Ownership Regulatory Policies in the U.S. Telecom Sector

by Henry Geller

Do not quote without the permission of the author.
©1994 Columbia Institute for Tele-Information

Columbia Institute for Tele-Information
Graduate School of Business
Columbia University
809 Uris Hall
New York, NY 10027
(212)854-4222

Ownership Regulatory Policies in the U.S. Telecom Sector

Henry Geller

Fellow
Markle Foundation
New York, New York

TELEVISION SELF-REGULATION AND OWNERSHIP REGULATION:
THE AMERICAN EXPERIENCE

March 10, 1995

A Symposium Presented by:

Columbia Institute for Tele-Information
Columbia University
New York, New York
U.S.A.

in cooperation with

Bertelsmann Foundation
Germany

Ownership Regulatory Policies in the U.S. Telecom Sector

Henry Geller[1]

Since the early 1940's, the U.S. has had multiple ownership policies in the telecommunications (telecom) sector. The main focus of these policies has been the broadcasting field, since telephone was until recently a common carrier monopoly sector and other electronic media like cable television have arrived on the scene in full force in the last two decades. This paper therefore will take up first the broadcast field and then turn to cable television, telephone (telco), and related matters. It will trace the history of the regulatory pattern, its present status, and then set out views and some predictions.

As will be developed, great change is in the offing for the telecom field, because of the dynamic technology and the convergence with the digital computer sector. The focus here, however, will be on policy issues in the near term, that is, the next five years to ten years or so.

In treating these issues, the emphasis will be upon the Communications Act of 1934, as amended, and its implementation by the Federal Communications Commission (FCC). All these electronic fields also come under the antitrust laws. However, except for the telephone sector, where there will be a brief discussion of the divestiture of AT&T, antitrust has not played as large a role in ownership regulation as have FCC regulatory

---

[1] Communications Fellow, The Markle Foundation; Senior Fellow, The Annenberg Washington Program.

rules.

I. Multiple Ownership Regulation in the Broadcast Field.

A. Radio.

FCC Actions, 1940-1983. The initial multiple ownership rules prohibited the issuance of a license to any person or entity already having a license in the same broadcast service unless the applicant could demonstrate that the issuance of the license (1) would have a pro-competitive impact, and (2) would not result in the concentration of control of broadcasting facilities in a manner inconsistent with the public interests.[2] This is a broadly worded test, and should have resulted in some hearings to determine whether or not a particular acquisition met the test. There were no such hearings. The history of FCC regulation in this field (and generally) is that broad, "mushy" standards are not implemented -- that only firm, objective standards are successful.

Accordingly, at the same time, the Commission adopted absolute limits on the common ownership of FM stations (6 stations)[3] and TV (3 stations, raised to 5 in 1944)[4], and in 1946, adopted a limited of 7 stations in AM.[5] In 1953, the FCC retained the same broad test -- no acquisition if the resulting

---

[2] See Further Notice of Proposed Rule Making, FCC 94-322, issued Jan. 17, 1995, at par. 2.

[3] 5 FR 2384 (1940).

[4] 6 FR 2284 (1941); 9 FR 5442 (1944).

[5] Sherman B. Brunton, 11 FCC 407 (1946).

concentration conflicts with the public interest -- but the real "bite" was in the numerical limits: 7 AM, 7 FM, and 5 TV stations.[6] There was a twofold rationale for thus limiting national ownership -- to promote diversity of ownership in order to diversify the sources of information coming to the American people and to safeguard against undue concentration of economic power.[7]

This second ground is of much less importance, and is more the province of antitrust regulation. Thus, in its Notice leading to a 1984 revision, the Commissiion stated,[8] "...the Commission's principal concern in implementation of its policy of diversification of ownership has not been the enhancement of economic competition but, rather, the advancement of diversity in sources of information to further First Amendment values." In its 1975 report,[9] the FCC found that separate ownership of co-located newspapers and broadcast stations is required in the public interest:

> If our democratic society is to function, nothing can be more important than insuring that there is a free flow of information from as many divergent sources

---

[6] Amendment of Multiple Ownership Rules, 9 Pike & Fischer RR 1563 (1953). The limit on TV stations was raised to 7, no more than 5 to be in the VHF band. Amendment of Multiple Ownership Rules, 43 FCC 2797 (1954).

[7] Amendment of Multiple Ownership Rules, supra, 9 Pike and Fischer at 1568.

[8] 48 FR 49438, at par. 51.

[9] Second Report and Order on Multiple Ownership, 50 FCC2d 1046, 1079.

> as possible ... [I]t is unrealistic to expect true diversity from a commonly owned station-newspaper combination. The divergency of their viewpoints cannot be expected to be the same as if they were antagonistically run.

The Supreme Court affirmed, stressing that the public interest standard "necessarily invites reference to First Amendment principles...and, in particular, to the First Amendment goal of achieving 'the widest possible dissemination of information from diverse and antagonistic sources.' Associated Press v. United States, supra, 326 U.S. at 20."[10] See also Policy Statement on Comparative Broadcasting Hearings,[11] where the FCC held that such hearings had as a "primary objective" the "maximum diffusion of control of the media of mass communications," since "diversification of control is a public good in a free society, and is additional[ly] desirable where a government licensing scheme limits access by the public to the use of radio and television facilities." Further, Congress has stressed the importance of the diversification principle, even in the case of low power television where thousands of so-called "beltway" stations are possible.[12]

---

[10] FCC v. NCCB, 436 U.S. 775, 795 (1978).

