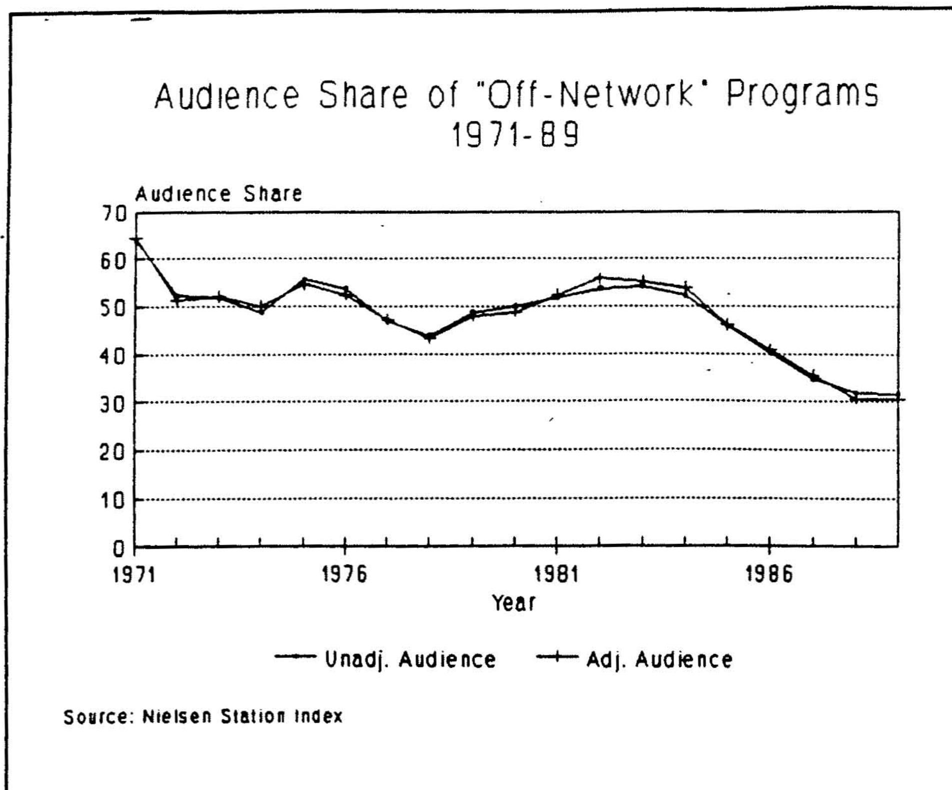

Figure 1

(c) The Distribution of Off-Network Audiences by Age of Program

We also examined how the audience size of off-network programs was affected by program age, where "age" is defined as the number of years since the last year of production. As will be recalled, the analysis submitted by the Coalition to Preserve the Financial Interest and Syndication Rules requires that "older" off-network programs not compete effectively with "newer" off-network programs.

Table A3 shows the 1989 share distribution of off-network programs by program age. The shares are based on the total off-network viewing audience. These figures suggest that newer programs are more popular than older programs. Programs still in production during 1989 captured 25 percent of the adjusted syndicated viewing audience. Programs one year old captured 12

percent of the adjusted market, programs two to five years old captured 20 percent of the adjusted audience, programs six to nine years of age captured 13 percent of the adjusted audience, while programs ten or more years old captured 29 percent of the audience. Figures for the "unadjusted" audience exhibit a similar pattern.

TABLE A3

DISTRIBUTION OF AUDIENCE BY AGE OF OFF-NETWORK SYNDICATED PROGRAM
(units are in thousands of households)

Latest Year in Production	Age	Audience	Adjusted Audience	Share	Adjusted Share
1989	0	35,364	40,683	29	25
1988	1	15,427	20,275	13	12
1987	2	7,595	11,897	6	7
1986	3	7,669	11,562	6	7
1985	4	2,717	4,112	2	3
1984	5	4,047	4,986	3	3
1983	6	10,162	11,609	8	7
1982	7	3,385	4,579	3	3
1981	8	850	1,661	1	1
1980	9	2,041	3,927	2	2
before 1980	10+	33,034	47,811	27	29

Sources: Nielsen Station Index, BIB Channels Television Programming Source Book, Volume II.

New programs captured a large share of the off-network syndication audience in 1989. However, we found that a substantial number of these newer programs were syndicated *prior* to the end of their network production runs. Specifically, of the fourteen shows in production in 1989 that were also in syndication, twelve had been syndicated prior to 1989. Table A4 lists these shows, along with the year they first appeared in syndication.

