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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C., 20554

In the Matter of	)	
	)	
Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests	)	MM Docket No. 94-150
	)	
Review of the Commission's Regulations and Policies Affecting Investment in the Broadcast Industry	)	MM Docket No. 92-51
	)	
Reexamination of the Commission's Cross-Interest Policy	)	MM Docket No. 87-154
	)	
Review of the Commission's Regulations Governing Television Broadcasting	)	MM Docket No. 91-221

To: The Commission

COMMENTS OF HSN, INC.

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February 7, 1997

SUMMARY

HSN, Inc. supports the Commission's efforts to modify its ownership and attribution rules to reflect the competitive realities of the video marketplace. But HSN is concerned that the rapid pace of marketplace changes -- in particular, the emergence and growth of numerous competing video distribution technologies -- may be outstripping the Commission's regulatory scheme and jeopardizing the future of free, over-the-air television service.

In a fiercely competitive video marketplace offering myriad program choices, presumptive structural ownership restrictions can no longer be categorically equated with "viewpoint diversity." Accordingly, HSN believes the Commission should significantly narrow the scope of its current restrictions on ownership and investment at the local level. By doing so, the Commission will enable broadcasters to achieve the efficiencies and attract the capital they need in order to compete more effectively in a crowded video marketplace -- for example, by devoting greater resources to the development and production of programming. At the same time, in order to ensure that the bedrock communications policy goal of viewpoint diversity is being served, the Commission should reinvigorate its application and enforcement of the public interest standard, in conjunction with vigorous enforcement of the antitrust laws by the appropriate government agencies.

If, on the other hand, the Commission determines to preserve a regimen of artificial structural restrictions as a surrogate for enforcement of broadcasters' public interest obligations, it is critical, at the very least, that any

remaining television duopoly rule be applied on the basis of a DMA standard -- the only appropriate basis for defining the geographic market in which stations compete for viewers, programming and advertisers. Furthermore, in order to allow UHF stations to achieve the operating efficiencies that will enable them to compete effectively -- and devote increased resources to the development and production of local programming -- the Commission should allow common ownership of two television stations in the top-100 markets where at least one of the facilities is a UHF station.

Finally, there is no need or rational basis for the application of the proposed "equity or debt plus" attribution standard to program suppliers, who represent the most likely investors in local stations -- particularly underdeveloped UHF outlets. Program supplier investment at the local level benefits not just local stations, but advertisers, other program suppliers and, most importantly, viewers, who benefit from more, and more diverse, programming.

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To: The Commission

COMMENTS OF HSN, INC.

HSN, Inc. ("HSN") hereby submits its Comments in response to the Commission's Second Further Notice of Proposed Rule Making, FCC 96-438 ("Ownership Notice"), and Further Notice of Proposed Rule Making, FCC 96-436 ("Attribution Notice"), both released on November 7, 1996, in the above-captioned proceedings.

I. THE COMMISSION SHOULD ELIMINATE PRESUMPTIVE STRUCTURAL RESTRAINTS THAT STIFLE INCENTIVES TO CREATE AND DISTRIBUTE INNOVATIVE PROGRAMMING.

HSN indirectly owns sixteen television stations (the "HSN Stations"), eight of which are high-band UHF stations. Although the programming on twelve

of these stations currently consists primarily of an in-home shopping service format, HSN is in the process of converting these stations into full-service local outlets. HSN contemplates that, over an approximately two to three year period, the home shopping service gradually will be replaced by news and information, children's, sports, and entertainment programming.

As the owner and operator of numerous television outlets located in large and competitive markets, HSN welcomes the Commission's efforts to modify its attribution and cross ownership rules so that they better reflect the competitive realities of the video marketplace. But HSN is concerned that certain of the proposals under consideration in these proceedings may actually undermine the bedrock policy goals of competition and diversity of programming -- and, in so doing, weaken the foundation of free, over-the-air television as it faces increasingly rigorous competition from other video distribution technologies. 1/ Specifically with respect to HSN, adoption of these proposals may have the paradoxical effect of *disserving* diversity and competition by denying it the efficiencies and capital necessary in order to transform its twelve underdeveloped UHF stations into vibrant local outlets.