[11] 1 FCC2d 393, 394 (1965).

[12] Thus, in its amendments to the Act authorizing the use of lotteries, 47 U.S.C. 309(i)(3)(A), Congress explicitly required that preferences be given to promote the Associated Press principle. It specified that when the lottery is "used for granting licenses...for any media of mass communications, significant preferences will be granted to applicants..., the grant to which...would increase diversification of ownership of the media of mass communications...", including to any applicant

There are three points to be briefly stressed. First, the objective is to diversify ownership or control; it is thus a structural effort to diversify the sources of information coming to the electorate. It is not aimed at diversifying programming or viewpoints; other regulations, such as the Prime Time Access Rule[13] or the fairness doctrine,[14] have been directed to that purpose.

Second, the diversification principle cannot be met by the claim of the chain owner that it will allow station managers editorial autonomy. This claim is speculative and difficult to check; in any event, it is the owner that selects the key station managers and can (and probably will) select those who reflect generally the owner's philosophy or views.

Third, the limits in the rule are rather arbitrary. But as the FCC has noted,[15] attempts to take into account such factors as population, geographical location, etc., have been "unsatisfactory or unworkable." The rule limits have worked

---

controlled by minority groups. See H. Rept. No. 97-765, 97th Cong., 2d Sess., 40-45 (1982).

[13] 47 C.F.R. 73.658(k) (limiting to three hours the amount of time a major network can program in prime time, and proscribing the use of off-network programming by a network affiliate in the top 50 markets).

[14] See Red Lion Broadcasting Co, Inc. v. FCC, 395 U.S. 367 (1969) (upholding the personal attack and political editorializing rules).

[15] Notice in FCC Docket No. 83-1009, 48 F.R. 49438, at par. 10.

precisely because of their certainty, and have never been waived.[16]

The foregoing has dealt with national ownership limits in radio. The FCC very early dealt with duopoly, the common ownership of more than one station in a particular area. It proscribed FM duopolies in its 1940 rule and AM duopolies in 1943. The rationale for this proscription is the Associated Press principle. Thus, the FCC stated in its First Report on Multiple Ownership:[17]

> A proper objective is the maximum diversity of ownership that technology permits in each area. We are of the view that 60 different licensees are more desirable than 50, and even that 51 are more desirable than 50. In a rapidly changing social climate, communication of ideas is vital. If a city has 60 frequencies available but they are licensed to only 50 different licensees, the number of sources ideas is not maximized. It might be that the 51st licensee would become the communication channel for a solution to a severe local social crisis. No one can say that present licensees are broadcasting everything worthwhile that can be communicated.

The duopoly rule dealt only with ownership of stations in the same service (FM or AM or TV). In 1970, the FCC, relying again on the diversification principle, adopted its one-to-a-market rule barring common ownership or control of more than one broadcast station in the same area.[18]

---

[16] Storer Broadcasting Co. v. United States, 240 F.2d 55 (D.C. Cir. 1956); dissenting opinion of Commissioner Rivera, Notice, supra, n.13, 48 FR at 49453.

[17] 22 FCC2d 306, 311 (1970).

[18] First Report and Order, supra; Memorandum Opinion and Order, 28 FCC2d 662 (1971) (permitting formation and transfer of AM/FM combinations).

FCC actions since 1983. In 1984 the FCC substantially revised its national ownership limits. A new deregulatory FCC had come on board, and, citing the explosive growth and change in the electronic mass media market, it sought to wholly deregulate this area by eliminating the national ownership limits. Under pressure from the interested Congressional committees, the FCC was forced to abandon its complete deregulation, and instead adopted a 12 station limit in each service.[19] At the same time, the Commission stressed the need to retain duopoly limitations, stating that "...the appropriate geographical market for diversity is primarily local and our local multiple ownership rules, which are unaffected by [this] Report and Order are the rules which are designed to promote diversity in that geographic market."[20]

The Commission returned to the radio rules in 1991, and adopted major revisions in its 1992 actions.[21] While it again noted the "dramatic increase in competition and diversity in the radio industry over the last decade...,"[22] it took particular note that radio broadcasters are subject "...to increasingly severe

---

[19] Amendment of Multiple Ownership Rules, 100 FCC2d 17 (1984), recon. granted in part, 100 FCC2d 74 (1985).

[20] Id. at 100; see also at 58.

[21] Revision of Radio Rules and Policies, 7 FCC Rcd 2755 (1992), recon. granted in part, 7 FCC Rcd 6387 (1992), further recon., 9 FCC Rcd 7183 (1994).

[22] The FCC cited the increase to over 11,500 radio stations, 1,500 TV stations, and cable serving 64% of the TV audience with music channels. 7 FCC Rcd at 6387.

economic and financial stress."[23] In the face of this threat, the FCC found it necessary to revise the ownership rules "to obtain the substantial efficiencies that common ownership can provide" (e.g., the opportunity to combine administrative, sales, programming, promotion, production, sharing of studio space and equipment).[24] It pointed out that silent stations do not contribute at all to diversity, and that in any event, the large number of radio stations ameliorated any concern about further relaxing the ownership rules.[25]

The Commission accordingly allowed a single entity to own an attributable interest in up to 18 AM and 18 FM stations.[26] The Commission also modified its local ownership rules to permit a single entity to own an increased number of stations within a local radio market, with a 25% cap on the combined audience share of all owned stations.[27] The Commission permitted without any

---

[23] Id. The FCC noted (id.):

> ...between 1985 and 1990, the growth rate of radio station revenues dropped nearly in half to, on average, six percent...Operating profits, on a per station basis, have fallen dramatically... More than half of all radio stations lost money in 1990, almost 300 stations are currently silent...

