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

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

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

December 21, 1990

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* 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 H. Kobayashi (202-326-3363) of the FTC's Bureau of Economics.

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

I. Introduction

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

Section II of this comment summarizes the relevant expertise of the staff of the FTC. Section III reviews the history of the current rulemaking, and provides a brief overview of our earlier comments in this proceeding. In our

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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 H. Kobayashi (202-326-3363) of the FTC's Bureau of Economics.

[2] *See Further Notice of Proposed Rulemaking* In the Matter of the Evaluation of the Syndication and Financial Interest Rules, MM Docket No. 90-162, issued October 22, 1990.

[3] This further comment is based on positive economic analysis and therefore does not explicitly address normative concerns falling outside the scope of such an analysis. These and other concerns not explicitly addressed in this further comment should be considered separately.

most recent comment, we concluded that a compelling economic case did not exist for continuing to impose a *per se* ban on the acquisition of certain ownership rights by television networks, that competition would be better served by removing the restrictions, and that any instances of alleged monopolization could be addressed through application of conventional antitrust enforcement powers.[4] These conclusions were largely based upon an analytical assessment of possible anticompetitive problems and the likely ability of the Fin-Syn rules to correct those problems. We also found no evidence that the networks behaved anticompetitively prior to the enactment of the rules. Furthermore, we found that subsequent changes in the market have made anticompetitive behavior unlikely in the future.

Section IV examines several regulatory options discussed in the FNPRM. These options include several regulatory policies apparently designed to attain a compromise solution between the "polar extremes" of complete repeal and retention of the rules as they currently exist. We comment on two basic types of compromise solutions that raise competition policy issues: (a) the regulation of the negotiation process between the networks and the producers and (b) the regulation of network ownership of financial interest and syndication rights.

We believe that regulating the negotiation process is unlikely to affect the ultimate outcome of the negotiations. Thus, we do not find compelling reasons to adopt any of the proposed restrictions on the negotiation process. Further, since the regulation of negotiations can potentially increase the costs of bargaining and might cause mutually beneficial transactions to be bypassed, adoption of these regulations may reduce efficiency. With respect to the regulation of network ownership rights, we suggest that conventional antitrust

[4] *See Comment of the Staff of the Bureau of Economics of the Federal Trade Commission*, In the Matter of the Syndication and Financial Interest Rules, MM Docket No. 90-162, September 5, 1990.

enforcement be used instead of specific regulatory limits. Thus, we also find no compelling reason to adopt regulations that would prohibit or limit network ownership of syndication rights.

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.[5] 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.[6]

The FTC staff previously has issued three comments to the FCC on the Fin-Syn rules.[7] 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;[8] (2)

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[5] 15 U.S.C. §§ 41 - 59.

[6] *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.

[7] *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; *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, and the FTC staff comments in this Docket, *supra* note 4.

[8] *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.

elimination of the prohibition on common ownership of cable television systems and national television networks;[9] (3) rules relating to whether cable television systems "must carry" television broadcast signals;[10] and (4) the FCC requirement that broadcast licenses be held for at least three years before being transferred.[11]

III. Background

A. History of the Current Rulemaking

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)(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.[12] 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

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[9] CT Docket No. 82-434.

[10] MM Docket No. 85-349.

[11] BC Docket No. 81-897.

[12] "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.

exclusive right to network exhibition in the United States.[13] That is, the Fin-Syn rules currently prohibit networks from engaging in program syndication, and from sharing in the profits from off-network distribution of any program not produced by the network. The rules were intended to constrain the three major networks' ability, individually or collectively, to act as *monopsonists* in the purchase of programs from independent producers, and from acting as *monopolists* in the sale of "off-network" programs to independent stations.

In response to the Fox petition, the FCC instituted a new rulemaking to evaluate the Fin-Syn rules.[14] On October 22, 1990, the FCC, responding to the comments and reply comments filed in response to the Notice of Proposed Rulemaking (NPRM) in MM Docket 90-162, issued a Further Notice of Proposed Rulemaking (FNPRM) to evaluate several options to modify the Financial Interest and Syndication (Fin-Syn) rules.[15]

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

The staff of the FTC has filed three previous comments with the FCC regarding the Fin-Syn rules. In 1983, the staff filed a comment and a reply comment on a similar proposal to modify or repeal the Fin-Syn rules.[16] In these comments, the staff expressed doubts that the Fin-Syn rules had served any of

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[13] 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).

[14] The Fin-Syn rules apply to networks defined as "interconnected program services" with 15 or more programming hours per week to at least 25 affiliated stations in 10 or more states." *See* 47 C.F.R. §73.658(j)(4). 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. 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.

[15] *See Further Notice of Proposed Rulemaking*, In the Matter of the Evaluation of the Syndication and Financial Interest Rules, MM Docket No. 90-162, issued October 22, 1990.

[16] *See* FTC staff comment and reply comment, *supra* note 7.

the FCC's goals. In addition, the staff's analysis suggested that the rules likely would reduce efficiency in the market for new programming. Accordingly the staff recommended that the rules be repealed.

