06-121

Prepared Statement of Bruce M. Owen[1]
FCC Public Hearing on Media Ownership
Los Angeles CA, October 3, 2006

Summary

Our society has widely accepted policy tools, both analytical and legal, to deal with problems of economic concentration. Those tools, the antitrust laws, work as well for TV networks as for other industries. In a nutshell, we ask whether consumers have sufficient alternatives so that sellers cannot behave anti competitively. This is a fact issue, not a matter of emotion or doctrine. Once upon a time the answer was that viewers and program suppliers had hardly any alternatives to the broadcast networks. That state of affairs is long past. Today, broadcast networks face intense competition from numerous rivals. Thus, even if one accepts the proposition that broadcast networks' use of the electromagnetic spectrum excuses regulatory interventions that would otherwise violate the First Amendment, there is no longer any policy basis for such intervention. Indeed, the chief consequence of imposing regulatory constraints on broadcast networks today is to weaken them as competitors, distorting the relevant markets, and hastening the day when viewers will lack any free off-air programming.

Of course, mass media are not the same as ordinary businesses in one important respect. Mass media are protected from *government*

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interference by the First Amendment.[2] The First Amendment aside, we all favor abundance and competition in what Justice Holmes metaphorically called the market for ideas.[3]

But an appeal to First Amendment values simply is not germane to most of the media ownership issues before the Commission. The truth is that a desire to promote political freedom through competition in the market for ideas has very little to do with mass media in general or broadcast TV networks in particular. As everyone knows, new, unpopular, contentious, and subversive ideas chiefly arise in obscure places, and nowadays spread by such means as the Internet. In any event, it is simply illogical to confuse the popularity and economic success of a channel of communication with its power to promote unpopular ideas.

Vertical Integration

Nothing could be more commonplace than to observe manufacturers buying some of their supplies from outside firms, while producing other inputs themselves. Such decisions are based on economic tradeoffs—what are called "make or buy" decisions. Ultimately, these decisions are driven by competitive marketplace pressures to minimize costs and to produce goods that consumers want.

[2] "Congress shall make no law abridging the freedom of the press." Constitution of the United States, Amendment I.

[3] "But when men have realized that time has upset many fighting faiths, they may come to believe even more than they believe the very foundations of their own conduct that the ultimate good desired is better reached by free trade in ideas -- that the best test of truth is the power of the thought to get itself accepted in the competition of the market, and that truth is the only ground upon which their wishes safely can be carried out. That at any rate is the theory of our Constitution." Abrams v United States, 250 U.S. 616 (1919), Holmes, J. dissenting.

Broadcast networks, like other media, produce some of their own content and buy other content from suppliers. When they buy from suppliers, they negotiate supply contracts that specify terms and conditions. If the supplier demands too high a price, the buyer can—indeed, must—turn to other sources or to its own internal production facilities. It is strange that this prosaic fact of commercial life generates such hysteria among suppliers of network video content. But in any case there is no rational basis for regulatory intervention. Even many years ago, when there were only three firms competing in the network television business, it made no sense to regulate vertical integration. How could it make sense today, when there are so many more broadcast and non-broadcast competitors for viewer attention, and for video content to fill their many channels?

Certain economic facts must temper any discussion of the performance of the broadcast networks. The facts are these:

- Broadcast networks survive by selling audiences to advertisers, and do so in competition with hundreds of other commercial media companies.

- Advertisers rely on ratings and demographic data to make their purchasing decisions. Therefore, networks must focus on these same measures. They have no choice.

- Further, the only way to generate ratings and demographics is to offer viewers programming that is more attractive than the many, many alternative choices that are available.

- The prices for program development, pilots, and series continue to rise, in large part because so many rival channels are now competing for the same talent and other inputs.

These facts constrain what the networks can do, and still remain in business.

Program suppliers often complain about their "deficit financing" problem, as if that were an invention of their network customers. The re-use of programming in multiple windows, combined with competition in program production, ensures that the cost of producing a given program <u>must</u> exceed the competitive price of a license for network exhibition. Hence the need for so-called "deficit financing." But there is no need to invent a new term for what is, in fact, plain old "financing." There is nothing special about this. Most businesses must invest money upfront and earn revenues and profits later. The Hertz Corporation pays a lot more for each car it buys than it collects from the first customer to rent the car. The upfront cost of the car is financed, or in Hollywood parlance, "deficit financed."