[24] Id. at 6388.

[25] Id. ?

[26] After two years, this limit increased to 20 stations, with three more allowed if the entity held a non-controlling interest in stations controlled by minorities or small business. Id.

[27] Thus, in markets with 15 or more stations, a single entity can own up to two AM and two FM stations, subject to the above 25% cap. Id.

restriction joint venture agreements that do not involve time brokerage or joint programming arrangements. These arrangements, it stated,[28] benefit the industry without jeopardizing diversity or competition. The Commission restricted unattributable time brokerage (also called local marketing agreements or "LMAs) to 15% of the brokered station's weekly broadcast hours; an agreement exceeding that will result result in ownership attribution to the broker, and could thus run afoul of the local ownership rules.[29]

B. Television

As noted, the FCC in 1984 raised the national ownership limit to 12 but with a maximum aggregate 25% national audience reach[30], so as to deal with the problem that a rule grounded solely on the number of stations does not take into account the market size of the stations. This 25% limit prevents a group owner from owning stations in each of the 12 largest markets, and in light of some present holdings,[31] is the more binding contraint on group acquisition of stations.

In 1991 the FCC issued a Notice of Inquiry to determine whether it should revise the above multiple ownership rules so

---

[28] Id.

[29] Id.

[30] These limits are raised to 14 stations and 30% if two or more of the stations are controlled by minorities. 47 C.F.R. 73.3555(1)(e)(ii)(iii), (2)(i)(ii).

[31] None of the top 25 television group owners has reached the 12 station limit but several like ABC are clearly restricted by the 25% audience limitation. See Further Notice of Proposed Rulemaking, FCC 94-322, at n.111.

that television stations could better respond to the tremendous changes that were occurring in the video market.[32] In 1992, the FCC issued a Notice of Proposed Rule Making[33], and in January, 1995, it issued a Further Notice of Proposed Rule Making.[34] The Further Notice contains an exhaustive analysis of television broadcasting's relevant markets (i.e., the delivered video programming market; advertising markets; and the video program production market) and a diversity analysis of television broadcasting. It then considers and makes recommendations as the national ownership rule, the local ownership rule, the radio-television cross-ownership rule, and LMAs.

On national ownership, the FCC tentatively concluded that liberalization of the national limits "would not have an adverse impact upon competitiveness of the markets for delivered video programming, the market for advertising, or the video program production market."[35] The Commission noted that the current national levels of industry concentration are low by antitrust standards.[36] Most important, "relaxing the national ownership

---

[32] 6 FCC Rcd 4961 (1991). This Notice was based on a staff report, F. Setzer and J. Levy, Broadcast Television in a Multichannel Marketplace, FCC Office of Plans and Policy, (1991), id. at 3996.

[33] 7 FCC Rcd 4111 (1992).

[34] FCC 94-322 (1995) (herein Further Notice).

[35] Id. at par. 98.

[36] Id. at par. 89 (using the antitrust Herfindahl-Hirshman-Indes (HHI).

limits will not increase the concentration of broadcast TV ownership within a local market."[37]

Similarly, the FCC concluded that raising the national limits would not have an adverse effect on diversity:

> Within the United States, the most important idea markets are local. For an individual member of the audience, the richness of ideas to which he is exposed turns on how many diverse views are available within his local broadcast market. For that individual, whether or not some of thos views are also disseminated in other local broadcast markets does not affect the diversity to which he is exposed. Accordingly, national owership limits, as opposed to local ownership limits, ordinarily are not pertinent to assuring a diversity of views to the constituent elements of the American public.[38]

The Commission therefore continued to propose the revisions in the 1991 Notice (i.e., permitting common ownership of 18, 20 or 24 stations and raising the audience to 30 or 35%). Further, the FCC advanced a new proposal -- eliminating the numerical station limit and allowing the audience reach limit to increase by some fixed percentage, such as 5% every three years, until it reached 50%, the final limit.[39]

In the local ownership area, where the Commission's concern with diversity is most acute (see above quotation), the FCC's Further Notice is much more cautious about relaxing current rules. It tentatively proposed only to decrease the prohibited

---

[37] Id. at par. 98.

[38] Id. at par. 99, quoting the 1984 Report, supra, 100 FCC2d at 37.

[39] Id. at par. 101.

overlap contour from Grade B to Grade A, "a substantially more realistic and accurate measure of a station's core market."[40] It requested comment on whether to permit common ownership in local markets, such as UHF/UHF or UHF/VHF combinations, but even then, with some assurance that such joint ownership does not reduce the number of independent suppliers below some critical level.[41]

As to the one-to-a-market rule,[42] the FCC proposed to either eliminate the rule (and thus rely on the local ownership rules to insure diversity and competition at the local level) or to codify the present waiver process. As to LMAs, the FCC proposed to treat them in television in the same way as it has done in radio (using the same 15% benchmark for attributing duopoly).[43]

Views and predictions. In my view, it would be sound policy to relax the national ownership limits in light of the great

---

[40] Id. at par. 117.