1/ See e.g., H.R. CONF. REP. 230, 104th CONG., 2D SESS. 113 (1996) (purpose of the 1996 Telecommunications Act is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition").

Unfortunately, the Commission has proceeded from the premise that diversity of ownership equates with diversity of programming. But that is not the case. Under the Commission's ownership restrictions, we have seen the exact opposite effect -- homogenous video program offerings throughout each television market. Fundamentally, HSN believes that presumptive structural restrictions -- such as the television duopoly rule and the proposed "equity or debt plus" attribution standard -- are a regressive vestige of an environment that has changed dramatically since the Commission last examined the attribution and ownership rules. In 1984, over-the-air broadcasters may very well have been the only game in town when it came to video program delivery. But as regulatory barriers to entry into the video marketplace have fallen for participants in other industry segments, traditional broadcasters face stiff and ever-increasing competition from national cable networks, local cable channels, direct-to-home satellite services, wireless cable operators and telephone companies. These systems have greatly expanded channel offerings (local and national), resulting in ever more vigorous competition for both advertising revenues and programming.

As expected, the proliferation of alternative outlets resulting from the deregulation of the video marketplace has substantially diminished the former perceived influence of traditional broadcasters. This is precisely as it should be. Yet, notwithstanding the proliferation of new entrants offering new technologies, programming options to consumers and niche advertising opportunities to businesses, television broadcasters remain subject to anachronistic structural

restrictions that simultaneously keep weak UHF stations weak, while making it difficult for new program suppliers to gain a competitive toehold in local markets. Indeed, as a result of the rules, undercapitalized local outlets are forced to function as "repeaters" for programming supplied by a few national distributors, without making any meaningful contribution to diversity. In other words, the rules, which are intended to preserve diversity and competition, increasingly diminish it by preventing broadcasters from competing as effectively as they must in order to survive in a crowded video marketplace.

If the Commission's paramount objective is to promote a vital broadcast service, at both the national and the local levels, that is responsive to viewers' needs, interests and concerns, then its regulatory scheme must provide incentives for broadcasters to develop, produce and distribute innovative programming. HSN is convinced that the efficiencies that can result from common ownership of television stations at the local level, and the capital infusion into underperforming local outlets that can be provided by their program suppliers, would create precisely such incentives. For example, the capital that would be required of HSN to replicate studio facilities would produce a far greater public interest benefit if it were channeled instead into program production. Ultimately, elimination or relaxation of these restrictions would enhance diversity, not diminish it.

Over the recent years, while competition in the video marketplace has exploded, the Commission has continued to rely on its structural restrictions on

ownership of, and investment in, television outlets as a surrogate for enforcement of broadcasters' public interest obligations. But, in the absence of ownership rules, a reinvigorated public interest standard would ensure that television stations provide programming that is responsive to the needs of their viewers, irrespective of their ownership. Each broadcaster should be prepared to make a meaningful commitment to provide local, educational and nonentertainment programming, and its performance under that commitment should be evaluated at renewal time. Establishing and enforcing an unambiguous process for performance review in connection with broadcast license renewal, together with enforcement of the antitrust laws by the Justice Department and the Federal Trade Commission to ensure that broadcasters do not amass undue market power, will ensure that the public interest is served far more effectively than perpetuating outmoded structural rules, which deny stations access to operating efficiencies and capital and actually thwart diversity.

If, however, the Commission is determined to pursue an incremental approach to the elimination of structural restraints, HSN urges the Commission to adopt rules which do not impede diversity and competition. In this connection, and as explained below, HSN believes that (1) the television duopoly rule, if it is retained, should be applied on the basis of a Designated Market Area ("DMA") standard only, rather than the hybrid DMA/Grade A overlap standard proposed in the Ownership Notice; (2) the duopoly rule should not apply to combinations in the top-100 markets involving at least one UHF station; and (3) the Commission should

not presumptively apply the proposed "equity or debt plus" attribution standard to program suppliers.

II. THE TV DUOPOLY RULE, IF IT IS RETAINED, SHOULD BE APPLIED ON THE BASIS OF A DMA STANDARD, WHICH PROPERLY DEFINES THE GEOGRAPHIC MARKET IN WHICH STATIONS COMPETE FOR VIEWERS, PROGRAMMING AND ADVERTISERS.