Investment dollars for program production have to come from somewhere, and broadcast networks often are the most efficient source of those dollars, which they supply by acquiring rights to downstream revenues. Again, this situation is commonplace in many markets. When GM sells a car to Hertz, it does not retain the right to resell the car once Hertz is finished with it. Unlike some program suppliers, GM does not think to whine to government agencies that Hertz is "demanding" resale rights in return for featuring GM rental cars.

As for discrimination against suppliers who retain downstream rights, networks have an overwhelming economic incentive to schedule programs so as to maximize ratings and demographics, regardless of a given program's ownership. The bulk of a program's revenue comes from the first network exhibition, and that revenue comes early. It makes no sense to give up $10 of revenue today in order to earn $2 of uncertain revenue five years hence.

Here are some more facts that constrain the freedom of action of broadcast networks far more effectively than any government regulation could do:

- The seven broadcast networks in existence in 2001 accounted for less than 25 percent of expenditures on video programming in that year, and the percentage has surely fallen further since 2001.[4]

- Broadcast networks do not have market power in purchasing programming. None of the broadcast TV networks, even when combined with its parent, purchased enough video programming in 2001 to have market power. The largest purchaser in 2001 purchased just 19.4 percent of the total, and this number also is now smaller than it was in 2001.[5]

- Broadcast networks do not control the new media. Of the 388 satellite-delivered national programming networks only 89, or 23 percent, are owned by one or more of the national broadcast networks.[6]

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[4] Bruce M. Owen and Michael G. Baumann, "Concentration Among National Purchasers of Video Entertainment Programming," January 2, 2003, submitted to the Federal Communications Commission in MB Docket No. 02-277 (Economic Study E). These figures are for purchases of national video entertainment programming rights in the United States by broadcast networks, syndicators, cable networks, and distributors of video recordings purchasing national exhibition rights.
[5] Id.

[6] FCC, *Eleventh Annual Report*, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 04-227, Released: February 4, 2005 ("Eleventh Annual Report"), especially ¶¶ 145-8.

- Of the 205 basic and premium cable networks for which subscriber data were available in 2004, the four major broadcast networks had *combined* ownership of just 33.7 percent, based on subscribers.[7]

- Forty-nine national networks were added to the FCC's list in 2004 relative to 2003. Of these, only 3 could be identified as owned by one of the four major broadcast networks.[8]

Localism Study

A "study" on the subject of localism in TV broadcasts was recently unearthed. The study purports to find that TV stations whose owners' corporate headquarters are located in the same DMA offer more minutes of local news.

Most TV stations are not mom and pop operations. In a world of ever-heightening competition for consumer time and attention, why would one expect to find differences in the behavior of stations, based on where the station's corporate executives are headquartered? (After all, most station *owners* are widely dispersed stockholders and institutions such as pension funds. Station *managers* operate locally as well as at corporate headquarters.) And if such a difference were found, why would one give it credence? And if credence, what reasonable policy conclusions could possibly be drawn?

Further, there is considerable reason not to credit the study. For example, it is not possible to obtain the underlying data to check its

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[7] Michael G. Baumann and Kent W Mikkelsen, "Response to Comments Regarding Economic Consequences of Retransmission Consent," submitted to the Federal Communications Commission in MB Docket No. 05-28, pp. 6-8

[8] Id.

accuracy. The results could be driven by bad data, miscoded data, a particular day, or a particular atypical station. The study also has some serious technical flaws.

Here are a few of the technical issues with the localism study:

- Apparently the "news" variable excluded weather and sports news. One bizarre implication is that the FCC should change its policies to encourage reduced coverage of weather and sports.

- Other findings are outlandish. For instance, another finding is that radio stations in the same DMA as their corporate headquarters *decreases* minutes of news on local TV stations. It is hard to think why this would be so, and the finding casts further doubt on the study's data and methods.

- The study is limited to stations with *some* local news programs. Therefore, if it happened that most stations located in the same market as their corporate headquarters produced *no* news at all, the study would not have picked up on that fact.

- Relatedly, the study's conclusion about the amount of local news is restricted to the makeup of a single half-hour. The study casts no light on whether or how a local headquarters, much less owners who live locally, affect the *total* amount of local news that a station airs over the entire broadcast day.

A final point on localism. It is simply wrong to think that TV station managers, wherever they may be headquartered, have the financial freedom to air programming viewers don't want, even if the FCC does want it. The station's managers, to survive in the marketplace against competition from <u>unregulated</u> media, must do their best to deliver what local viewers—and advertisers—want. This is a business decision, hardly a matter of conscience or a moral principle. Any station manager has strong incentives to give viewers the (affordable) programming that attracts viewers, which is not necessarily the programming the manager likes.