[41] Id. at pars. 120-123.

[42] This rule provides that a entity cannot own both a radio and TV station in the same local market. The FCC amended the rule in 1989 to permit waivers as long as the combination was in one of the top 25 markets and 30 separately owned licensees remained after the combination, or if the waiver request involved a failed station. See Further Notice, at par. 124.

[43] Id. at par. 138. The FCC is also reviewing its attribution rules that are the base for application of multiple ownership requirements. Review of the Commission's Regulations Governing Attribution of Broadcast Interests, FCC 94-324, issued Jan. 12, 1995. The current rules for voting stock attribution are 5% and, in the case of institutional investors, 10%. Id. at par.8. In its review, the FCC seeks to promote capital investment while at the same time dealing realistically with holdings or financial arrangements that do involve substantial control or influence.

changes in the video distribution market and the clear trend for even greater competition and fractionation as a result of cable channel expansion, Direct Broadcast Satellite (DBS), telco entry, etc. And it is clear that there will be further relaxation of the television national ownership limits. The FCC is moving to do so. This move has the full support of Congress. In legislation in the last (103rd) Congress, Congress signalled that such changes should be occur,[44] and that signal has been repeated in the legislation in the (104th) Congress, with the addition that there is explicit requirement to move the national television audience limit to 35 percent.[45]

The process will continue in both houses so that it is not now possible to be definitive. As indicative of the far reaching reform favored by the Republican side, special mention should be made here of the Chairman's Draft of Senator Larry Pressler, Chairman of the Senate Committee on Commerce, Science and Transportation. On February 1, 1995, he released a draft of the Telecommunications Competition and Deregulation Act of 1995. In Section 207, the draft repeals the local cable-TV broadcast station ban (discussed within at II) and all the ownership restrictions in 47 CFR 73.3555 of the FCC rules, thus repealing the local newspaper-broadcast ban (also discussed within at II), the one-to-a-market rules, and all broadcast duopoly and national

---

[44] See Sec. 701, S.1822, 103d Cong., 2d Sess.

[45] Section 207(b), S.652, 104th Cong., 1st Sess.

ownership restrictions.[46] Such sweeping and drastic reform, in my view, is misguided.

Most important, it is unsound policy as to the duopoly aspect. The FCC is right to stress the importance of diversifying the sources of information (the Associated Press principle) at the local level. While it may be no violation of the antitrust laws if one entity were to own two TV stations in an area with 10 or more stations, it certainly means that the government is not diversifying the sources of information, especially on local issues, available to the people in that area.

The FCC would strongly oppose the elimination of the duopoly rules. So also did the Democratic Committee leaders, with result that S.652 emerged from the Senate Commerce Committee only with the requirement for review of the multiple ownership limits and the above noted increase of the national audience percentage to 35 percent.[47]

Significantly, and just as important as the merits, the broadcasters have considerable "clout", and in the TV area, a majority do not want the sweeping relaxation sought by Senator Pressler and other Republicans. Thus, at a recent National

---

[46] Through inadvertence, the draft fails to repeal the national network-cable TV ownership restriction, because it does not appear in Sec. 73.3555. It should be noted that Senate Commerce Committee Republican members and Senate Majority Leader Robert Dole signed off on the draft, and indicated their support in a "Dear Colleague" letter, stating that it was a "good starting point for the debate to follow in the 104th Congress." Telecommunications Reports, February 6, 1995, at 1.

[47] See Sec. 207, S.652, 104th Cong., 1st Sess.

Association of Broadcasters (NAB) Board Meeting, the Board supported a more modest proposal than the FCC eventual 50% limit. It sought only an increase to a 30% audience cap, because network affiliates feared giving the networks too much power to acquire stations.[48]

Further, while some stations like repeal of the duopoly restriction, thus facilitating LMAs, many others strong oppose this move on the ground that "...television LMAs create an unlevel playing field in the market because the opportunity is not available to all the players [and] the one stations that's able to do an LMA can exert leverage in programs deals and advertising sales not available to others..."[49] They argue that LMAs are "de facto duopolies, which are supposed to be forbidden in the TV business." Id. Several program distributors also oppose relaxation of this restriction. Id.

In sharp contrast to the dispute among TV stations, the NAB Radio Board would like to see all radio ownership rules relaxed or eliminated, leaving antitrust regulation as the governing

---

[48] See Broadcasting & Cable, Jan. 23, 1995, at 9 ("NAB board supports 30% TV ownership cap"). See also Broadcasting & Cable, Feb. 6, 1995, at 6-7 ("TV dereg: too much of a good thing") (stations opposing Chairman Pressler's draft proposal because it "would upset the broadcast market and harm many stations" -- because "repeal of all ownership limits would only enhance the networks' market power"). The networks naturally strongly favor elimination of the ownership restrictions.