On September 5, 1990, the FTC staff filed a comment in response the FCC's NPRM in this docket.[17] Our comment addressed two major competition policy issues addressed by the rules: the networks' ability to act as *monopsonists* in the purchase of programming, and the networks' ability to act as *monopolists* in the sale of off-network programming. With respect to the *monopsony* issue, any such power held by the networks (and existing evidence did not support such a claim) has likely declined due to changes in the marketplace. In addition, we noted that, even if monopsony power were present, prohibiting or restricting the extent of vertical integration by the networks would exacerbate, rather than diminish, the attendant welfare losses. With respect to the *monopoly* issue, we noted that this concern arises only if the relevant antitrust market is limited to "newly-produced-off-network" programs and that existing (albeit scarce) evidence did not support such a market definition. Given these considerations, we concluded that: (i) a compelling economic case does not exist for continuing to impose a *per se* ban on the networks' acquisition of certain ownership rights to newly-produced television programs; (ii) competition would be better served by removing the restrictions; and (iii) any instances of anticompetitive behavior could be better addressed through application of conventional antitrust enforcement powers.

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[17] *See* the FTC staff comment, *supra* note 4.

IV. The FNPRM

The FNPRM seeks additional comment on an array of regulatory options contained in the comments and reply comments submitted in response to the original NPRM. In general, the options on which the FCC seeks comment "suggest modification of the financial interest rule, subject to certain safeguards, and a narrowing of the prohibitions against network participation in foreign and domestic syndication."[18] While neither complete repeal nor complete retention of the rules has been ruled out, the FNPRM focuses on various compromise solutions.[19] Given this focus, our comment will analyze the "compromise options" contained in the FNPRM. We have grouped the options into two major categories: (a) regulation of the negotiations between the networks and producers, and (b) relaxation but not elimination of the ownership restrictions currently placed on the networks by the Fin-Syn rules.

A. Regulation of the Negotiations

The FCC has solicited comment on two basic options to regulate the negotiations for syndication rights: prohibiting negotiations over syndication rights until after the completion of negotiations over the network fee,[20] and/or allowing negotiations over syndication rights to take place if and only if the seller initiates the negotiations.[21] The FCC has also requested comment on the practice of deficit financing.

1. An Analysis of the Regulations

The FNPRM requests comment on regulations that would control both the order and the time period in which negotiations over the syndication rights

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[18] See the FNPRM, *supra* note 2, p. 1.

[19] *See* the FNPRM, *supra* note 2, item number 22 and *Broadcasting Magazine*, October 29, 1990, p. 31.

[20] *See* the FNPRM, *supra* note 2, item number 10.

[21] *See* the FNPRM, *supra* note 2, item number 9.

for an individual program could take place. Specifically, one option would require that negotiations over the syndication rights could only take place separately and after the negotiations over the network rights have been concluded and a pilot has been scheduled. In addition, the FCC has asked for comment on whether negotiations over syndication rights should be prohibited after some specified point in time. If both of these options were adopted, negotiations would be allowed to take place only during a prespecified window of time.

Economic analysis suggests that separating negotiations over the network fee from those over syndication rights will not alter the overall bargaining outcome. The explanation for why the split-negotiation option would not affect the ultimate bargaining outcome was contained in the 1980 Report of the FCC Network Special Staff Inquiry.[22] The Report demonstrates that if the networks possess market power, the Fin-Syn rules (which essentially forbid the second round of negotiations) could not diminish their ability to exercise that power. Prohibiting (or limiting) the networks from owning syndication rights forecloses only one vehicle with which the networks could extract monopoly profits; other, potentially equally effective, vehicles remain available. For instance, the Report demonstrates that any *increase* in compensation a producer expected to receive from holding (rather than selling) the syndication rights could be extracted by the networks through a reduction in the fees paid (or by charging a slotting allowance) to the program producers for the original network runs. Thus, separating the negotiations over the network fee and the syndication rights can change the way in which a producer is compensated, but the expected

[22] *See*, Network Inquiry Special Staff, *New Television Networks: Entry, Jurisdiction, Ownership and Regulation, Volume II* (F.C.C. 1980). *See*, also Warren-Boulton, *Economic Analysis and Policy Implications of the Financial Interest and Syndication Rule*, Submitted on Behalf of the Coalition to Preserve the Financial Interest and Syndication Rule, MM Docket 90-162, June 14, 1990.

total amount of compensation a program producer receives should remain constant.[23]

In addition, separating the negotiations over the network fee and the syndication rights would not effectively prohibit the networks from exercising their market power in the way envisioned by the economic model submitted by the Coalition to Preserve the Financial Interest and Syndication rule.[24] Under the assumptions of the Coalition's model, only a limited financial interest in the revenues (not profits) from syndication is required to diminish the programmers' incentives to make investments that improve the value of the program in the syndication (but not in the first-run network) market. Thus, to the extent the model describes accurately the syndication market, the networks could achieve the desired effect on programmers' incentives so long as the negotiations for syndication rights occur prior to the latter years of the network run. Given that the options typically suggest a relatively short delay between negotiations over the network fee and syndication rights, the Coalition's model would appear to predict that these regulations on the negotiations would be analytically equivalent to complete repeal of the rules.

