EX PARTE OR LATE FILED

WILMER, CUTLER & PICKERING
2445 M STREET N.W
WASHINGTON, D.C 20037-1420

TELEPHONE (202) 663-6000
FACSIMILE (202) 663-6363

4 CARLTON GARDENS
LONDON SW1Y 5AA
TELEPHONE 011 (44-71) 839-4466
FACSIMILE 011 (44-71) 839-3537

RUE DE LA LOI 15 WETSTRAAT
B-1040 BRUSSELS
TELEPHONE 011 (322) 231-0903
FACSIMILE 011 (322) 230-4322

FRIEDRICHSTRASSE 95
BRIEFKASTEN 29
D-10117 BERLIN
TELEPHONE 011 (49-30) 2643 3601
FACSIMILE 011 (49-30) 2643 3630

JOEL ROSENBLOOM
DIRECT LINE (202)
663-6216

July 19, 1995

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Permissible Ex Parte Presentation in MM Docket No. 94-123, Review of the Prime Time Access Rule

Dear Mr. Caton:

This letter is submitted in duplicate for the record of MM Docket No. 94-123 on behalf of Capital Cities/ABC, Inc. ("ABC"), CBS Inc. ("CBS") and National Broadcasting Company, Inc. ("NBC"), pursuant to Section 1.1206(a) of the Commission's Rules, governing ex parte contacts by persons outside the Commission in non-restricted proceedings. On July 11, 1995, the Law and Economics Consulting Group, Inc. ("LECG"), acting on behalf of the Association of Independent Television Stations, Inc., King World Productions, Inc. and Viacom Inc., submitted on an ex parte basis a 206-page "Surrebuttal" to the economic analyses that were timely submitted with the comments and reply comments of ABC, CBS and NBC, as well as those submitted with the comments and reply comments of the Coalition to Enhance Diversity. The submission of a massive document containing detailed economic analyses, 45 days after the date for formal reply comments (which was itself twice extended) and at a time when it is widely reported that resolution of this proceeding by the Commission is imminent, is a step obviously conducive to delay -- a delay that LECG's sponsors apparently desire, but which they make no effort to justify.

Fortunately, as the attached statement of Economists Incorporated shows, the Commission need not expend major time and effort to discern the lack of merit in the LECG Surrebuttal. Even cursory examination discloses that the Surrebuttal utterly fails either to resurrect the LECG analyses that were subjected

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to devastating critiques in timely reply comments or to undermine the points made by Economists Incorporated on behalf of ABC, CBS and NBC. The inability of LECG to provide a more persuasive response, even after granting itself a month and a half extension of time, dramatically illustrates the absence of any credible basis for the retention of PTAR.

Respectfully,

Joel Rosenbloom

cc-w/enc.: Michael Katz
Julius Genakowski, Esq.
Lauren J. Belvin, Esq.
Lisa B. Smith, Esq.
Jane Mago, Esq.
David R. Siddall, Esq.
Roy J. Stewart, Esq.
Douglas Webbink
Alan Aronowitz, Esq.

COMMENT ON LECG SURREBUTTAL

Re: Review of the Prime Time Access Rule, Section 73.658 (k) of the Commission's Rules (MM Docket No. 94-123)

This paper comments on several points raised in the lengthy "Surrebuttal" recently submitted *ex parte* in this proceeding by The Law and Economic Consulting Group (LECG).

We point out first that LECG has failed to resuscitate its econometric analysis purporting to show that the Prime Time Access Rule (PTAR) has "caused" the growth in the number of independent stations and their ratings. Second, we explain why LECG's conclusion that increases in advertising prices in the 1980s were attributable to network market power is unsound. Finally, we comment on LECG's admission that PTAR has imposed significant harm on consumers.