TABLE A4

SHOWS IN PRODUCTION AND IN DOMESTIC SYNDICATION IN 1989
(FIRST YEAR OF SYNDICATION)

Show	Year
Cosby Show	(1987)
Cheers	(1987)
Dallas	(1984)
Dynasty	(1985)
Family Ties	(1987)
Growing Pains	(1989)
Highway to Heaven	(1988)
Hunter	(1989)
Kate and Allie	(1988)
Knots Landing	(1986)
Newhart	(1987)
Night Court	(1988)
Simon and Simon	(1987)
Who's the Boss?	(1987)

The data underlying Table A3 suggest that it may be possible for the networks to acquire programs that would have captured a large share of the audience viewing off-network syndicated programs. However, that the networks have permitted such a high percentage of these newer shows to be syndicated prior to the end of their network runs (i.e., the networks apparently have foregone exercise of their exclusivity clauses) suggests that foreclosure is not an empirically important phenomenon.

(d) Factors Determining the Success of an Off-Network Program

Lastly, the data allowed us to examine econometrically certain underlying factors related to the size of off-network program audiences. For each program currently in syndication in November 1989, we obtained data on (1) the total number of households that viewed the program during that month, (2) the dates that the program had been in production, (3) the year the program first entered syndication, (4) the total number of episodes that had been produced, and (5) the number of times the show appeared in the 4-8 p.m. time

slot on independent stations located in the top fifty independent television markets during November 1989. We used these data to estimate a series of equations in which the total number of viewers for each program was regressed on the number of episodes produced, program age (defined as the number of years since the program was last produced), the number of times the program appeared in the 4-8 p.m. time period on independent stations in the top fifty independent television markets during November 1989, and a dummy variable that indicated whether the program entered syndication prior to the end of its production run. This analysis should be viewed as an attempt to explore in greater detail certain factors influencing program popularity, rather than as an attempt to exhaustively model the market for syndicated programming.[78]

Table A5 presents the results of this analysis. The regression results are consistent with the notion that older programs are likely to be less popular than newer programs. In our first three equations (columns 1 - 3 of Table A5), the coefficient on the age variable in negative, and is different from zero at conventional levels of statistical significance. The coefficient on the "number of episodes" variable has the expected positive sign; it is not, however, significantly different from zero at the standard significance levels.[79]

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[78] A more attractive empirical technique for delineating the boundaries of an antitrust market involves the estimation of the "residual demand curve" facing the firms in that market (*see* Baker and Bresnahan, "Estimating the Demand Curve Facing a Single Firm," 33 *Journal of Industrial Economics* 427 (1985)). We could not implement this method, as it requires certain data (i.e., data on prices, quantities, and production costs) to which we lacked access. The empirical analysis presented here is an attempt to expand upon the analyses submitted by other parties to this proceeding.

[79] Given that the programs that appear in the dataset are programs that have been successfully syndicated (i.e., most of the programs in the data set have passed the 80-100 episode threshold generally required for syndication), this lack of significance is not surprising. *See* note 33, *supra*. The regression results suggest that, *ceteris paribus*, additional shows beyond the 80-100 episode threshold do not significantly increase the audience captured by a program.

The audience figures for any given program will in part reflect the time slot in which it is televised. Any program, regardless of quality, will likely receive higher ratings if it is broadcast at (say) 5:00 p.m. as opposed to 1:00 a.m.. To take account of this, regression specification (2) (column 2) includes a variable measuring the number of times the program was shown during the 4-8 p.m. time slot on an independent station in a "top 50" independent television market during November 1989.[80] The period 4-8 p.m. typically is considered the period of peak audience availability for syndicated programing. When this variable is included in the analysis, the impact of "program age" on program popularity is diminished, although an impact is still present at a statistically significant level.

Specification (3) (column 3) attempts to control for the fact that, for programs of a given age, there are likely to be substantial differences in program popularity that arise from factors that are not subject to network control. To account for this, specification (3) adds a dummy variable that equals 1 if the program's first year of domestic syndication precedes its final year of production. Recall that the Coalition's economic analysis of the rules suggests that the networks will take actions to reduce the syndicability of *marginal* programs. Programs that enter syndication prior to the end of their network run would generally be very popular programs,[81] and would thus be

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[80] We cannot rule out the possibility that the time slot in which a program is televised is both a determinant of, as well as partly determined by, the popularity of the show. If so, the estimated parameters reported in specifications (2) and (4) might not accurately reflect the true relationship between a program's time slot and its audience size. Alternatively, it might be that program age is a determinant of the time slot, and that both age and time slot influence program popularity. In this case, the coefficients on the 4-8 p.m. time slot variable reported in columns 2 and 4 would provide reasonable estimates of the *partial* impact of the time slot on audience size, but would not necessarily reflect the *total* impact (i.e., part of the effect that the time slot appears to have on audience size should be attributed to age).

