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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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MAR 21 1997
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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. 87-7

REPLY COMMENTS OF
PEGASUS COMMUNICATIONS CORPORATION

Pegasus Communications Corporation ("Pegasus") respectfully submits this reply in response to comments received by the Commission in the above-captioned proceeding. Pegasus submitted initial Comments in this proceeding urging that the Commission not overlook the benefits that television duopoly can play in increasing the diversity of viewpoints and the economic competition in smaller television markets. Because of these benefits, Pegasus urged in its initial comments that any changes in the Commission's rules which permit television duopoly not be restricted to the larger television markets. As set forth below, Pegasus wishes to reemphasize that this conclusion is based on an economic analysis of the situation in the smaller markets, and the factual nature of competition and operation in those markets. As such, nothing in the comments of any of the other parties who participated in this proceeding has provided any factual support for a conclusion contrary to that advanced by Pegasus.

Background

Through the television duopoly rule, the Commission seeks to promote two complementary objectives: (i) diversity of program voices, and (ii) robust economic competition in local television markets[1/]. These objectives point to two relevant sets of questions. First, with respect to diversity, the Commission must make a determination as to how it will decide the manner in which diversity is to be measured. On this issue, a number of questions must be answered. Is diversity strictly a function of the number of media owners in a market, or does the economic prosperity of the competitors foster programming which can meaningfully promote the public interest so as to truly promote the diversity of viewpoints in a given market? Are most television markets currently reasonably diverse and competitive? If not, why? What effect would duopoly have on the level of diversity in television markets?

Second, with respect to competition, the Commission must determine what the economic factors are that affect market competition, and how these factors would be affected by relaxation of the duopoly rule. Here again, the Commission must face the question of whether competition is by definition fostered by a greater number of independent owners regardless of the financial health of their media properties, or whether a fewer number of owners might in fact foster more true competition in the television marketplace.

In reviewing the initial comments, it appears that parties who oppose relaxation of the duopoly rule implicitly assume that diversity is measured primarily by the gross number of television voices in the market and that most markets currently are at least minimally diverse. They therefore focus their attention on preserving existing diversity. These commenters assume

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1/ See Multiple Ownership Rules, 22 FCC2d 306, 307 (1990), recon. granted in part 28 FCC2d 662 (1971).

that a detailed economic analysis of the effects of permitting or prohibiting duopoly is unnecessary given the generally accepted principle that fewer owners must result in a loss of diversity. Even many of those commenters who favor relaxation of the duopoly rule implicitly accept this principle, attempting to justify duopoly by arguing that, as there are a multitude of media voices, not just television voices, in any market that will provide a competitive outlet to viewpoints and an alternative source for advertising, duopoly will not unduly harm local diversity. For the most part, however, the commenters do not attempt to assess the degree to which local stations really provide an outlet for local expression contributing to diversity in various markets, nor do they review the effectiveness of competition among the marketplace players in the television marketplace. Instead, these parties merely argue in favor of duopoly only as a means of strengthening weaker stations.

While the supporters of duopoly are certainly correct in their assessment of the numerous media alternatives to television, and are correct in arguing that duopoly will aid weaker stations to become more robust marketplace competitors, the comments do not focus on more substantive reasons justifying the relaxation of the current local ownership rules. As Pegasus demonstrated in its initial comments in this proceeding and further establishes below, many markets currently are highly concentrated as a result of (1) VHF and UHF spectrum allocation decisions made up to 50 years ago and (2) predictable economic factors. Therefore, questions concerning the existing state of television markets and the effect of relaxation of the duopoly rule on these markets can be subjected to rigorous analysis rather than left to untested, though seemingly obvious, assumptions. As further amplified below, when such an economic analysis is undertaken, the need for duopoly in all markets, including the smaller markets, becomes evident.

I. Analysis of Relevant Market Data Illustrates that Most Markets Currently Lack Diversity and are Highly Concentrated

Pegasus' initial comments demonstrated at some length that, in smaller DMAs, competition and diversity are already the exception, not the norm. Whether measured by number of stations, by market share of the top stations, or by prevailing advertising rates, all indicators suggest a systemic loss of competitiveness and diversity as market size decreases. Pegasus' initial Comments also demonstrated that the UHF/VHF signal difference materially exacerbates this problem and that local news offerings become much rarer as market size decreases.