[49] Broadcasting and Cable Mag., Feb. 6, 1995, at 8-9 ("Broadcasters battle over LMAs").

regime.[50]

In light of the above noted broadcaster opposition and the opposition of the FCC in view of its long held position on the importance of the local diversification policy, it is likely that the TV national ownership limitation will be raised, at most to 35%, perhaps with a promise to reevaluate it at appropriate intervals, and that the duopoly rule, including the 15% LMA benchmark, will be retained, with only some minor adjustment such as use of the Grade A contour. In radio, while there are no FCC pending proceedings, there may well be further relaxation either by the Congress or the FCC, both at the national and local levels, with the latter restricted to markets with some specified large number of stations (e.g., 20 or more).

II. Local Cross-Ownership of Television Broadcast Stations and Newspapers or Cable Television.

In 1975, the FCC, in order to promote the Associated Press principle, found that separate ownership of co-located daily newspapers and broadcast stations is required in the public interest.[51] Earlier in 1970, the FCC barred ownership of cable systems by television broadcast stations in the same market.[52] Congress codified the latter proscription in the 1984 Cable

---

[50] Broadcasting and Cable Mag., Jan 23, 1995, at 10; April 3, 1995, at 14 ("NAB presses for radio dereg").

[51] See quotation at p.3, supra, from Second Report and Order, 50 FCC2d at 1079; 47 C.F.R. Sec. 73.3555(d).

[52] CATV, Second Report and Order, 23 FCC2d 816 (1970); 47 C.F.R. Sec. 76.501 (1975).

Television Act, Sec. 613(a).[53]

While there have been occasional efforts to remove these restraints, they are not in dispute as much as the broadcast limitations discussed in Part I, and there is no FCC pending proceeding that deals with them. However, as noted, Senator Pressler's draft would have repealed these restrictions, and the issue may be raised again, if the industries involved press for relief. In my view, such relief would be most unsound policy.

First, we are again dealing with diversity on the all-important local level. Further, for information people rely heavily on television,[54] the daily newspaper, radio and cable television, which is increasingly providing local cable news channels and local cable originations. It follows that these principal sources of local information should be in different hands, if the underlying basis of the First Amendment, as set forth in Associated Press, is to be maintained.

Second, there is growing competition for local advertising between cable and broadcasting. And third, the entity, whether newspaper or cable system or TV station, has full opportunity to acquire the other medium outside its local area. Thus, broadcast licensees have extensive cable holdings, and newspapers can and do own broadcast stations outside their localities.
Significantly, even though grandfathered, the Washington Post and

---

[53] 47 U.S.C. 533(a).

[54] Further Notice, supra, at n.101.

the Detroit News swapped stations in order to be in compliance with the spirit of the rule.[55]

In 1970, the FCC also barred cable ownership by broadcast television networks.[56] In 1992, the FCC modified this rule to permit network-cable cross ownership, provided that the combination does not exceed (i) 10% of home passed by cable nationwide and (ii) 50% of the homes passed in an Area of Dominant Influence (ADI) by cable systems that are owned by the network.[57] The Commission stated that it would review these structural retrictions in three years to determine the necessity of retaining them.

In my view, that review should end in their elimination. Even so, there will probably be little movement by the networks into cable, in light of the present prices of cable systems. Rather, the networks have largely decided to enter cable by providing national cable programming channels.

The networks are also barred by an FCC rule from operating two separate network programming services, like the former Red and Blue NBC networks.[58] This provision is outmoded in light of the many cable and DBS networks now in existence, with many more

---

[55] As noted, Senator Pressler's draft proposals as to these two restrictions were also blocked by the Democratic opposition, and thus are not reflected in S.652 as it goes to the floor.

[56] Second Report and Order, 23 FCC2d 816 (1970), recon. denied, 39 FCC2d 377 (1973); 47 C.F.R. 76.501(a)(1).

[57] Report and Order, 7 FCC Rcd 6156, 6168 (1992).

[58] See 47 C.F.R. 73.658(g).

in the offing. There is now some movement to eliminate the rule.[59]

III. Cable ownership restrictions.

Section 11(c)(2) of the 1992 Cable Act requires the FCC to place limits on the number of subscribers that one entity can reach, because of Congressional concern about the increasing horizontal concentration in cable. Congress found that this increase had the potential to create entry barriers for new programmers and to reduce the number of available media voices.[60]

Accordingly, the FCC in 1993 adopted a subscriber limit prohibiting any one entity from having an attributable interest in cable systems that in the aggregatge reach more than 30% of cable homes passed nationwide. In order to encourage diversity, it allowed the ownership of additional cable systems reaching up to 35% of homes passed, provided such additional systems are controlled by minorities.[61] It stated that it would review these limits every five years to determine whether they remain reasonable under prevailing market conditions.

A district court ruled that this subscriber limit provision

---

[59] See Broadcasting & Cable Mag., April 10, 1995, at 77.

[60] 1992 Cable Act, Sec. 2(a)(4).

[61] Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992: Horizontal and Vertical Ownership Limits, Second Report and Order, 8 FCC Rcd 8565 (1993).

of the 1992 Act is unconstitutional on its face.[62] The FCC stayed the effective date of its regulation until final resolution of the appeal of the district court's ruling. In my opinion, the district court's ruling is mistaken under settled First Amendment jurisprudence, and will be reversed. Senator Pressler's draft did not seek repeal of the national subscriber limitation.

Section 11 of the 1992 Act also required the FCC to deal with the issue of vertical integration -- common attributable ownership of both a cable system and program networks -- by prescribing reasonable limits on the number of channels on a cable system that can be occupied by a video programmer in which the cable operator has an attributable interest. Congress thus sought to reduce the ability of operators to favor their affiliated programming services.