The neutrality argument contained in the Network Inquiry Special Staff Report (i.e., that the ultimate outcome of the bargaining process will be unchanged) appears to hold with equal force for all of the proposed regulations affecting negotiations cited in the FNPRM. Prohibiting negotiations for syndication rights after a certain date and forbidding the networks from initiating the negotiations also would seem unlikely to alter the ultimate bargaining outcome or have an effect on the networks' ability to exercise market power. Such regulations might increase the producer's expected

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[23] The regulations are likely to increase the deficits faced by the producers. The issue of deficit financing is discussed in Section IV.A.2, *infra*.

[24] *See* the Coalition's economic comment, *supra* note 22.

revenues from the sale of syndication rights due to increased bargaining power in the second negotiation,[25] but this increase can also be expected to be anticipated by the networks and offset by decreases in the network fee. However, such restrictions on the types of permissible contracts might prevent contracts that would have otherwise been voluntarily agreed to.[26] For example,

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[25] In terms of the economic model of bargaining, the proposal that prohibits the networks from initiating the negotiations could be thought of as dictating who makes the first offer in the second negotiation. The economic literature on bargaining suggests that changes in the order of offers and counteroffers can change the second round bargaining outcome. In general, there seems to be a first mover advantage when there is complete information about the relative values placed on the good by the two parties. *See*, e.g., Rubinstein, "Perfect Equilibrium in a Bargaining Model," 50 *Econometrica* 97 (1982). However, since the regulations only apply to the second round of the bargaining process (and not the first), the ultimate outcome is unlikely to be changed. The first mover advantage can also arise in incomplete information settings, although such results are in general not unique and require strict and sometimes arbitrary assumptions about non-equilibrium beliefs of the bargainers. *See*, e.g., Perry, "An Example of Price Formation in Bilateral Situations: A Bargaining Model with Incomplete Information," 54 *Econometrica* 313 (1986). Another interpretation of this proposal would be that only the seller would be able to make offers in the second-round, with the networks able only to reject any offers. This would also give the seller a second-round (but not a first-round or overall) advantage over the regime where either the seller or buyer could make offers. For such a model of bargaining, see Fudenberg, Levine and Tirole, "Infinite-Horizon Models of Bargaining with one-sided Incomplete Information," in Roth, ed. *Game-theoretic Models of Bargaining*, Cambridge University Press (1985). Prohibiting bargaining over syndication rights after a certain time period has passed would be akin to changing the second-round negotiations from an infinite horizon to a finite horizon model. The economic bargaining literature is also mixed with respect to the effects from this change. See Fudenberg, *et al.*, *id.*

[26] In general, legal restrictions on the types of contracts allowed are inefficient and cannot be in the best interest of both parties. Efficiency explanations for legal restrictions on contracts are based on the existence of externalities imposed on third parties (*e.g.*, society). *See, e.g.*, Rubin, "Unenforceable Contracts, Penalty Clauses and Specific Performance," 10 *J. Legal Stud.* 237 (1981). For a non-externality based argument, see Aghion and Hermalin, "Legal Restrictions on Private Contracts Can Enhance Efficiency," 6 *J. L. Econ. & Org.* 381 (1990). In this model, restrictions on contracts may reduce expenditures on information production. However, this reduction may cause movements toward or away from the efficient level of information production. The staff of the FTC, in examining proposed state restrictions on advertising and other types of information production, has generally concluded that any such restrictions should be limited to deceptive or misleading claims. *See, e.g.*, Letter to Albert Bell, Esq, re. proposed amendments to the Ohio Code of Professional Responsibility, from M. D. Kindt, Regional Director, FTC Cleveland Regional Office, November 3, 1989.

not allowing the networks to initiate negotiations or prohibiting bargaining after some date could conceivably cause some mutually beneficial transactions to be forgone.

In sum, we conclude that regulating the negotiation process is unlikely to affect the negotiated outcome. Economic analysis suggests that even if the proposed regulations increase the explicit price paid by the network for syndication rights, any such gains are likely to be offset by a reduction in the network fee. In addition, the restrictions may increase negotiating costs, causing mutually beneficial transactions to be bypassed. Given the possibility that regulating the negotiation process can potentially increase costs without altering the ultimate outcome, we conclude that there is no obvious basis to support the restrictions on negotiations contained in the FNPRM.

2. Deficit Financing

The FCC has also asked for comments on deficit financing, and whether deficit financing would disappear if networks were allowed to purchase "back-end rights".[27] As has been pointed out by previous commenters on the Fin-Syn rules, it is exactly the ban on networks' ownership of syndication rights that gives rise to "deficit financing".[28] If programs were supplied competitively and networks were allowed to purchase all rights to a program, the total fee paid by the network (including the network fee and compensation for the expected value of the syndication rights) to the marginal producer would equal the costs

[27] "Back end rights" include domestic and foreign syndication rights, revenues from video sales and other promotional items. *See* the FNPRM, *supra* note 2, footnote 9.