[81] These programs would have already enjoyed a network run of at least three years; otherwise, they would not have been syndicated.

programs for which the probability of syndication would unlikely to be affected by the networks' actions. These may be programs so suitable for syndication that the purchase or exercise of exclusivity is too expensive for the networks. Presumably these programs will reach larger than average audiences. The dummy variable that is included in specification (3) attempts to control for this possibility, so that the individual contribution of program age to program popularity may be better identified. The coefficient on this variable has a large positive coefficient, and is statistically significant in specification 3. Specification (4) (column 4) includes both the number of "top 50" entries in the 4-8 p.m. time slot, and the "exclusivity" dummy variable. The coefficient of the age variable falls further, and is no longer statistically different from zero.[82]

The regression results contained in columns 1 - 3 suggest that newer programs can capture larger audiences than older programs. However, as the coefficient estimates presented in column 4 suggest, when account is taken of differences in the time slots, and the possibility that the networks will choose not to purchase the syndication rights to a program, the effect of program age on audience size becomes small, and is statistically insignificant.[83]

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[82] An earlier study conducted by ICF concluded that older off-network programs were not close substitutes for recent off-network programs. Using the rate at which ratings of syndicated programs decay over time, they concluded that syndicated program "values decay significantly over time." *See Comments of the Committee for Prudent Deregulation, supra* note 20. According to their results, the average rating of a four year old program, based on DMA (or market by market) ratings, is 77 percent of the average rating of a program in the first year of syndication. The average rating of a ten year old program is 46% of the average rating of a program in the first year of syndication. The decay rates reported in the ICF study do not take into account the possibility that much of the decay in ratings may be traced to the fact that older programs are shown in less attractive time slots. Some of our regression results suggest that the decay rates reported in the ICF study may understate the competitiveness of older programs. A similar analysis is included in the Coalition's reply comments. *See* footnote 71, *supra.*

[83] When examining share data, as in Tables A1-A4, the use of the adjusted audience variable correctly adjusts for the fact that hour shows take up two half hour slots. In the regression analysis, the dependent variable is intended to measure how many households view a program per showing. Use of the
(continued...)

The econometric evidence provided by regression specifications 1 - 3 is consistent with the existence of an antitrust market consisting of "newer off-network" programs, but by itself does not establish the existence of such a market. This evidence suggests that newer programs are "higher quality" than older programs; accordingly, we would expect these programs to command a higher price than older programs. Older programs may compete in the same antitrust market with newer programs if enough program buyers would be willing to switch from high-price, high-quality programs to lower-priced, lower-quality programs, in response to an attempt to price the former supracompetitively. This possibility is particularly relevant to the Coalition's argument that the programs that would be withheld from syndication are the low-quality, marginal programs. As noted earlier, however (see footnote 78), we could not directly test for this, as we lacked price and cost data for older and newer programs.

The evidence provided by specification 4, by contrast, is not consistent with the existence of a "newer off-network program" antitrust market, as it suggests that audience size does not vary with program age. Absent such a relationship, a monopolist seller of newer off-network programs would not be able to anticompetitively raise the price of such programs, as program purchasers would switch to competitively-priced, but equally popular, older programs, forcing a rescission of the price increase.

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[83](...continued)
adjusted audience measure would overstate the popularity of hour shows *vis-a-vis* half hour shows, and thus is not an appropriate variable for these purposes.

TABLE A5

Dependent Variable = Total Audience (1000s of households)

Independent Variable	(1)	(2)	(3)	(4)
Constant	1041.8 (4.90)**	323.2 (2.15)**	1053.0 (3.12)**	251.12 (1.05)
Number of Episodes	2.17 (1.23)	1.10 (1.34)	.592 (.300)	.832 (.626)
Age[84]	-47.97 (-5.10)**	-15.0 (-2.24)**	-46.77 (-2.85)**	-12.19 (-1.06)
Number of Top 50 entries in 4-8 p.m. time slot	-	140.2 (13.8)**	-	139.10 (11.13)**
No Exclusivity[85]	-	-	776.69 (2.46)**	349.97 (1.62)
Mean of the Dependent Variable (1000's of households)	754.1	754.1	910.5	910.5
F	13.97	84.80	10.64	48.6
R^2	.157	.632	.239	.658
N	152	152	106	106

** Significant at the 95% level
* Significant at the 90% level

[84] "Age" measures the number of years since the program's final year of production.

[85] This is a dummy variable equal to 1 if the first syndication year came before the last year of the production run, and equal to zero otherwise.