If the Commission determines that the television duopoly rule should be retained, the goals of viewpoint diversity and economic competition will best be served by adopting a DMA-based overlap standard. The Commission already has recognized that "DMAs may be better than either Grade B or Grade A signal contours as measures of the market" (Ownership Notice at ¶ 20) precisely because the DMA reflects the " 'core market' (i.e., the viewers the station is *trying* to reach)." Id. at ¶ 11. In other words, the DMA represents the geographic market in which television stations compete and in respect to which their programming and advertising decisions are made.

Simply stated, the *only* audience relevant to a television station and its program suppliers and advertisers is the audience within the station's DMA. This is an established fact of the competitive video marketplace. The duopoly rule should be applied accordingly.

The Commission recognizes that DMAs "are workable, marketplace-recognized boundaries delineating common viewing patterns in areas of effective competition that facilitate transactions between advertisers and broadcasters." Ownership Notice at ¶ 14. In this connection, DMAs "are designed to reflect actual

household viewing patterns and advertising markets -- critical ingredients for determining a station's geographic market, both for competition and diversity purposes." Id. at ¶ 15.

In determining the geographic market of effective competition, the Commission considers that area "where buyers would buy and where sellers would sell in response to a small but significant and nontransitory price increase . . . ." Further Notice of Proposed Rule Making, Review of the Commission's Regulations Governing Television Broadcasting, 10 FCC Rcd 3524, 3533 (1995) ("1995 Ownership Notice"). See also Haring, J., and Shooshan, H., "Removing Regulatory Barriers to Stronger Local Television Service," February 7, 1997, at 4 ("Removing Barriers") (Attachment A hereto) ("the behavior of buyers and sellers is what actually determines the boundaries of genuinely relevant economic markets"). Under this analysis, there is extremely low cross-elasticity of demand and supply between DMAs precisely because stations in different DMAs are not substitutable outlets for either viewers or advertisers. See id. at 6. HSN believes that defining local markets for purposes of applying the duopoly rule in the same manner that they are determined in the real world by viewers, programmers and advertisers is preferable to relying on an arbitrary measure such as the predicted coverage area of a station based on engineering assumptions. See id. at 5 (overlapping signals do not necessarily reside in the same relevant economic market).

The singular appropriateness of DMA as a market determinant, in contradistinction to the Grade A contour, is illustrated by reference to the

Baltimore, Maryland and Washington, D.C. markets, where several stations exhibit Grade A overlap. Yet broadcasters, program suppliers and advertisers alike make decisions for these markets based on the characeristics of each station's respective DMA, notwithstanding the fact that a subset of its viewers may reside in the other. Thus, common ownership of a Washington and a Baltimore station with overlapping Grade A contours would not obviate the need for each station to present coverage of local issues relevant to viewers in its community. Accordingly, a common news staff and production facility will still produce news programming distinctly targeted to each market. See id. at 12 (notwithstanding signal overlap, where distant, i.e., non-DMA, stations do not attract significant audiences, common ownership "does not affect programming decisions"). Similarly, an advertiser targeting the Washington market will not purchase time on Baltimore television stations in response to an increase in Washington advertising rates. Because the advertiser's message would only reach a small portion of the target audience, the return on investment would not justify the "bargain" media buy. See id. at 4-8.

The attached Declaration of Rick J. Blangiardi (Attachment B) confirms that neither local, regional nor national advertisers purchase time on a station in one DMA for the purpose of reaching television households in another. Similarly, program suppliers will sell the same product to stations in both DMAs, notwithstanding the fact that stations in one DMA may reach some subset of viewers in the other. See also "Removing Barriers" at 15-16. Thus, as a practical matter, the portion of a station's Grade A contour that happens to fall outside the

station's assigned DMA is not a factor in decisions affecting local competition and diversity.

III. THE DUOPOLY RULE SHOULD NOT APPLY TO COMBINATIONS IN THE TOP-100 MARKETS INVOLVING AT LEAST ONE UHF STATION.

To the extent the duopoly rule prevents broadcasters from taking advantage of the significant efficiencies that may be associated with local common ownership, it reduces, rather than enhances, diversity. Obviously, the public interest is harmed if a weak station remains weak -- or worse, fails altogether. Therefore, if the Commission retains the duopoly rule, it should provide an exemption for combinations in the top-100 markets involving at least one UHF station.