The growth of independent stations

LECG candidly admits that the time frame of its analysis did not permit gathering all of the data needed to do a valid econometric analysis (Surrebuttal at 20). That LECG's effort was inadequate for lack of time and resources may explain the shortcomings EI identified in the Reply round but does not negate them. We pointed out for example that LECG failed to assess the impact of cable in promoting station growth during the critical years 1980-86 (a point LECG acknowledges, Surrebuttal at 30). Further, we noted that LECG failed to take into account growth in advertising demand (in its Surrebuttal at 65 LECG admits that they "certainly agree with EI that an outward shift in the demand curve for advertising did occur during this long run period"). As we pointed out, not taking these factors into account means LECG's entire econometric effort is worthless. Nothing in the Surrebuttal remedies this failure. It is simply wrong to assert, as LECG does at 41, that because it did the *only* econometric study, that study must be accepted as the best evidence on the issue despite its shortcomings. A hopelessly flawed econometric study provides no basis for making sound public policy.

With regard to the effects of cable growth on the number of independent stations, LECG asserts that even if they had data for the 1980-86 period and had included some measure of cable growth, their analysis would be improved but their result unchanged. However, LECG's attempt to control for the effect of cable growth on independent stations is inadequate because their data involve so few observations and because those observations are not for the years when the relationship in question could best be assessed (the 1980s). Therefore there is no basis for LECG's conclusion that cable had no effect on the growth of independent stations, and that all that growth was due to PTAR. Studies by others, including the FCC and FTC staffs, have found that the growth of cable did have an effect on the growth of independent stations.[1] There is no reason to doubt the validity of these studies or their implication that the growth in independent stations due to cable must at least partly offset, and may completely offset, any effect that can be attributed to PTAR. If, as it appears, factors other than PTAR were chiefly or entirely responsible for the rapid growth of independent stations during the 1980s, LECG's arguments are for naught.

When something (such as the number of independent stations) is growing, a regression that includes time as an explanatory variable will tend to find that time "explains" the growth, even though other factors may be responsible. LECG admits that trends starting in other years would do as well as their time trend beginning in 1971 in explaining the growth of independent stations (Surrebuttal at 29). By using and reporting only the T71 trend, LECG has assumed its result: that PTAR was responsible for the growth of independent stations. Indeed, LECG's concession that their selected time trend is correlated with other time trends means that they can-

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1 *Comments of the Staff of the Bureau of Economics of the Federal Trade Commission,* March 7, 1995, MM Docket No. 92–123 at 23; Florence Setzer and Jonathan Levy, *Broadcast Television in a Multichannel Marketplace,* FCC Office of Plans and Policy Working Paper No. 26, June 1991, at 17–18. See also Robert W. Crandall, *The Economic Case Against the FCC's Television Network Financial Interest and Syndication Rules,* June 14, 1990, MM Docket No. 90–162, at 38.

not reject the hypothesis that PTAR had nothing to do with the growth of independent stations. Thus, LECG's carefully-worded statement that "we must be careful and modest in interpreting our results" due to this issue is a monumental understatement (Surrebuttal at 29). The time trend correlation invalidates their analysis.

Ratings of independent stations

In the first round of comments in this proceeding, LECG submitted an analysis purporting to show that independent station ratings had increased on account of PTAR. In the Reply round EI pointed out that most of the ratings increase in LECG's "third period" (the years 1987 and 1993) is due to the advent of the Fox network. Now LECG has dropped 1993 and claimed that Fox was insignificant in 1987. However, if one simply compares 1987 to the pre-PTAR era, no significant increase in independent station ratings in either the access period or the spill-over periods can be found. Perhaps this explains why LECG has now redefined the periods designated as short-run and long-run. In its Surrebuttal, LECG has now moved the year 1979 from the "short-run" to the "long-run" period (compare Surrebuttal at 5 with LECG first round comments[1]). LECG has argued that the Rule did not begin to have a significant effect until after 1975 (Surrebuttal at 98), a position consistent with their original classification of 1979 as the "short run". But reclassification of 1979 as the "long run" permits LECG to contrive a long-run effect of PTAR on independent ratings.

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1 In their initial filing in this proceeding, LECG at page 35 of the "Appendices to Economic Report," defines three periods: Period 1 is pre-PTAR (1966-70); Period 2 is the immediate post-PTAR years (1971-76, 1979); and Period 3 is the most recent post-PTAR years (1987, 1993). On page 41 of the appendix, when discussing "Short-Run Impacts" LECG compares Period 1 to Period 2, implying that Period 2 is the short-term including 1979. Starting on the same page, when discussing "Longer-Run Impacts" LECG compares Period 1 to Period 3 and Period 2 to Period 3, implying that Period 3 is the longer term excluding 1979.