[28] *See* Besen, Krattenmaker, Metzger, and Woodbury, *Misregulating Television: Network Dominance and the FCC*, Chicago: Univ. of Chicago Press (1984), pp. 131-132.

of producing the program.[29] If the networks were barred from purchasing some or all of the syndication rights, one would expect the networks to pay for only the limited rights acquired.[30] Under these circumstances, the size of the deficit will equal the total expected value of the rights retained by the producer. Thus, "deficit financing" can be expected to persist as long as some restrictions on network ownership are retained, and the more severe the restrictions, the larger will be the expected deficits.

B. Regulation of the Networks' Ownership Rights

The second set of regulatory options relax, but do not abolish, restrictions on the types of rights the network can own. The options concerning the regulation of ownership rights contained in the FNPRM are varied. Options include (1) distinguishing foreign from domestic syndication rights;[31] (2) structural limitations on total program ownership by a network;[32] and (3) the (*de facto*) restriction of control rights.[33] Each of these are discussed in separate

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[29] Studies of network-programmer relationships suggest that prior to adoption of the rules, the networks compensated program producers for syndication rights, and these up front payments approximated the expected value of these rights in the syndication market. *See, e.g.*, Crandall, "FCC Regulation, Monopsony, and Network Television Program Costs," 3 *Bell J. of Econ.* 483 (1972), and Woodbury, Besen and Fournier, "The Determinants of Network Television Program Prices: Implicit Contracts, Regulation and Bargaining Power," 14 *Bell J. of Econ.* 351 (1983).

[30] As noted by Besen, *et al.*, *supra* note 28 at 131, "It would be surprising indeed if the networks, in acquiring the typical rights to two runs of series episodes, agreed to compensate producers for all their production costs. One would no more expect the network to pay the full value of a series when such limited rights are acquired than one would expect the first person who leases a car to pay the entire cost of its production."

[31] *See* the FNPRM, *supra* note 2, item number 20.

[32] *See* the FNPRM, *supra* note 2, item numbers 11-13 and 24-25. These structural limits would prevent the networks from taking an ownership position or from producing in-house more than a certain percentage of their current prime time schedules.

[33] *See* the FNPRM, *supra* note 2, item number 15 (anti-discrimination rules), item numbers 26-28 (anti-warehousing rules), and item numbers 14, 19, 21 and 22 (limiting networks to minority (noncontrolling) ownership positions).

sub-sections.

1. Domestic versus Foreign Syndication Rights.

From an antitrust perspective, there is a simple difference between allowing the networks to acquire foreign versus domestic syndication rights. The acquisition of foreign syndication rights by the network cannot harm domestic independent television stations and their viewers even if the networks can act as *monopolists* in the sale of off-network programming to these stations. Thus, one would restrict acquisition of foreign syndication rights only if questions of network *monopsony* power exist. Given the unlikely chance that such power exists (and the absence of any evidence in support of it), we question whether any limitation on network ownership of foreign syndication rights is warranted. Whether any restrictions on domestic syndication rights should be retained are discussed in the remainder of the comment.[34]

2. Structural Limitations on Program Ownership by the Networks

Another set of compromise options contained in the FNPRM involve structural regulations on each network's ownership of domestic financial interests and syndication rights. The FNPRM contains options to limit the ability of networks to integrate forward into syndication and to integrate backward into production.

(i) Limits on Forward Vertical Integration by the Networks

As a safeguard to prevent the networks from exercising market power in the sale of syndicated programming, the FNPRM requests comment on options to limit the share of programs in which the networks can take a

[34] In a somewhat related matter, the FNPRM solicits comments on the likely reasons for and effects of increased foreign ownership of program producers. *See* the FNPRM, *supra* note 2, Section IV. From an antitrust perspective, foreign ownership, *per se*, does not imply anything about anticompetitive behavior, all other things held constant. *See* Section 3.23 of the U. S. Department of Justice Merger Guidelines, June 14, 1984, *reprinted* in 4 Trade Reg. Rep. (CCH) para. 13,103.

financial or ownership interest. As noted in our earlier comment, it is not clear that such safeguards are necessary.[35]

Limiting the networks' ability to retain ownership interests in their prime time programs would require a showing that "newly-produced-off-network" programs constitute a relevant antitrust market. At this time, however, this crucial first step of traditional antitrust analysis, defining the relevant antitrust market, has not been resolved.[36] If anything, currently available evidence suggests that "newly-produced-off-network" programs do not constitute a relevant antitrust market.[37] Unless the existence of such a limited market can be established, structural limitations on any network's ownership rights would not appear necessary because the networks, individually or as a group, seem unlikely to be able to acquire market power in a broader market containing "all off-network-syndicated programs" or "all syndicated programs."

The options contained in the FNPRM generally limit an individual network's rights of ownership to a maximum percentage of its total prime time schedule. We would suggest that, to the extent that structural limits are used at all, they should be defined as a percentage of the total number of programs in the relevant antitrust market, (*e.g.*, syndicated or "off-network" syndicated programs). Further, we suggest that any implementation of binding limits be based on the finding that the major networks together possess market power in the relevant market. When market power does not exist, ownership limits that are binding at a small percentage of a network's schedule can inhibit procompetitive contractual arrangements. For example, strict ownership limits could constrain or deter the formation of an "emerging network" because the

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[35] *See* the FTC staff comment, *supra* note 4, Section VII, pp. 22-36.