UHF stations remain uniquely disadvantaged. The typical UHF station's reach and audience are smaller, and its advertising revenues commensurately lower, than those of its VHF counterparts. In order to achieve coverage comparable to that of their VHF competitors, UHF stations must broadcast at higher power levels, incurring substantially higher costs, with the result that revenue that could be spent on programming goes toward operations. Additionally, continuing disparities between VHF and UHF receiver performance exacerbate the greater susceptibility of UHF signals to attenuation by natural obstacles, such as terrain and structures. In short, as "less good machines" with

lower productivity per advertising availability than VHF stations, UHF stations are permanently saddled with higher unit costs. 2/ At the same time, UHF stations represent the last remaining broadcast outlets available to new program services and distributors. See "Removing Barriers" at 19-20.

Permitting local combinations involving at least one UHF station would enable stations to convert operating cost savings into higher quality local programming. Innovative programming, in turn, captures market share and generates larger advertising revenues. See id. at 17-18. Ultimately, opportunities for local duopolies would enhance the ability of UHF stations to operate as full service competitors, thereby enhancing competition and diversity. 3/

The Commission previously has recognized that structural changes in the video marketplace and the inherent advantages enjoyed by multichannel video program providers necessitate a leveling of the playing field if broadcasters are to have a fair and reasonable opportunity to compete. More than five years ago, for

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2/ See H.R. REP. NO. 204, 104th CONG., 1ST SESS. 118 (1995) (need for substantial deregulation of local television ownership is "especially true with respect to UHF stations which continue to operate with significant technical and economic handicaps. . . . Permitting common ownership of stations will promote the public interest by harnessing operating efficiencies of commonly owned facilities, thereby increasing competition and diversity").

3/ See H.R. REP. NO. 204, 104th CONG., 1ST SESS. 118 (1995) (creating strong presumption in favor of UHF/VHF combinations) ("significant changes in local video markets, which include increases in the number of local television stations and other multichannel competitors, require substantial deregulation of the local television ownership rules . . . and greater reliance on market-place forces to assure vigorous competition and diversity").

example, the Commission's Office of Plans and Policy ("OPP") concluded that "common ownership . . . of more than one station in a market may permit exploitation of economies of scale and reduce costs or permit improved service. Joint newsgathering operations, for instance, might permit improvements in the quality of local news coverage." Broadcast Television in a Multichannel Marketplace, DA 91-817 (released June 27, 1991), at 170. These are precisely the public interest benefits that could result from permitting local combinations involving UHF stations.

The Commission previously has recognized the inherent UHF handicap by granting duopoly rule waivers to permit combinations involving UHF stations. 4/ The logic of these waivers is clear: "it makes little sense to insist on strict compliance of the duopoly provision . . . to assure maximum diversity of programming viewpoints, if the result of that insistence could be to force these stations off the air, thereby diminishing diversity by a loss of the station's programming." 5/ These cases provide strong support for the creation of a top-100 market UHF exemption that will save both Commission and broadcaster resources.

4/ See, e.g., Act III Communications Holdings, L.P., 11 FCC Rcd 5735, 5737 (1996) (citing increased operational and signal propagation costs associated with UHF stations); Sunshine Television, Inc., 8 FCC Rcd 4428, 4429 (1993) (citing FCC study showing heavy financial losses for UHF stations).

5/ Channel 33, Inc., 4 FCC Rcd 7674, 7679-80 (1988); see also Taft Broadcasting, 7 FCC Rcd 3854, 2855 (1992) (when considering waiver, Commission weighed opportunity for programming enhancement and the financial viability of the stations at issue).

