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

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| In the Matter of | ) | |
| Review of the Commission's Regulations Governing Television Broadcasting | ) | MM Docket No. 91-221 |
| Television Satellite Stations Review of Policy and Rules | ) | MM Docket No. 87-8 |

To: The Commission

**PEGASUS COMMUNICATION CORPORATION'S**
**REPLY IN SUPPORT OF ITS PETITION FOR RECONSIDERATION**

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Pegasus Communications Corporation ("Pegasus"), by its undersigned attorneys, hereby files its Reply to the Opposition and Response to Petitions for Reconsideration filed by UCC et al. ("Opposition") in the above-referenced proceeding. As demonstrated more fully below, UCC's Opposition should be summarily denied because it merely repeats the same tired and quixotic incantations of the past twenty years to support the new duopoly rule. In so doing, UCC completely ignores the extensive, wholly contrary evidence in the record demonstrating that the Commission's new duopoly rule fails to provide relief precisely where it is most needed -- in small to medium sized markets such as those in which Pegasus has used LMAs to serve the public interest by helping to launch new over-the-air stations that materially expanded both competition and programming diversity. By contrast, UCC's Opposition will inevitably produce the same unacceptable situation that existed in these markets before LMAs -- stations will remain unbuilt and silent or be left to limp along without making any meaningful contribution to diversity or

competition all because of the theoretical insistence on separate ownership and management. UCC's Opposition should also be dismissed because it misreads various statutory limits on the Commission's authority to regulate existing television LMAs and misleadingly miscasts the constitutional argument raised by Pegasus in its Petition for Reconsideration.[1]

## I. INTRODUCTION & SUMMARY

As noted in its Petition for Reconsideration, Pegasus is the owner and operator of UHF television stations in medium to smaller markets (ranging from DMAs 51 to 165). Pegasus also provides programming and other services to a second UHF television station in some of these markets pursuant to LMAs. Each of these second stations has only recently commenced operating as an affiliate of either the WB or UPN networks and could not have done so but for the investment and involvement of Pegasus through LMAs. Given this operating experience, Pegasus's Petition for Reconsideration argued that the Commission's rote insistence on 8 independently owned and operated television voices would undermine rather than further its competition and diversity goals in medium to smaller markets because it ignored the economic realities faced by prospective new television entrants in those markets. In particular, Pegasus demonstrated that the relatively inelastic fixed station start-up costs combined with low overall market revenues, higher levels of cable penetration and the presence of entrenched, well-established (largely VHF) television stations in these medium to smaller markets had stifled standalone new over-the-air station entry.

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[1] Given the substantial evidentiary and constitutional issues implicated by UCC's filing, Pegasus hereby request a waiver of the page limitations contained in section 1.429(g). 47 C.F.R. § 1.429(g).

As a result, Pegasus argued that the current duopoly rule would not survive intermediate scrutiny, the minimum level of scrutiny required under the Constitution given the First Amendment interests at stake and the enormous change in the media marketplace since the Commission first adopted its broadcast ownership rules, because the rule improperly focused exclusively on ownership diversity and was accordingly not narrowly tailored to further an important governmental interest in medium to small sized markets. Pegasus also argued that the Commission's decision to limit grandfathering relief to television LMAs entered into before November 6, 1996 was prohibited by the Telecommunications Act of 1996 and impermissible under the Administrative Procedure Act ("APA") because it effectively requires the retroactive application of the Commission's new duopoly rule to transactions that occurred as many as three years earlier.

To address these fundamental problems, Pegasus argued that the Commission should adopt a presumptive duopoly rule for medium to small markets that, subject to certain 'bright line' limiting criteria, would allow both the formation and subsequent sale of any duopoly whenever a new, separately programmed television station was added to the market or rescued from bankruptcy.[2] Pegasus demonstrated that its proposed duopoly rule would actually enhance both the Commission's competition and diversity goals by recognizing and counteracting the economic entry barriers that have combined to stifle new station start-up in these markets. In particular, Pegasus emphasized that the prospective ability to transfer two stations as a duopoly was crucial

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[2] Pegasus proposed that every duopoly so created be allowed to be transferred as a combination unless the Department of Justice or Federal Trade Commission objected. Pegasus Pet. at 39-41. To the extent the Commission was not inclined to accept this proposal, Pegasus alternatively proposed that these duopolies by transferrable unless their combined market share exceeded the lesser of (i) 40% or (ii) the market share of the number one station in the market. Id.

in medium to smaller markets because it would encourage investment and enable cost effective access to equity and lending capital that was vital to the long term viability and success of the affected stations.