In its Comments, Pegasus' main argument was that the underlying causes of the lack of diversity and competitiveness in smaller markets are principally economic and should be addressed as such. These economic issues are elaborated further below. But it is important here to note that the current duopoly proceeding should be viewed as an opportunity to materially *increase* diversity and competitiveness in smaller markets that currently have neither.

II. Analysis of Variable, Fixed and News Production Cost Data by Market and Station Size Illustrates that Relaxation of the Duopoly Rule will Increase Diversity and Competitiveness

An analysis of the operational costs of stations, reviewed on the basis of market and station size, reveals that relaxation of the duopoly rule, far from exacerbating the already grim state of diversity and competition in most markets, would actually help to remedy it. Attached as Exhibits A and B are tables of detailed financial data taken from the NAB 1996 Television Financial Report. Exhibit A summarizes key cost data for all stations, and for ABC, CBS and NBC affiliates, by DMA size; Exhibit B summarizes substantially the same information by station revenue. This data leads to the following conclusions:

- Variable costs: The sum of agency and national representative commissions is a relatively constant 20% of gross revenue, regardless of DMA size or station revenue. Programming costs (exclusive of news) are harder to average, since they tend to be much higher for large independent stations than for stations affiliated with the major networks. Nevertheless, the numbers for network affiliates suggest that programming costs are maintained at roughly 10 to 12% of net revenue regardless of station or DMA size (*i.e.*, as revenues decline, so must the programming investment), and this number holds true for the smaller independents as well. Sales costs, however, increase substantially as a percentage of net revenue as DMA size and overall station revenues decline, from as low as 5% for the largest stations and DMAs to as high as 12 to 15% for the smallest. These critical variable cost items therefore amount to at least 35% of gross revenue for even the largest stations and DMAs, and to at least 45% of gross revenue for the average station in DMAs below number 60.

- News: News production costs typically amount to another 10 to 15% of net revenue and also tend to vary constantly with revenue at least until a station reaches a certain minimum expenditure level of approximately $500,000, as it is difficult to provide a minimally credible news product for a lesser amount. The cost associated with news, plus the other costs set forth above, bring total variable costs to 55 to 60% of total revenue for markets below DMA 60, leaving only 40 to 45% of revenue to cover all fixed costs and to provide a return on investment. As a result, because the production of local news would eat up so much of the budget of a smaller station, most smaller stations manage to provide little, if any, local news product.

- Fixed Costs: Fixed costs, which include general and administrative expenses, engineering costs and required capital expenditures, rise rapidly as a percentage of revenue as station and DMA size decrease. General and administrative expenses are a relatively modest 7 to 8% of net revenue for the largest stations and DMAs, but these expenses escalate towards 15 to 20% of net revenue for stations with revenues less than $10 to 15 million and in DMAs below number 30, and can exceed 40% for stations with revenues below $2 million. Engineering costs as a percentage of net revenue also increase significantly as station and DMA size decline, from an average of less than 5% to as much as 7 to 8% in smaller DMAs to a nearly prohibitive 10 to 14% for the smallest stations. Capital expenditures also rise significantly as a percentage of net revenue as station and DMA size decrease, from a low of 3% for the largest stations and DMAs, to a high of 7% for smaller stations and DMAs. These fixed costs therefore total only about 15% of revenue for the largest stations, but approach 28% in DMAs 61-70 and exceed 30% in DMAs 91-100. Moreover, these costs can approach 50% for stations with revenues below $5 million. Furthermore, the median minimum operating expense (exclusive of agency and representative commissions, news, sales and programming costs and capital expenditures) seems to be about $1.2-1.3 million per year even for the smallest stations.

Thus, based on the costs associated with operating a television station, the NAB figures indicate that at least 25% of all stations with revenues of $5 to 15 million are apparently unprofitable, and the *average* station with revenues under $5 million is unprofitable.