Finally, we identified flaws in LECG's assessment of the supposed carry-over effects of PTAR on the ratings of independent stations from 8–9 p.m. The LECG Surrebuttal makes no attempt to repair these flaws. In sum, it is apparent that LECG has failed to make a credible showing that repeal of PTAR would have any significant adverse effect on the ratings of independent stations or of nascent networks. The real losers from repeal would be the first-run syndicators of talk and game shows, who have enjoyed a protected market for a quarter century at the expense of television viewers.

Advertising prices and network market power

LECG's discussion of advertising market competition in Surrebuttal section III is hopelessly confused. LECG attempts to argue that absent PTAR the market for network advertising would not be as competitive as it is with PTAR. Specifically, LECG addresses advertising market definition and evidence of market power. With respect to the former, LECG argues that the "Cellophane fallacy" has misled EI (and, presumably, Owen & Wildman in *Video Economics*) into defining an advertising market that is too broad. With respect to market power, LECG claims the increase in television advertising prices in the 1980s proves the market is not competitive. LECG also claims PTAR itself and the presence of new independent stations increased advertising demand. None of this makes any sense.

The Cellophane fallacy in market definition arises when a monopolist has raised prices to the profit-maximizing level, so that other goods appear to be good substitutes. For this concept to be applicable here, the broadcast networks would have to be engaged in collusion, in order to operate as if they were a monopolist. LECG provides no basis for such an assumption. Instead, there is ample evidence of network competition both with each other and with national spot market, barter-syndication and cable network sellers.[1]

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[1] See Economists Incorporated, "An Economic Analysis of the Broadcast Television National Ownership, Local Ownership and Radio Cross-ownership Rules", submitted on behalf of ABC, CBS, NBC and Westinghouse in Review of

The notion that increasing advertising prices in the 1980s proves the advertising market is not competitive is absurd. Even in a textbook perfectly competitive industry, such as wheat farming, it is assumed that the industry supply curve is upward-sloping. An outward shift in demand therefore leads to a price increase, and a price increase is no evidence of market power. The long-run supply curve for television advertising must be upward-sloping because as audiences and availabilities increase there will be growing difficulty and expense in attracting audiences away from other activities. The short-run supply curve must be upward sloping because of the lags and delays involved in new stations, cable networks, etc. entering in response to the price increase.

The idea that PTAR itself created a new or additional demand for television advertising makes no sense. PTAR's principal effect is to restrict the quality of programming, therefore reducing overall viewing, and thus restricting the size of audiences available for sale to advertisers. It follows that PTAR has been responsible not for enhancing the *demand* for advertising but rather for increasing the price of advertising by restricting its *supply*.

Consumer welfare losses from PTAR

In the course of responding to EI's quantification of the consumer welfare loss due to PTAR, LECG (a) admits that PTAR had adverse effects on consumer welfare in the past (up to $2.3 billion worth) and (b) claims that there are no longer any adverse effects on welfare. The basis for the latter claim is that first-run programs are now equivalent to network programs from the point of view of popularity and—though this is only implicit—consumer willingness to pay. (Surrebuttal at 107.) Hence, when such programs are substituted for network programs on account of PTAR, there is no welfare loss. If LECG were correct in making this claim, it would follow that PTAR was unnecessary. If network affiliates could attract the same audiences with currently-available first-run syndicated shows as with original network shows, there would be no need to prohibit them from broadcasting the latter. Further, in-

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the Commission's Regulations Governing Television Broadcasting (MM Docket No. 91-221), May 17, 1995, at 18-36.

dependent stations would not be harmed if affiliates now could broadcast original network shows during the access period.

What is important about all of this is that LECG has admitted, as it must, that PTAR imposes costs on television viewers. Those costs are part of the price society pays for using PTAR to transfer revenues from one part of the television industry to another. If PTAR is to have the effects desired by the first-run syndicators, the welfare losses must perforce continue. Whether the welfare loss is $2 billion, as LECG admits, or $200 billion, or even $200 million, it is not a price consumers should be required to shoulder for the continued enrichment of a few syndicators.

July 19, 1995