UCC has no real answer to Pegasus's arguments regarding the marketplace realities in medium to smaller markets and, accordingly, its Opposition simply ignores them. Instead, UCC weakly argues that consolidation in these markets "could most undermine [the Commission's] competition and diversity goals" even though this theoretical argument is directly contradicted in the record. UCC Opp. at 11. UCC also vainly argues that the Commission's decision to limit grandfathering relief to LMAs entered into prior to November 6, 1996 was not prohibited by the Telecommunications Act of 1996 and does not violate the APA's prohibition against retroactivity because Pegasus and other "petitioners never had a right to enter into LMAs." UCC Attribution Opp. at 10 (emphasis in original).[3] Finally, UCC attempts to recast Pegasus's constitutional challenge to the FCC's exclusive focus on ownership diversity in creating the 8 separate voices duopoly rule into a general debate as to whether separate ownership of stations ever matters. The Commission should give short shrift to UCC's arguments because they fail to address, much less

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[3] Opposition and Response to Petitions for Reconsideration of UCC et al., filed in Review of Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests, MM Docket No. 94-150 ("UCC's Attribution Proceeding Opposition") at 10. Despite the Commission's decision to address the treatment of existing LMAs in the Local Television Ownership Proceeding, see Review of the Commission Regulations Governing Television Broadcasting, Second Further Notice of Proposed Rulemaking, MM Docket No. 91-221, FCC 96-438, ¶ 83, released November 7, 1996, UCC nonetheless filed its opposition to Pegasus's arguments regarding the treatment of existing LMAs in the Commission's attribution proceeding. Pegasus has responded to UCC's arguments in its Reply in the Local Television Ownership Proceeding (MM Docket No. 91-221) to remain consistent with the Commission's intentions regarding the treatment of existing television LMAs.

overcome, the legal and factual showing made by Pegasus documenting the need for more extensive duopoly relief in small to medium sized markets.

## II. ARGUMENT

### A. UCC Completely Ignores The Marketplace Realities in Medium to Small Markets.

UCC's support for limited duopoly relief through the rigid insistence on 8 independently owned television voices in the name of competition and diversity will undermine those very goals in small to medium markets. UCC's theoretical arguments that the 8 voices rule is supported by broadcast television's status as a "unique medium" and because it is the "primary source of news and information" for many Americans are not even responsive to Pegasus's arguments because they ignore the evidence in the record demonstrating that new, standalone entry by over-the-air stations has been stymied in small to medium sized markets by a combination of economic barriers.[4] By ignoring the barriers to new over-the-air entry, UCC's Opposition ignores Pegasus's showing that 8 separately owned television voices will never be achieved in these markets.

Specifically, UCC's support for the 8 voices test represents a fundamental misunderstanding of marketplace realities in small to medium sized markets. As demonstrated in Pegasus's Petition for Reconsideration, without the assistance of LMAs, there has been little new over-the-air entry in medium to small markets. See Pegasus Petition at 28-31. The competitive environment in these markets is exceedingly intense. Cable penetration in these markets is typically in excess of the national average of 67 percent and, depending on the market, anywhere

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[4] See, e.g., Petition for Reconsideration of Pegasus Communications Corporation at 28 ("Pegasus Petition"); Petition for Reconsideration of ALTV at 29-30; Petition for Reconsideration of Local Station Ownership Coalition at 18.

from 3 to 12 basic cable networks routinely attract audience shares equal to or greater than over-the-air stations despite the fact that the basic cable networks do not reach every television household in the market. This cable competition, combined with very limited overall market revenues and the presence of several (typically VHF) television stations make new UHF station entry extremely difficult. UCC's failure to address, much less refute, this evidence warrants the summary dismissal of its arguments. Simply put, UCC's assumption that new television stations somehow have a unique power that permits automatic success in these markets is undermined by the uncontradicted evidence in the record.