It is more difficult to establish a typical capital expenditure model for a new television station since costs depend on whether a new tower must be built, the tower's height, the transmitter's power and other factors, but it has been Pegasus' experience that total costs approaching $5 million or more are fairly typical, especially if start-up costs and initial operating losses are factored in, and, critically, that this total does not change materially as market size decreases. A reasonable return on such an investment might be roughly $750,000 per year (including additional required capital outlays), with a minimum annual operating cost of $1 to 1.5 million and an allocation of approximately 45% of gross revenue to cover variable expenses. Therefore, minimum annual revenue of $3 to 4 million would be required to operate a profitable television station. Furthermore, the addition of a credible news product would raise minimum revenue requirements to at least $5 to 7 million and probably higher given the relative risk involved. Market revenues would therefore have to exceed $30 million (approximately DMAs 100 and larger) to sustain four highly-competitive stations; a highly-competitive six-station market would require closer to $50 million in revenues (which is limited to approximately the largest 75 DMAs).

The costs of operating a viable television station and consequent market revenue requirements explain much of the concentration and lack of diversity in local markets. These costs cannot be overcome in a stand-alone operation. However, as detailed in Pegasus' initial filing, permitting duopoly in smaller markets will allow stations to (i) share the substantial costs of investment in infrastructure (reducing them by 30-50% each, depending upon circumstances),

(ii) share the prohibitive fixed, general and administrative and engineering costs; and (iii) share the operating costs associated with a credible news product. These savings can be invested in programming and promotions, thereby substantially increasing program diversity, news voices and competition for advertising. Where there is now but a single strong station in a market, duopoly, through the sharing of these costs, will allow the development of several strong competitors, who will be able to provide programming which will truly serve the public need by addressing local issues. Without duopoly, the non-dominant stations are destined to scrimp by with little or no local origination, or to fail. If the Commission truly wants to allow competition to flower, particularly in the smaller markets, economics dictates that duopoly be permitted.

CONCLUSION

In its Comments, Pegasus requested that the Commission approve television duopoly in smaller markets, as long as such duopoly does not merely contribute to the already dominant position of the one or two stations that often have a stranglehold on the revenues and audiences in these markets. Thus, Pegasus advanced the proposal that the Commission approve duopoly without regard to the service (*i.e.,* VHF or UHF) of the stations involved, as long as the combination to be formed did not have a market share which exceeded 40 percent. Pegasus reiterates its request here. Only by adopting such a proposal can the Commission assure that smaller television markets will obtain the benefits of programming supplied by the emerging television networks, as channels which now lay fallow will be activated. In addition, duopoly will contribute to a real diversity of viewpoints in television markets as stations which have in effect been network translators, providing little or no local content, will be able to afford news production. The combined operation will also allow a firmer financial basis for the conversion to digital television. Finally, through the introduction of news and other quality programs which combined stations will for the first time be able to afford, the economic dominance of smaller markets by the entrenched VHF powerhouse will finally be challenged. Thus, the Commission has the opportunity through this proceeding to allow viewers in smaller television markets to enjoy the benefits of numerous outlets for quality programs and news previously enjoyed only in larger markets. Pegasus urges the Commission to adopt its proposals, and not to allow this opportunity to pass.

For the reasons set forth above, Pegasus respectfully requests that the Commission adopt the proposals set forth herein.

Respectfully submitted,

PEGASUS COMMUNICATIONS CORPORATION

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Exhibit A

NAB Statistics by DMA Size

1996 Television Financial Report

12-Mar-97

NAB Statistics
1996 "Television Financial Report"