In its <u>Second Report and Order</u>, <u>supra</u>, n.35, the FCC adopted rules permitting an operator to carry programming supplied by affiliated programmers on not than 40% of the system's activated channels. This 40% limitation struck an appropriate balance, the Commission stated, between increasing diversity through vertical integration and reducing the ability of such operators to unduly favor their affiliated programming. Again, the Commission allowed leeway (two addditional channels or an increase to 45%) to encourage the carriage of additional video programming if it

---

[62] <u>Daniels Cablevision, Inc.</u> v. <u>U.S.</u>, 835 F. Supp. 1, 10 (D.D.C. 1993), appeal pending before Court of Appeals for the District of Columbia Circuit, Case No. 93-5290.

is controlled by minorities.

Section 11 also required the FCC to determine whether cable and other multichannel distributors should be subject to limitations on the degree to which they could participate in video program production. The Commission noted the above provisions and also other requirements in Section 19 of the 1992 Cable Act, prohibiting a video programmer affiliated with a cable operator from discriminating against a multichannel video programming distributor and limiting the ability of programmers that are vertically integrated with cable operators to enter into exclusive licenses with cable operators. It found, on the basis of the provisions of Sections 11, 12, and 19, that there was no need to impose limits on participation in video programming production.[63]

Section 11 amends Section 613(a) to provide that a cable operator may not hold a license to offer MMDS (multichannel multipoint distribution service) or SMATV (satellite master antenna TV) service that is separate and apart from its franchised cable service in any portion of the franchise area served by the cable system. The FCC had adopted rules in 1991 barring local cross-ownership of cable and MMDS, and it simply amended those rules to more fully reflect the nuances of the 1992 Act.[64] The FCC adopted new rules implementing the cable/SMATV

---

[63] Id. at .

[64] 8 FCC Rcd at 6842.

cross-ownership provision[65] and revised the rule on January 30, 1995 to better reflect the legislative history.[66]

Views and predictions. Congress was dealing with a difficult issue in this area of vertical integration. Allowing vertical integration certainly has brought strong diversity benefits such as C-SPAN, The Discovery and Learning Channels, HBO, Showtime, etc. On the other hand, such vertical integration, combined with large Multiple System Owners (MSOs) holdings as in the case of TCI and Time-Warner, has clear drawbacks.

The FCC's 1990 Cable Report,[67] points up these drawbacks. For example, in 1985 NBC sought to enter the general cable news market as a competitor to CNN. When TCI, the largest cable operator, refused to let NBC compete with CNN, NBC was forced to develop CNBC, a consumer news and business channel. NBC did gain carriage, but as its chairman testified, " a number of large MSOs insisted as a condition of carriage that CNBC not become a general news service in direct competition with CNN, which is owned in part by TCI, Time Warner, Viacom, and other MSOs."[68]

In 1993, in the context of a retransmission consent situation, CBS tried to get MSO acceptance for a competing news

---

[65] Id. at 6846; 47 C.F.R. sec. 76.501(e)(2).

[66] Memorandum Opinion and Order, FCC 95-21, pars.15-32.

[67] FCC 90-276, at pars. 121-23.

[68] Id. at par. 120.

channel and ran into a stone wall. At a 1994 conference, Rupert Murdoch, chairman of the News Corporation (Fox), stated: "I would have like to start a news channel, but [TCI President John] Malone and [Time Warner Chairman] Gerald Levin would not give me the time of day."[69]

In my view, Congress struck a good balance. It permitted the vertical integration for the benifits to the consumer in substantially greater programming diversity, and at the same time, especially through the provision that makes the vertically integrated programming available to competitors like DBS and the telcos, took steps to alleviate the problems caused by vertical integration. For it is only strong competition to cable that will fully and effectively solve the horizontal/vertical problems such as the above example involving a competing 24-hours news channel.[70] This is clearly a First Amendment horror story: The

---

[69] Broadcasting & Cable Magazine, Jan. 17, 1994, at 8. A week later in another interview in the same magazine (Jan. 24, 1994, at 22), Murdoch stated:

> There are at least four companies, perhaps five, that would like to start a 24-hour news channel. The only one that's made a serious effort has been CNBC. It is now getting distribution, but it had to limit itself to business news. They were very limited, and still are. But so long as they can't be sure of distribution, they're never going to get the chief executives or the chairmen of these companies to take the risk and make that investment.

[70] In a September 1993 American Enterprise Institute Study, Vertical Integration in Cable Television, D.H. Waterman and Andrew A. Weiss conclude (at 94) that the "issue upon which policy makers must focus ...is not vertical integration but the sources of market power at the facilities level."

underlying premise of the amendment is that the American people receive information from sources as diverse as possible, yet the cable industry structure restricts the American people to a single 24-hour news channel. A pervasive telco broadband common carrier system, with a requirement to serve all comers indifferently, is much needed as a First Amendment safety valve as we enter the next century.