[36] *See* the U. S. Department of Justice, Merger Guidelines, *supra* note 34.

[37] *See* our earlier comment, *supra* note 4, Section IV.A, pp. 23-28.

limits would apply despite the new firm's lack of presence in the syndication market.

Even in instances where concerns about market power in the relevant antitrust market appear to exist, ownership limits defined as a percentage of a network's schedule might be unable to address these concerns. For example, if the networks can successfully predict which programs will make it into syndication, a cap limiting network ownership to half of their current schedule will not prevent the networks from taking ownership interest in all of the programs that eventually make it into syndication.[38]

In addition, strict structural limits may be improper even if they are based on a properly defined antitrust market. Use of such rigid limits may unnecessarily interfere with pro-competitive transactions. Traditional antitrust analysis does recognize that a concentrated market structure is a necessary, but not a sufficient, condition for the existence of market power. This approach allows the authorities to take into account other factors, such as possible

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[38] The possibility that a 25% limit may not prevent the networks from acquiring ownership rights in all programs that make it into syndication is discussed in the Comments of the Program Producers and Distributors Committee in Response to the Further Notice of Proposed Rulemaking, MM Docket 90-162, November 21, 1990, p. 13. The following calculations suggest that a 25% limit will be binding. Suppose the probability that a program is renewed equals 24% after the first year, 72% after the second, 84% after the third, and 76% after the fourth. *See* Owen and Wildman, *Video Economics, forthcoming* Harvard University Press, 1991, Table 4-8, p. 4-34. Using these numbers, the probability that a show makes it into its fourth year as a on-network prime time series (and thus into syndication) is 14%. Under the unrealistic assumptions that the networks know, *ex-ante*, which programs will make it into syndication and that all programs are cancelled after the fifth year, the networks, in order to control all of these programs, would, in any given year have to have an ownership interest in approximately three out of twenty first year shows, three out of the four shows that made it into the second year, all three shows that made it into their third and fourth years, and both shows that made it into their fifth year. The implies that the network would have to take an ownership interest in over 40% of their current schedule (much greater than the 25% suggested in the example contained in the comments of the Program Producers and Distributors Committee). Under the more realistic assumptions that the networks are uncertain about which shows will be successful, and that shows may last more than five years, this percentage will have to be even higher.

efficiencies, that could make a proposed transaction, even one that would result in high combined market shares, on balance procompetitive.[39]

For these reasons, we believe competition would best be served by addressing instances of alleged monopolization through application of conventional antitrust enforcement powers.[40] Under such a system, it would not be necessary to limit any network to ownership of a maximum percentage of its prime-time schedule. Neither would it be necessary to place limits on in-house production. At most, we would suggest that any structural limits be enumerated solely in the form of non-binding guidelines or policy statements.

(ii) Limits on Backwards Vertical Integration by the Networks

The FNPRM seeks comment on an option that would limit the amount of in-house programming done by the networks. Adoption of such an option would reimpose a condition contained in the Department of Justice consent

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[39] *See* Purpose and Underlying Policy Assumptions, Section I of the U. S. Department of Justice Merger Guidelines, *supra* note 34. With respect to competition policy, use of traditional antitrust enforcement and market definition would allow the FCC to bypass the issue of defining a "network" and to avoid considering special waivers for "emerging networks". *See* the FNPRM, *supra* note 2, Section VII. For earlier decisions on emerging networks, *see Christian Broadcasting Network, Inc.* 87 F.C.C. 2d. 1076 (1981), and the ruling on the original Fox petition to reopen BC Docket 82-345, January 30, 1990. Such an approach would base any antitrust or regulatory interventions upon the showing that a firm or group of firms would likely exercise market power rather than basing such decisions on the contractual structure of the firm. For the FCC's current definition of a network *see* footnote 14, *supra.*

[40] *See* the FNPRM, *supra* note 2, items 16-18. In their 1983 comments, the Department of Justice concluded that "the Department is not confident that the antitrust laws can be relied upon as the most effective tool for ensuring against possible anticompetitive practices in this area." *See Comments of the U. S. Department of Justice* In the Matter of Amendment of 47 C.F.R. § 73.658(j), the Financial Interest Rule, BC Docket No. 82-345, January 26, 1983, pp. 39-41. In their latest comment, however, the Department, cites changes in the marketplace and seems to have concluded that the antitrust laws may be sufficient to deter anticompetitive behavior by the networks. *See Comments of the U. S. Department of Justice* In the Matter of Evaluation of the Syndication and Financial Interest Rule, MM Docket No. 90-162, June 14, 1990, p. 34.

decrees that expired on November 30, 1990.[41] Vertical integration by the networks into programming brings up two distinct policy issues.[42] The first issue is the effect that limits on vertical integration have on efficiency, both in general and under the assumption that the networks possess monopsony power. In our earlier comment, we found that limits on vertical integration may decrease efficiency generally, and may increase the welfare losses from monopsony. The second issue is the effect that limits on vertical integration have on the distribution of rents between program producers and the networks. The redistribution of rents, in and of itself, raises no *separate* efficiency issue, and lies outside the scope of this comment.