UCC's predictable objections to the transferability of duopolies in these markets deserve similar treatment. Specifically, the Commission should reject UCC's absurd argument that the restrictions on transferability will not discourage "genuine investors" in these markets because these investors will determine that "the immediate efficiencies and profitability that duopolies promise will override any concerns about transferability." UCC Opp. at 13. UCC's argument once again is totally detached from the marketplace realities.

First, contrary to UCC's knee-jerk assumption, the operation of a new station in these markets, even with the benefit of an LMA, is most certainly not immediately profitable given the substantial amount of capital that is still required to put them on the air in the first place. The competitive environment described above combined with the relatively low levels of revenues in these markets makes the profitable operation of a new entrant a challenge. The combination of the competitive environment and low overall market revenues in turn makes investment in a new over-the-air station difficult to attract, even with the benefit of an LMA.

Second, the prospect that the start-up station will have to be sold separately adds a layer of uncertainty regarding the investor's ability to recoup its investment. This uncertainty

necessarily translates directly into a reduction in value of the start-up station by the investor.[5] The combination of these factors effectively produces a double whammy that severely restricts the ability of operators in these markets to attract equity or lending capital. By contrast, Pegasus's proposal to permit the transfer of duopolies in these markets, even if never exercised, will encourage rather than discourage investment and in turn help expand both programming diversity and competition in these markets. Because UCC again failed to address these marketplace realities, its theoretical objections to the transferability of duopolies should similarly be dismissed.[6]

### B. The Commission is Statutorily Precluded from Limiting Grandfathering Relief to Television LMAs Entered into Before November 6, 1996.

UCC's arguments on the statutory limits imposed on the Commission's treatment of previously existing television LMAs fare no better. UCC first argues that section 202(g) of the Telecommunications Act of 1996 ("the 1996 Act"), which provides that "nothing in this section shall be construed to prohibit the origination, continuation or renewal of any television LMA that is in compliance with the regulations of the Commission," defers complete discretion to the FCC regarding the appropriate treatment of LMAs. See UCC Opp. at 4. In support of its argument, UCC compares section 202(g) to other provisions of the 1996 Act that directed the Commission

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[5] This analysis is much the same for obtaining lender financing. The increase in uncertainty increases the price the lender will charge for its capital. These increased capital costs can quickly increase to the point where new over-the-air entry will not make economic sense because the revenues needed by the new station to pay its borrowing costs cannot be achieved.

[6] UCC's remarkable argument that the public interest might somehow be served "if such investments were less attractive," UCC Opp. at 13, represents its fundamental misunderstanding of the marketplace. By definition, a station that is not an attractive investment will not be a competitive factor in the market or a significant contribution to diversity and, in fact, is unlikely to be built at all.

to change specific rules against the language of section 202(g) and argues that section 202(g) does not require the Commission to grandfather all television LMAs. See id. at 5.

UCC's Opposition misreads Section 202(g) and Pegasus's arguments in its Petition for Reconsideration. Pegasus never contended that section 202(g) precluded the Commission from changing the regulatory treatment of LMAs prospectively. Instead, Pegasus argued that section 202(g) explicitly prohibited the Commission from interfering with the continuation of any LMA that complied with the Commission's regulations at the time it was entered into. See Pegasus Pet. at 7-8. As noted by Pegasus in its Petition for Reconsideration, this interpretation of section 202(g) is not only supported by the language itself, it is also clearly supported by the regulatory history in this very proceeding. See id. at 6-7. Specifically, section 202(g) was quite clearly a Congressional response to the Commission's proposal in early 1995 to attribute television LMAs and provide some limited grandfathering relief to those LMAs already in existence.[7]

Moreover, UCC's interpretation of section 202(g) effectively converts the provision into a nullity because, under UCC's interpretation, it would merely restate what was already the case -- namely that the FCC had discretion to determine the appropriate treatment of LMAs under the rules. Such an interpretation violates accepted principles of statutory construction.[8] Finally,

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[7] In early 1995, the Commission's Further Notice of Proposed Rulemaking in this proceeding proposed to attribute television LMAs to the station providing programming and proposed to grandfather any LMA entered into prior to the adoption date of the Further Notice. Review of the Commission's Regulations Governing Television Broadcasting, Further Notice of Proposed Rulemaking, ("Television Further Notice") 10 FCC Rcd. 3524 ¶ 138 (1995). In adopting this proposal, the Commission noted that "[i]f the local TV multiple ownership rules are not relaxed, such an attribution provision would preclude TV LMAs in any market where the time broker owns or has an attributable interest in another TV station." Id.