As an interim measure, Congress should make the commercial leased channel provision of Section 612 more effective. This provision, which requires the larger cable systems to set aside 10-15% of their channel capacity for commercial leasing, has so far been a failure because of its onerous conditons.[71] In the 1992 Act, Congress failed to eliminate the conditions and simply added a paragraph authorizing the FCC to determine the operator's maximum rates and to establish reasonable terms for leased use. Congress would have been better advised to delete the constraining conditions and require the cable operator to engage in last-offer arbitration if no agreement on terms is reached after a stated brief interval;[72] the programmer, after posting a bond, would then gain immediate access, which is essential for success.

In sum, competition in facilities will eventually solve the

---

[71] See D. Lampert, Cable Leased Access, The Annenberg Washington Program, 1991.

[72] In last-offer arbitration, the arbitrator chooses between the final offers of the two parties, forcing them to be realistic and thus closely simulating the market bargaining process.

problems in this area, and make unnecessary the 30% ownership limitation and leased access requirements. In the meantime, these provisions serve a useful purpose, and significantly, the Pressler draft does not seek their repeal.

That may be because as a practical matter, they do not interfere with the consolidation within the cable industry that is now occurring. The pattern that has emerged in the 90's is for the small cable companies to sell out to the larger ones like TCI and Time Warner. The reason for the sale is twofold: The industry faces increased competition, especially from telco entry, and second, the cable industry not only wants to meet the telco competition but to provide competition to the telcos in the delivery of voice and data. On both counts, considerable investment in facilities (e.g., fiber optics; opto-electronics) and geographic scope are needed. The smaller companies have difficulty raising the necessary investment funds or are reluctant "to bet the ranch on telephone."[73] They thus sell to the larger multiple system owners (MSOs).

Further, to compete with the telcos, the cable systems seek to "cluster" their holdings in the same geographic area "to approximate what the telephone companies already have."[74] The

---

[73] The Washington Post, Feb. 8, 1995, at C1-2 ("Time Warner to Buy Cablevision Industries").

[74] Id. (statement of Time Warner Cable official). The Time Warner Chairman stated that after all the deals are done, three-quarters of all its subscribers will be located in 33 large clusters of at least 100,000 subscribers each. The seller, Cablevisions Industries (CI), stated that it could never have

Federal Trade Commission raised questions about this regional concentration but then recognized the validity of such "clustering" if cable is to compete successfully with telco, and permitted the mergers to go forward without challenge.[75]

The merger/"clustering" pattern can readily be carried out within the FCC's 30% benchmark, and will run its course over the next few years.[76] It does raise concern among public interest advocates, especially if cable rate regulation is removed, as proposed in the Pressler draft.[77]

IV. Telco ownership limitations.

The restrictions here stem from two governmental actions -- the 1984 Cable Act provision barring the telcos from engaging in cable television operations in the same area as their telco service, and the provisions of the Modified Final Judgment (MFJ) that led to the divestiture of AT&T.

A. The 1984 Cable Act limitation.

In 1966, the FCC adopted rules barring telcos from engaging in cable television operations in their service areas and

---

achieved similar cluster on its own: "Convergence requires greater critical mass and tighter subscriber clusters to compete successfully than CI has on its own." Comms. Daily, Feb. 8, 1995, at 1.

[75] See Broadcasting & Cable Mag., November 28, 1995, at 36, 40 ("John Malone, State of the Art").

[76] Since January 1994, in at least 30 major deals, systems with 10.1 million subscribers changed hands in transactions valued at an estimated $19.8 billion, with TCI and Time-Warner the largest participants. Id. at 2.

[77] Post article, supra, at C2.

requiring divestiture of cable systems owned by telcos that were in conflict with the rule.[78] In 1984 Congress essentially codified the FCC rule in the Cable Act,[79] prohibiting telcos from providing video programming to subscribers in their service areas, except in specified circumstances (e.g., sparsely populated rural areas). The telco could build the system for lease back to the cable operation (as was done in Washington, D.C.). The telcos can also provide video dialtone (VDT) -- that is, a common carrier broadband gateway available to all comers.[80] The 1984 restriction bars the direct involvement of telcos in the selection and control of video programming over their facilities.

As a matter of policy, the FCC believes that the restriction should be lifted (id.), and is joined in that view by the Clinton Administration, including the Department of Justice and the Commerce Department.[81] Further, the telecom reform bills in the 103rd Congress also opted to remove the restriction, as S.652 in the 104th Congress.[82] As discussed below, however, legislation in this contentious area is never sure.

The telcos have sought relief in the courts, and in a series

---

[78] See General Tele. Co. v. U.S., 449 F.2d 846 (5th Cir. 1971).

[79] Section 613(b), 47 U.S.C. 553(b).

[80] Second Report and Order, 7 FCC Rcd 5781 (1992).

[81] See Chesapeake & Potomac Tel. Co. v. United States, 830 F. Supp. 909, 914, n.8.

[82] Sec. 203, S.652, 104 Cong., 1st Sess.

of decisions that commenced in 1993,[83] have successfully won every case on the merits. The courts have declared the provision violative of the First Amendment, largely on the ground that the statute fails to meet the constitutional requirement that it be narrowly tailored, since the complete ban on telco participation in the provision of video programming in their service areas is "an unnecessarily severe means of achieving the government's objectives."[84]

It is therefore certain that the telcos, in addition to VDT, will be allowed to provide video programming over their facilities, subject to conditions such as the use of a separate subsidiary.