In our earlier comment, we examined, in general terms, the relationship between vertical integration and economic welfare. In that comment, we showed that vertical integration would likely increase the efficiency with which programs are produced and distributed, and would likely increase programming output.[43] We showed that vertical integration can improve efficiency by mitigating problems of opportunism in contractual relationships where transaction-specific assets are present. With respect to the problem of monopsony, we showed that, to the extent the networks collectively exercise monopsony power (and existing evidence does not support such a claim), vertical

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[41] *See* 5 Trade Reg. Rep., (CCH) at 50,766 (1980) [ABC Decree], 1980-81 Trade Cases at 63,594 [CBS Decree], and 1978-1 Trade Cases, at 61,855 [NBC Decree].

[42] In addition to the issues discussed in this section, limits on in-house production may indirectly limit the ability of the networks to acquire market power in the sale of "off-network" programs. However, this issue was discussed in the previous section, and any potential problems can be addressed directly by focusing on network holdings of syndicated programs rather than focusing on how the programs were produced. Another argument is that limiting in-house production can indirectly limit the extent to which networks unfairly favor programs in which they own a financial interest. The issue of favoritism is discussed generally in Section IV.B.3(i), *infra*.

[43] *See* the FTC staff comment, *supra* note 4. For a similar analysis, *see* the DOJ comment, *supra* note 40, Section III A. 1.

integration may reduce any welfare losses attributable to monopsony power. Thus, limits on network in-house production can exacerbate, rather than diminish, any welfare losses stemming from any existing network monopsony power.[44]

In general, regulations that limit the extent to which a firm in any industry can vertically integrate focus upon vertical integration or vertical restraints as the cause of market power. Economic analysis suggests that such a focus on the vertical relationship is probably misplaced. If no market power exists at either vertically related stage, vertical integration or vertical restraints cannot create market power. And even if one of the parties does possess horizontal market power, focusing on the source of the horizontal market power would lead to more appropriate policy rules.[45] Given that vertical integration, *per se*, is unlikely to cause problems associated with market power, and given the plausible efficiency effects of vertical integration, we conclude that no compelling case exists to reimpose limitations on in-house programming by the networks.[46]

The FNPRM also asks whether the expiration of the limitations on in-

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[44] *See* the FTC staff comment, *supra* note 4, pp. 19-22.

[45] In commenting on proposals to prohibit gasoline refiners from engaging in the retail sale of gasoline, the staff of the FTC concluded that existing antitrust laws would "address possible anticompetitive practices more effectively than would legislation restricting new entry by potential competitors and regulating contractual relationships between suppliers and purchasers of gasoline." *See* Prepared statement of R. Rowe, Director of Litigation, Bureau of Competition, Federal Trade Commission, before the Joint Subcommittee Studying Divorcement of the Virginia Senate and House of Delegates, October 23, 1990. *See* also letters from R. Rowe to A. Diamonstein, Chairman, General Laws Committee, House of Delegates, Commonwealth of Virginia, March 2, 1990, and to D. E. Bosley, Representative, House of Representatives, Commonwealth of Massachusetts, April 9, 1990.

[46] Since the welfare effects of vertical restraints are ambiguous even when horizontal market power exists, and since plausible efficiencies exist for such relationships, the antitrust law uses a rule of reason analysis instead of *per se* rules to analyze certain non-price vertical relationships.

house production will directly or indirectly (by interfering with the Prime Time Access Rule (PTAR)) reduce diversity.[47] A rule that limits in-house programming will certainly cause programming to be produced by parties other than the networks. However, given that the networks still have complete choice over which programs they will broadcast, it is not clear whether changing who produces network shows will increase or decrease the diversity of network programming.

With respect to the distributional consequences of vertical integration, we noted in our earlier comment that allowing a network to integrate vertically may result in reduced profits for the program producers who remain independent. Thus, the rules may cause a transfer of rents from networks to producers. While our earlier comments did not directly address whether the rules should be used to transfer rents from the networks to producers, they noted that from an efficiency standpoint such transfers may only be achieved at a substantial cost.[48]

3. The Restrictions on Network Ownership of Control Rights.

A third set of possible ownership restrictions involve allowing the networks to acquire passive financial interests in but not control rights over syndicated programs. Possible restrictions include direct regulation of network decisions to prevent the networks from favoring programs in which they took or held an ownership interest, direct regulation to prevent the anticompetitive warehousing of programs, and limiting the networks' ownership of syndication

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[47] The PTAR limits network affiliates in the top fifty markets to carrying no more than three hours of network supplied programming or off-network programming during the four-hour-long prime time period.

[48] The Department of Justice has suggested that it may not be appropriate to use the rules to transfer rents between the networks and the producers absent significant adverse effects on program production. They note in their comment that "if the transfers involve primarily the distribution of rents between producers and networks, the issue is not an appropriate subject of governmental intervention." *See* the DOJ comments, *supra* note 40, pp. 27-28.

rights to a minority (non-controlling) position. We examine these options below.