HSN believes that a rule that has the effect of keeping weak stations weak -- by, for example, making it less likely that an HSN station will be able to evolve into a full-service outlet -- actually diminishes diversity. On the other hand, viewpoint diversity will not be meaningfully reduced by creating a UHF exemption. Indeed, the Commission has stated that "it may be possible to have a decrease in outlet diversity without a corresponding decrease in viewpoint diversity" because "group television station owners generally allow local managers to make editorial and reporting decisions autonomously and . . . group-owned stations are more likely than others to editorialize." 1995 Ownership Notice, 10 FCC Rcd at 3550. See Citadel Communications, Co., 8 FCC Rcd 855, ¶ 16 (1993) ("as the video marketplace becomes increasingly competitive, as it is today, the potential diversity and competition detriments from overlapping signal contours generally decrease"). In this connection, HSN believes that a diversity analysis that is strictly limited to competing broadcast television outlets is no longer defensible in light of the proliferation of largely unregulated competitors in the local video program distribution market. The appropriate denominator in calculating diversity in a given market must include consideration of the entire range of video sources available to consumers -- including cable channels, DBS, wireless cable and telephone company video platforms.

IV. ARBITRARILY SUBJECTING PROGRAM SUPPLIERS TO THE "EQUITY OR DEBT PLUS" ATTRIBUTION STANDARD WILL ADVERSELY AFFECT COMPETITION AND DIVERSITY.

HSN urges the Commission not to adopt a presumptive 33 percent "equity or debt plus" attribution standard for program suppliers. As shown below, arbitrarily treating the debt or equity interests held by program suppliers as attributable would contradict the Commission's competition and diversity goals by undermining legitimate business opportunities, discouraging the flow of capital investment into the broadcast industry, and reducing predictability and certainty in transactions. See Notice of Proposed Rule Making, Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, 10 FCC Rcd 3606, 3614 (1995) ("1995 Attribution Notice") (stating goals of the proceeding).

Because the television industry is more decentralized and competitive than ever before, the Commission should reconsider whether program suppliers have a significant ability to "exert influence such that the interest may implicate diversity and competition concerns." Attribution Notice at ¶ 14. The highly competitive nature of the video distribution market results in an inability to leverage a station's "dependence" on programming, and undermines the argument that program suppliers and their local outlets are in a special relationship that should trigger the "equity or debt plus" standard.

Indeed, in a competitive broadcast marketplace with a finite allotment of distribution channels and a growing number of competing program suppliers, local stations may have more leverage than their program suppliers. This reality is

reflected in the increase in the affiliation costs of the major networks over the past two years, beginning with the switch of the former New World television stations to the Fox Network, and continuing with the increased demand for affiliates created by the emergence of the UPN and WB networks. Meanwhile, satellite program syndicators are virtually indistinguishable operationally from their "network" counterparts, requiring in-pattern clearances and reserving a portion of the advertising time associated with the programs. In a marketplace where demand for local outlets exceeds supply, creating new impediments to a program supplier's ability to secure distribution makes no sense, and would involve the Commission in an arbitrary exercise in line-drawing.

In fact, in today's video marketplace, restrictions on ownership and investment only disserve diversity by making it more difficult for new program suppliers, such as HSN, to emerge. The "prime real estate" for program distributors -- VHF and strong UHF stations -- is already taken. To survive, a program supplier may need to assemble less valuable parcels -- weaker UHF stations -- in more markets and secure its interest through some direct investment in order to provide the foundation for local distribution.

To the extent the Commission is concerned about potential overreaching by networks -- a concern that is no longer valid in today's marketplace -- existing regulations already guard against concerns of undue influence by program suppliers. As the Commission has recognized in these proceedings, both the Option Time and the Right to Reject rules, 47 C.F.R.

§ 73.658(d) and (e), respectively, prevent "program suppliers such as networks [from using] nonattributable interests to exert influence over critical station decisions, including programming and affiliation choices." Attribution Notice at ¶ 17. These regulations, together with the antitrust laws, would prevent programmers from exercising undue influence over critical station decisions. Meanwhile, entities such as HSN would be free to invest in local outlets in order to increase competition in markets throughout the country. After all, a station may be extremely reluctant to bet the bank on an untried new locally oriented television service without having the supplier share the risk through an ownership interest in the station. There is no valid reason to discourage such investment.

HSN respectfully submits that, by proposing a new rule that would prevent entities such as HSN from investing in local infrastructure to create viable outlets for their product, the Commission has it precisely backwards. Because of the need to assemble an ad hoc portfolio of local outlets, a program service such as HSN may be the most likely investor in weak UHF stations. Then, as these stations are upgraded, advertisers, other program suppliers and viewers all benefit -- the latter through more and better programming, including local programming. By suggesting that the "equity or debt plus" restriction is needed because program services may have a special incentive to "work around" the existing attribution rules, the Commission is, in effect, acknowledging the unintended consequences of the rules: they inhibit entry by efficient risk-sharers.