Notes
- As % of Gross Revenues

ABC/CBS/NBC

	Revenues >$75mm	Revenues $35-$50mm	Revenues $15-$25mm	Revenues $10-$12mm	Revenues $5-$6mm	Revenues $3-$4mm	Revenues <$2mm
National/Regional -	40.20%	48.30%	46.50%	49.50%	45.00%	44.20%	33.70%
Local -	59.30%	50.50%	52.30%	49.30%	54.00%	54.80%	64.90%
Political -	0.40%	1.20%	1.20%	1.20%	1.10%	1.00%	1.40%
Agency Commissions -	14.90%	14.80%	14.20%	13.60%	12.40%	11.80%	11.00%
Rep Commissions -	4.20%	5.30%	5.90%	6.00%	6.30%	7.40%	9.70%
Total	19.10%	20.10%	20.10%	19.60%	18.70%	19.20%	20.70%
Network Compensation*	3.70%	6.20%	5.90%	5.60%	7.30%	8.00%	5.10%
Capital Expenditures*	2.10%	3.60%	6.00%	6.40%	6.60%	12.10%	9.10%
Engineering*	4.50%	5.00%	5.10%	6.00%	6.90%	8.70%	11.90%
Program*	10.80%	14.70%	13.40%	13.20%	13.10%	17.10%	17.40%
Production*	1.20%	1.50%	2.80%	4.00%	3.30%	4.10%	5.30%
News*	17.90%	15.50%	16.00%	16.50%	12.40%	13.30%	10.90%
Sales*	4.50%	8.20%	8.20%	10.00%	10.70%	13.40%	18.60%
Advertising & Promotion*	2.90%	3.30%	2.90%	2.80%	2.10%	2.70%	1.60%
General & Administrative*	6.90%	11.50%	13.80%	13.60%	19.70%	23.30%	24.20%
Total Expenses*	48.70%	57.70%	62.20%	66.10%	68.20%	82.60%	89.90%
Median Operating Expense	*$55,043,923*	*$24,395,028*	*$11,386,094*	*$7,234,001*	*$3,773,982*	*$2,768,013*	*$1,236,955*
Excl. News, Sales, Progr.	*$17,519,113*	*$9,005,444*	*$4,503,182*	*$2,889,223*	*$1,770,789*	*$1,300,229*	*$591,647*

All Independents

	Revenues >$40mm	Revenues $25-$40mm	Revenues $15-$25mm	Revenues $5-$15mm	Revenues $2-$5mm	Revenues <$2mm
National/Regional -	34.30%	53.90%	52.80%	47.40%	59.50%	55.10%
Local -	65.60%	46.00%	46.90%	52.50%	40.40%	44.80%
Political -	0.10%	0.10%	0.20%	0.10%	0.00%	0.10%
Agency Commissions -	14.60%	14.50%	15.50%	13.50%	12.10%	9.50%
Rep Commissions -	4.90%	6.70%	5.10%	6.90%	7.50%	9.10%
Total	19.50%	21.20%	20.60%	20.40%	19.60%	18.60%
Network Compensation*	0.00%	0.00%	0.00%	1.70%	5.20%	7.20%
Capital Expenditures*	2.70%	2.80%	4.40%	8.00%	12.10%	28.30%
Engineering*	4.00%	3.50%	4.70%	6.40%	10.80%	14.00%
Program*	38.00%	33.90%	31.10%	28.40%	18.50%	19.70%
Production*	2.20%	1.60%	1.90%	2.30%	5.70%	6.20%
News*	8.40%	5.30%	6.20%	3.60%	3.00%	2.10%
Sales*	5.00%	8.70%	10.10%	13.90%	13.10%	15.40%
Advertising & Promotion*	3.20%	3.60%	4.30%	4.60%	5.10%	4.00%
General & Administrative*	7.50%	8.20%	11.90%	16.00%	26.10%	40.60%
Total Expenses*	68.30%	64.80%	70.20%	75.20%	82.30%	102.00%
Median Operating Expense	*$43,813,830*	*$21,793,115*	*$12,610,113*	*$5,608,831*	*$2,022,864*	*$1,053,646*
Excl. News, Sales, Progr.	*$10,841,197*	*$5,683,698*	*$4,095,592*	*$2,185,356*	*$1,172,425*	*$669,375*

Exhibit B

NAB Statistics by Station Revenue

1996 Television Financial Report

12-Mar-97

NAB Statistics
1996 "Television Financial Report"