(i) Anti-Discrimination Regulations and Favoritism

The FCC has solicited comment on regulations that would ensure that networks were not discriminating against programs in which they do not have an ownership interest. As noted in our previous comments, empirical analysis suggests that, prior to enactment of the rules, the networks did not favor programs in which they held an ownership or financial interest. This observation is consistent with the hypothesis that an unconstrained network would be *less* likely to renew (or otherwise favor) programs in which it has a financial interest if these shows tend to be more risky (i.e., more likely to be unsuccessful).[49]

In practice, any regulation designed to prevent "favoritism" or "discrimination" would pose real risks. For example, a simple quota mechanism that required equal treatment (e.g., renewal rates) for owned and nonowned programs that did not take into account underlying differences in the types of shows could result in a network inefficiently basing its ownership and renewal decisions upon compliance with the rule rather than upon sound business judgement.

A more complex regulatory system which attempted to distinguish efficient from inefficient favoritism would entail substantial regulatory costs and could well become a regulatory morass. As noted in the FNPRM, anti-discrimination regulation that attempted to be sensitive to efficiency concerns

[49] See Crandall, "The Economic Effect of Television Network Program Ownership, 14 *J. L. & Econ.* 385 (1971). We suggest that the favoritism issue be analyzed using the vertical restraints approach discussed above. That approach showed that if neither party possesses horizontal market power, "favoritism" cannot create market power where it did not exist previously. Further, even if one of the parties does possess horizontal market power, the focus on the vertical relationship is probably misplaced: focusing on the source of horizontal market power would lead to more appropriate policy rules.

would require government oversight over almost all network decisions.[50] We do not think that it would be "feasible for the federal government to be involved in conduct that inherently involves basic business and subjective judgments."[51] Such micro-management by a regulatory agency would likely impose significant burdens on the networks and taxpayers. Moreover, producers of cancelled programs could be expected to petition the regulatory agency that their cancellations were the result of illegal "favoritism" rather than sound business judgement. Studies of the transportation and health care industries show that significant inefficiencies can be fostered when private parties can appeal for regulatory relief whenever decisions fall against them.[52] One need look at no more than at the vast amount of government and private resources used in this proceeding to get an idea of the likelihood that such "rent seeking" behavior will occur.

(ii) Anti-Warehousing Regulation

In addition to the structural limitations mentioned above, the FNPRM contains two additional regulatory options designed to prevent the networks from anticompetitively warehousing syndicated programming in which they own a financial interest. The first would directly regulate warehousing by forcing the networks to sell off-network programs on a "commercially timely"

[50] Such decisions would include, for example, the terms of sale of network owned off-network programming to network affiliates, and the renewal, scheduling, and promotion of shows during their network run.

[51] *See* the FNPRM, *supra* note 2, Section II, item 15.

[52] For example, several studies of the trucking industry indicate that allowing incumbents to use the regulatory process to delay or prevent entry by potential competitors leads to higher shipping rates. *See* Owen, *Deregulation in the Trucking Industry*, FTC Bureau of Economics Issues Paper (May 1988) and the cites therein; and Winston, *et al.*, *The Economic Effects of Surface Freight Deregulation*, The Brookings Institution (1990). Similar effects have been shown to arise in health care markets when incumbent providers use regulatory processes to impede entry of competitors. *See* Sherman, *The Effect of State Certificate of Need Laws on Hospital Costs: An Economic Policy Analysis*, FTC Bureau of Economics Staff Report (January 1988).

basis. The second would reduce the potential for anticompetitive warehousing by limiting networks to a minority (non-controlling) ownership interest.

(a) Direct Regulation of Warehousing

The FNPRM contains a option to directly prevent the networks from warehousing programs. Such regulation would require the regulatory agency to scrutinize network syndication decisions and intervene when it decided that a network failed to market a syndicated program on a "commercially timely" basis. In addition, the regulatory agency would have to scrutinize network pricing decisions to insure that *de facto* availability was not being denied via an artificially high price. That is, any anti-warehousing regulation would appear also to require some form of price regulation.

As mentioned above, requiring a regulatory agency to regulate the private decisions of firms can lead to significant inefficiencies. For example, any attempt by the FCC to regulate price would likely lead independent television stations to lodge numerous complaints about network pricing of individual programs, thereby forcing the FCC to arbitrate a large number of bargaining disputes over what constitutes a "fair" price. The incentive for private parties to use such a regulatory pricing system to advance their private goals rather than to promote competition may result in costs that approximate the economic value of the rents generated by the productive activity being regulated.[53]

(b) Limitation of Ownership to a Minority Interest

Any network's ability to "warehouse" programs anticompetitively can also be restricted by limiting the networks to a minority interest in any given program. Such a limitation would prevent the networks from acquiring control

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[53] *See* Posner, "The Social Costs of Monopoly and Regulation, 83 *J. Pol. Econ.* 807 (1975), and Baumol and Ordover, "Use of Antitrust to Subvert Competition," 28 *J. L. & Econ.* 247 (1985).

rights to a program.[54] By keeping the networks from acquiring control rights, the financial sacrifice involved in warehousing the program to keep it off the market could not occur without the consent of the majority partner. Unless the majority partner (the program producer) can be induced to make a decision to inappropriately hold his program off the market, a decision that would not be in his own interest, warehousing would be unlikely to occur.