[8] See Freytag v. Commissioner, 501 U.S. 868, 877 (1991) (expressing "a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same statement"); Crawford Fitting Co. v. J.T. Gibbons, Inc., 482 U.S. 437, 441 (1987) (rejecting a

(continued...)

contrary to UCC's assertions, Pegasus has always recognized that the Commission was free under section 202(g) to deny grandfathering relief to any existing television LMA that did not comply with the Commission's policies regarding LMAs and premature transfers of control. However, this flexibility does not change section 202(g)'s unmistakable limit on the FCC's ability to change the regulatory treatment of existing LMAs that complied with the FCC's rules at the time they were entered into. Accordingly, UCC's interpretation of section 202(g) should be rejected.

UCC's attempt to avoid Pegasus's argument on retroactivity should also be rejected. In its Petition for Reconsideration, Pegasus argued that the Commission's attempt to limit grandfathering relief was also prohibited by the APA. See Pegasus Pet. at 9-12. Specifically, Pegasus illustrated that regardless of how "clear" the notice was of the Commission's intent to attribute television LMAs in November of 1996, the impact of its announcement depended crucially on the extent of the changes it adopted to the duopoly rule. See id. at 11-12. Because the changes to the duopoly rule were decided nearly three years later when the Commission released its Report & Order in this proceeding, Pegasus demonstrated that the Commission's attempt to limit grandfathering relief to television LMAs entered into before November 6, 1996 effectively amounted to the retroactive application of its recently enacted duopoly rule -- a result expressly prohibited under the APA. See id. (citing Georgetown University Hospital v. Bowen, 821 F.2d 750, 756 (D.C. Cir. 1987)). [9]

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[8] (...continued)
statutory interpretation that rendered related statutory provisions meaningless).

[9] Moreover, Pegasus illustrated that the effect of attribution notice was ambiguous because its post November 5, 1996 LMAs involved only non-dominant UHF stations, each of which resulted in the construction of previously unbuilt stations and produced demonstrable public interest programming benefits in its markets -- benefits that would not have been achieved but for the combined operations of the stations. At the time that the Commission announced its decision to
(continued...)

UCC's two-fold response to this argument is entirely meritless. First, UCC recasts Pegasus's argument into a challenge to the sufficiency of the Commission's notice that it intended to attribute television LMAs.[10] As noted above, Pegasus's argument focused not on the clarity of the Commission's attribution announcement but on the ability of Pegasus or any other broadcaster to determine the ultimate impact of any final attribution decision on its operations. Because the impact of the attribution decision necessarily depended on whatever changes the Commission adopted to its duopoly rule, UCC cannot avoid the unmistakable fact that the decision to limit grandfathering relief NECESSARILY requires the retroactive application of the 1999 duopoly rule to post November 5, 1996 transactions. Because such a result is clearly prohibited under the APA, UCC's attempt to twist Pegasus' argument clearly fails.

Perhaps because it recognized the Commission's problem with retroactivity under the APA, UCC's second argument evinces a level of desperation. Specifically, UCC attempts to rewrite history by arguing that the Commission's decision to limit grandfathering relief does not involve an impermissible retroactive application of the new duopoly rule because Pegasus "never had a right to enter LMAs." UCC Attribution Opp. at 10.[11] Because UCC's assertion is clearly at

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[9] (...continued)
attribute television LMAs, it also announced proposed changes to the duopoly rule that would have allowed Pegasus to own the stations it had LMAs with. See Second Further Notice ¶¶ 33, 42-46, 54-55 (proposing duopolies for UHF-UHF combinations, permanent waivers for duopolies involving vacant and new allocations in small markets and when the applicant demonstrated public interest programming benefits would result from the combination). In entering these post November 6, 1996 LMAs, Pegasus took comfort from these proposals and the fact that its LMAs enhanced competition and programming diversity.

[10] See UCC Attribution Proceeding Opposition at 7.