V. CONCLUSION

Because of effective marketplace competition, the public interest would be served by the elimination of structural restrictions on local ownership and investment. If the Commission elects to retain the duopoly rule, however, HSN urges that it be applied on the basis of a DMA-based standard, and further urges the Commission to create an exemption for top-100 market combinations involving at least one UHF station. Furthermore, the Commission should encourage program suppliers to invest in local broadcast outlets in order to increase competition in the video marketplace on both the local and national levels.

Respectfully submitted,

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ATTACHMENT A

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Removing Regulatory Barriers To Stronger Local Television Service

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February 7, 1997

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SUMMARY

The Commission has an opportunity to adjust its television broadcast ownership rules to the reality of a rapidly expanding mass media marketplace. It is a marketplace characterized by an abundance of independent delivery channels and an almost bewildering array of options for consumers. The Commission should conform its local ownership rules to this reality, especially where, as we have shown, its rules restrain efficient competition and reduce real diversity.

Among those steps should be:

- Adopting a definition of local television market consistent with the relevant economic market (*i.e.*, using DMAs) and not relying on signal contours;
- Utilizing a presumptive waiver of its duopoly rules to permit common ownership of two stations (*e.g.*, UHF/UHF combinations) in large markets in order to strengthen otherwise marginal stations; and
- Applying an attribution standard that does not make it more difficult for networks to enter into arrangements which will strengthen local television stations financially.

I. Introduction

Regulation is frequently seen as a substitute for competition where competition cannot be expected to prevent exploitation of monopoly power. Regulation can also be a complement to competition where perceived market failures arise for reasons other than monopoly.[1] When it acts to restrain competition, however, regulation is neither a substitute nor a complement for competitive enterprise. In this circumstance, regulation may operate as the cause of problems rather than their cure. Rather than enhancing the efficiency with which consumer wants are satisfied, regulation in this perverse case reduces economic efficiency and prevents the realization of productive economies that can potentially enhance consumer welfare.

The FCC's limitations on local station ownership have, for the most part, become an example of regulation of the latter type. Originally conceived (or possibly misconceived) as a means of promoting program diversity,[2] any efficacy

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[1] Regulation may be warranted where high transactions costs prohibit economic internalization of external or neighborhood effects through voluntary contractual arrangements. An example of this is pollution regulation. In practice, polluters and those who are harmed by pollution cannot work out a deal to limit pollution because there are too many people involved.

[2] While preserving diversity of ownership is a valid concern for regulators, the diversity rationale for broadcast ownership limitations has always been suspect among economists and

(continued...)

or scarcity rationale these rules may have at one time possessed is being undercut by the revolutionary changes in communications technology that have occurred over the last quarter century and show no signs of abating. These changes have increased the number and types of competing program services by many, many orders of magnitude. They have simultaneously enabled consumers to express their preferences for different types of programming with their dollar votes as well as their willingness simply to watch or listen — an economic change of salutary significance in terms of the market's capacity to produce consumer sovereignty.

In light of these technical and economic changes, the Commission should examine closely its local ownership rules and eliminate or redraft them so that they will not inhibit the development of stronger broadcast services by preventing the infusion of investment needed for upgrading the operations of economically marginal stations and the efficient sharing of financial risk in the development of new attractive programs. The rules should not prevent what they are ostensibly

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[2] (...continued)
other students of the industry. In a commercially supported system in which rewards reflect audience size, common ownership is likely to produce greater diversity of program types for any given number of stations and greater increases in diversity as station numbers increase than is individual ownership. *See* P. Steiner, "Program Patterns and Preferences, and the Workability of Competition in Radio Broadcasting," *Quarterly Journal of Economics*, 67(2), May 1952; R. Noll, M. Peck and J. McGowan, "Economic Aspects of Television Regulation," *Studies in the Regulation of Economic Activity*, The Brookings Institution, 1973; and P. Wiles, "Pilkington and the Theory of Value," *Economic Journal*, Vol. 73, June 1963.