Relative to direct regulation of warehousing, the minority interest limitation is likely to entail lower enforcement and rent seeking costs. Instead of relying on complaints by interested parties to a regulatory agency, the minority interest limitation avoids warehousing by relying on the incentive of the majority party to make a decision that is in its own interest (*i.e.*, to syndicate the program on a commercially timely basis).

(c) The Relative Merits of the Anti-Warehousing Options

We note that limiting warehousing by placing a cap on the networks' ownership share of programs, by limiting the networks to a minority ownership position, and by regulating warehousing directly should be viewed as substitutes. That is, each of these mechanisms could be used to limit the networks' ability to warehouse syndicated programs. Thus, it is unnecessary to impose more than one of these options to address warehousing concerns. In addition, the options are not perfect substitutes. The highest costs are likely to be imposed through direct regulation.

Moreover, we continue to believe that a compelling case for anti-warehousing regulation does not exist. There is no evidence that a necessary

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[54] A large body of literature has emphasized the separate value of control rights in a firm. For example, in cases where multiple classes of stock have been issued, the stock possessing the superior voting rights commands a premium over the stock with inferior voting rights. *See e.g.*, Easterbrook and Fischel, "Voting in Corporate Law," 26 *J. L. & Econ.* 395 (1983); Lease, McConnell and Mikkelson, "The Market Value of Control in Publicly-Traded Corporations," 11 *J. Fin. Econ.* 79 (1982); and Levy, "Economic Evaluation of Voting Power of Common Stock," 38 *J. of Fin.* 79 (1982).

condition for the networks to act as monopolists in the sale of syndicated programming, i.e., that "newly-produced off-network" programs constitute a relevant antitrust market, is satisfied. Absent this condition, the likelihood of the exercise of market power is small.[55] In addition, evidence of network behavior prior to and after enactment of the Fin-Syn rules suggests that the potential for anticompetitive warehousing is small.[56] To the extent that any of the anti-warehousing options were modelled after those suggested in the 1983 Department of Justice Comments, we note that the Department's latest comment drops its support for such a safeguard because the changed marketplace makes the assumption of network market power insupportable.[57] Finally, to the extent

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[55] This statement applies both to the networks' ability to anticompetitively warehouse programs and to their ability to impose a "financial interest tax" on program producers. In both of these theories, it is the marginal program (and not popular programs) that will be warehoused. As noted in our earlier comment, 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 close substitute for and compete in the same antitrust market as a marginally profitable, newly-produced off-network program. *See* the FTC staff comment, *supra* note 4, p. 33.

[56] For a discussion of the networks' behavior prior to enactment of the rules, *see* the FTC staff comment, *supra* note 4, pp. 25-26. In addition to the economic warehousing theories, which suggest that the marginal programs would be warehoused, the independent television stations, in their comments, suggest that the networks would, in the absence of the rule, warehouse the best shows (e.g., Cosby, Cheers). *See Further Comments of the Association of Independent Television Stations*, Inc., MM Docket No. 90-162, November 21, 1990. However, the networks' behavior subsequent to imposition of the rules suggest that this outcome is remote. *See* the FTC staff comment, *id*, pp. 26-27. If warehousing of the most popular shows is a profitable strategy, we would expect to observe the networks choosing to purchase the exclusivity rights while the show was still running on the network. In addition, we would also expect to observe the networks and their affiliates outbidding the independent television stations for the syndication rights to off-network shows (and broadcasting these shows in the early morning hours) immediately after the show ended its network run. In general, the networks have chosen not to purchase exclusive rights to the most popular shows that are still in first-run production for network exhibition, and independent stations have outbid the network owned and operated and affiliated stations for newly-produced off-network shows. *See* Appendix B of the Association of Independent Television Stations comment, *id*.

[57] *See* the Department of Justice comments, *supra* note 40, pp. 33-34.

that these options were intended to mitigate the theoretical problems raised in the economic analysis presented by the Coalition to Preserve the Financial Interest and Syndication Rules, we note that the possibility of warehousing has been significantly downplayed in the Coalition's economic analysis, and that neither the direct anti-warehousing regulations nor limiting the networks to a minority interest would successfully prevent the anticompetitive use of the "financial interest tax".[58]

V. Concluding Remarks

This lengthy proceeding has been punctuated by the wide gulf between the major networks, which vigorously advocate complete repeal of the Fin-Syn Rules, and the program producers, who argue that retention of the rules is critical to the continued health of the television industry. The FNPRM has asked for comment on several "compromise" options. While compromise is in many situations an effective mechanism for settlement of disputes, in this situation a compromise may lead to a result that is less desirable than either complete elimination or complete retention of the rules. Our analysis of these options lead us to continue to believe that the best course for the FCC is to repeal completely the existing Fin-Syn rules.

[58] Both the Department of Justice and the staff of the Federal Trade Commission found that the potential was remote for anticompetitive harm from the "financial interest tax." *See* the FTC staff comment, *supra* note 4, and the *Reply Comments of the United States Department of Justice*, MM Docket 90-162, October 5, 1990.