[11] UCC goes on to note that "since their rise in the early 1990s, UCC et al. and others had consistently questioned LMAs as outright illegal artifices of control employed to evade the broadcast ownership rules." UCC Attribution Opp. at 10.

odds with settled Commission precedent regarding the permissibility of television LMAs, it too should be summarily rejected. Regardless of whether UCC supported the decision, there can be no doubt that the Commission's rules and policies clearly permitted television LMAs through the date that the new attribution rule took effect. Pegasus submits that there can also be no doubt that the Commission's attempt to limit grandfathering relief to pre-November 6, 1996 television LMAs violates the APA's prohibition on the retroactive application of agency rules.

### C. The Duopoly Rule's Exclusive Focus on Ownership Diversity Will Not Survive Intermediate Scrutiny.

In its Petition for Reconsideration, Pegasus also highlighted the Commission's repeated recognition that today's mass media marketplace bore little resemblance to the media marketplace that existed when the Commission first adopted its ownership rules. See Pegasus Pet. at 16-19. The Petition highlighted numerous instances in which the Commission eliminated or liberalized a variety of rules that had been enacted to ensure diversity or competition in the media marketplace. See id. Pegasus argued that these dramatic changes in the media marketplace had eliminated any basis to suggest that the number of available channels of video programming was still scarce. See id.

Pegasus noted that elimination of scarcity was important because scarcity was the basis relied upon by the Supreme Court for its deferential review of the Commission's restrictions on the First Amendment rights of broadcasters. See Pegasus Pet. at 14-16. Pegasus argued that the absence of scarcity would, at a minimum, subject the Commission's new duopoly rule to intermediate scrutiny -- a standard that requires any limit on First Amendment rights to be narrowly tailored to serve an important governmental interest. Under this standard, Pegasus questioned whether ownership diversity, by itself, constituted an important governmental interest.

It then argued that even if it did, the Commission's duopoly rule would not survive intermediate scrutiny because, as discussed above, the rule would diminish rather than enhance both diversity and competition in medium to smaller sized markets. See id. at 19-22, 27-37.

UCC's Opposition is telling more for what it ignores about Pegasus's arguments than for what it responds to. UCC's Opposition ignores the argument that there is no longer scarcity of outlets for video programming. UCC's Opposition also ignores the argument that the Commission's duopoly rule will be subject to intermediate scrutiny. Instead, UCC's Opposition devotes almost 7 of its 20 total pages to argue that there is a nexus between ownership of a media outlet and the content that the outlet broadcasts or otherwise produces -- an argument that implicitly concedes that programming diversity, not ownership diversity itself, is the proper regulatory focus. See UCC Opp. at 13-19.

UCC fails to address Pegasus's primary constitutional argument. Pegasus does not contend that ownership does not have any impact on the content broadcast by a television station, nor does Pegasus contend that diversity is not a desirable outcome. Instead, Pegasus argues that the Commission's exclusive focus on ownership diversity will not survive intermediate scrutiny because it fails to address the economic factors discussed above that are just as important in determining a station's ability to produce diverse content. See id. at 27-37. UCC's failure to address this argument is telling because it again suggests that UCC's Opposition was prepared for a theoretical discussion that did not have the benefit of the record that was compiled in this proceeding. Pegasus submits that a careful, balanced review of this record will lead to the conclusion that more extensive duopoly relief is needed to ensure the expansion of programming diversity and competition in medium to smaller markets. Without such action, Pegasus submits

that a reviewing court will find that the duopoly rule is not narrowly tailored to serve an important governmental interest.

## III. CONCLUSION

Because UCC failed to address, much less refute, the showing made by Pegasus in its Petition for Reconsideration regarding the existing barriers to new over-the-air entry in medium to smaller markets, Pegasus submits that the Opposition to its Petition for Reconsideration should be summarily rejected. To address these severe restrictions, Pegasus urges the Commission to amend its duopoly rule to permit broadcasters to own any new station added to the market or rescued from bankruptcy and to allow the transfer of these duopolies, subject only to an appropriate market share test. This proposal would address these impediments to new over-the-air entry in medium to small markets by reducing the level of investment needed to enter and encouraging new investment. Without such action, Pegasus submits that the Commission will undermine the level of over-the-air diversity and competition in these markets, the very goals it seeks to enhance through its ownership rules.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I, Tami Smith, hereby certify that a copy of the foregoing "Pegasus Communication Corporation's Reply in Support of its Petition for Reconsideration" was sent this 16th day of December, 1999 via first class mail, postage prepaid to:

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