<u>Notes</u>
~ *As % of Gross Revenues*
* *As % of Net Revenues*

All Stations	All Stations DMAs 1 to 10	ABC/CBS/NBC DMAs 1 to 10	All Independ. DMAs 1 to 10	All Stations DMAs 31 to 40	ABC/CBS/NBC DMAs 31 to 40	All Independ. DMAs 26 to 50	All Stations DMAs 61 to 70	ABC/CBS/NBC DMAs 61 to 70	All Independ. DMAs 51+
National/Regional~	40.90%	42.00%	37.80%	50.40%	47.50%	57.10%	43.00%	42.20%	51.60%
Local~	58.90%	57.60%	62.30%	49.10%	51.80%	42.70%	55.90%	56.50%	48.40%
Political~	0.30%	0.40%	0.00%	0.60%	0.70%	0.10%	1.10%	1.30%	0.10%
Agency Commissions~	14.70%	14.90%	14.50%	14.50%	14.50%	14.00%	13.60%	13.50%	11.30%
Rep Commissions~	4.80%	4.30%	4.90%	5.70%	5.40%	6.60%	6.10%	6.00%	10.90%
Total	19.50%	19.20%	19.40%	20.20%	19.90%	20.60%	19.70%	19.50%	22.20%
Network Compensation*	2.20%	3.70%	0.40%	3.80%	4.80%	0.10%	5.10%	5.80%	8.40%
Capital Expenditures*	3.00%	2.90%	3.30%	4.90%	5.60%	6.40%	7.00%	5.50%	12.70%
Engineering*	4.50%	4.60%	4.60%	4.30%	4.60%	4.70%	5.80%	5.60%	8.90%
Program*	20.30%	11.90%	35.90%	16.00%	14.40%	32.30%	12.40%	11.30%	18.40%
Production*	1.70%	1.40%	2.10%	1.50%	1.60%	2.50%	3.70%	3.90%	2.40%
News*	13.50%	17.50%	7.00%	12.10%	14.60%	3.80%	13.40%	14.30%	2.90%
Sales*	5.20%	4.70%	6.50%	8.00%	7.60%	11.80%	9.70%	9.30%	13.90%
Advertising & Promotion*	3.10%	3.00%	3.40%	3.00%	2.90%	3.50%	3.10%	2.80%	4.30%
General & Administrative*	7.70%	7.50%	8.40%	14.10%	13.80%	14.70%	14.80%	14.90%	27.80%
Total Expenses*	56.00%	50.60%	67.90%	59.00%	59.50%	73.30%	62.90%	62.10%	78.60%

ABC/CBS/NBC	All Stations DMAs 91 to 100	ABC/CBS/NBC DMAs 91 to 100	All Stations DMAs 121 to 130	ABC/CBS/NBC DMAs 121 to 130	All Stations DMAs 151-175	ABC/CBS/NBC DMAs 151-175	All Stations DMAs 176+	ABC/CBS/NBC DMAs 176+
National/Regional~	47.90%	46.20%	48.30%	46.80%	47.40%	46.50%	47.90%	48.50%
Local~	50.40%	51.80%	51.20%	52.60%	50.70%	51.50%	49.70%	49.30%
Political~	1.70%	2.00%	0.50%	0.60%	1.80%	1.90%	2.40%	2.30%
Agency Commissions~	13.70%	13.70%	12.70%	12.90%	11.00%	10.90%	9.40%	9.20%
Rep Commissions~	6.80%	6.50%	7.50%	6.70%	7.60%	7.60%	7.00%	6.80%
Total	20.50%	20.20%	20.20%	19.60%	18.60%	18.50%	16.40%	16.00%
Network Compensation*	5.70%	6.00%	4.80%	4.80%	6.20%	6.60%	5.90%	6.10%
Capital Expenditures*	7.20%	6.10%	6.80%	7.00%	6.20%	6.20%	6.60%	6.60%
Engineering*	6.50%	6.50%	7.10%	7.00%	6.60%	6.50%	7.70%	7.70%
Program*	12.60%	12.60%	14.80%	13.60%	12.30%	12.40%	10.00%	9.60%
Production*	2.30%	2.20%	4.60%	4.80%	4.30%	4.30%	4.50%	4.20%
News*	10.90%	12.40%	13.20%	15.40%	11.90%	12.50%	10.30%	10.80%
Sales*	10.80%	10.40%	13.40%	12.50%	12.20%	12.00%	12.10%	11.50%
Advertising & Promotion*	2.80%	2.50%	2.30%	1.70%	2.10%	1.90%	1.80%	1.60%
General & Administrative*	18.20%	17.40%	19.00%	17.70%	19.60%	19.40%	22.00%	22.20%
Total Expenses*	64.10%	64.00%	74.40%	72.70%	69.00%	69.00%	68.40%	67.60%