This means that unless there is a drastic shift, government policy is aimed squarely at a two-wire world. For although the telco will be allowed to provide video programming, neither the telco nor the cable operator will be permitted to buy out the other in the same service area. Other than in rural areas,[85] both

---

[83] Chesapeake & Potomac Tel. Co. v. U.S., 830 F. Supp. 909 (E.D. Va. 1993) aff'd, 42 F.3d 181 (4th Cir. 1994); see, e.g., Ameritech Corp. v. United States, 867 F. Supp. 721 (N.D. Ill. 1994); BellSouth Corp. v. United States, 868 F. Supp. 1335 (N.D. Ala. 1994).

[84] U.S. West v. U.S., 855 F. Supp. 1184, 1193 (W.D. Wash. 1994), aff'd, No. 94-35775, D.C. No. CV-93-01523-BJR (9th Cir. December 30, 1994).

[85] Such areas are now defined as having 10,000 or less population. S.1822 in the last Congress would have raised that figure to 50,000, which would permit buy-outs in roughly half the cable communities in the country. See The New York Times, Feb. 2, 1995, at D19.

the Antitrust Division and the FCC would block such buy-outs because the clear governmental policy is to spur competition and thus break the two local bottlenecks -- the local loop of the local exchange carrier (LEC) and the coaxial drop of the cable industry. With buy-outs, the main competitor to the LEC and the cable system is removed.

The Senate bill, S.652, would repeal the present bar in Section 612(b) on telco's rendering cable television service in the same local area.[86] The Administration has expressed great concern about this repeal because it would result in "...the absence of a ban on mergers between or acquisition of cable TV providers and telcos in the same area."[87] While such a ban, with exceptions for rural areas or situations where the cable or telco is a failing operation, is clearly desirable, its absence is not fatal. In repealing the bar, Congress, for solid policy reasons and in recognition of the court cases, is simply permitting telco entry into cable television in the same area. It is not authorizing telco (or cable) buy-outs in flagrant derogation of competition and the antitrust laws. Stated differently, unless Congress affirmatively permits such acquisitions by exempting them from the application of antitrust law, the Department of Justice, as shown by the conditions it has insisted upon in

[86] Section 203, S.652.

[87] Telecommunications Report, April 10, 1995, at 1. This concern was expressed by Vice President Gore to Senator Pressler. Id.

permitting mergers to go forward, would move to bar these buy-outs.

However, it should be acknowledged that this competitive policy has been criticized as thwarting the goals of the National Information Infrastructure (NII). Thus, in their recent article,[88] several futurists, who have the ear of Speaker Gingrich, argue that "forcing a competition between the cable and phone industries" is wholly wrong, and that the Government should be promoting collaboration. John Malone, the TCI Chairman, has echoed this collaboration theme, in answering the question of "how many wires down the street?":[89]

> First of all, that depends on whether or not the over-building continues. If you are talking about fiber to the node and coaxes to the home, there is either going to be one, which will belong to cable, or there will be two, which will belong to cable and telephony. There is the possibility at some point there may be unity, i.e., you build one system and the two entities compete over that one. Because that would be very capital-efficient. It would really lower the breakeven point for both people. That is a possibility that has been talked about and I think will come into sharp focus when people see how capital-intensive this whole thing is and what kind of economic results you get.
>
> If it's just an overbuild it's going to have the same fate as all historic overbuilds did: twice the capital, half the revenue and double the operating expense. This is not a lush business; the results won't be there. I think in the smaller rural markets the model will be one wire, jointly owned with competition on that wire.

---

[88] E. Dyson, G. Gilder, G. Keyworth, and A. Toffler, Cyberspace and the American Dream: A Magna Carta for the Knowledge Age, in Future Insight, Aug. 1994, The Progressive and Freedom Foundation.

[89] Broadcasting & Cable Mag., Nov. 28, 1994, at 44.

But this suggestion has been made before -- namely, that just as the international carriers have long cooperated in building the trans-oceanic fiber optic cables, with each having an indefeasible right of use (IRU) and competing with one another, so also cable, telco, and perhaps the power companies could join to obtain economies of scale in the construction of the broadband highway into the home or local business, with each then competing over that single wire. It would appear that no industry is really interested in advancing this notion; rather, each seeks to get there "fustest" with the broadband wire and associated equipment, software, and "killer applications."

In my view, there will be no Congressional provision authorizing general in-region buy-outs by exempting them from application of antitrust law. The only possible relief will be to raise the rural exemption for such buy-outs to communities with less than 50,000 population (instead of the present 10,000 figure).

The long term future of this governmental two-wire policy depends on technological and market developments that cannot now be predicted. Thus, Dr. Robert Crandall, after setting out four alternative scenarios for the development of new broadband networks, concludes:[90]

> This futuristic exercise simply confirms that all forecasts about the future structure of the tele-

---

[90] R.W. Crandall, The Economic Impetus for Convergence in Telecommunications, in Crossroads on the Information Highway, Institute for Information Studies, 1995, at 15.

> communications infrastructure are extremely risky. Economists cannot predict the future very well when technology is changing slowly; interposing the rapid technical change currently gripping the telecommunications sector makes any predictive exercise impossible.

One possible scenario, at least during the early stages of of the two-wire regime, is that the telco and cable television reach a kind of equilibrium with respect to their competition with each other. Each has its own solid base of operation, and can therefore afford to enter the other's field to gain some market share (this would favor cable as 10 or 20% of $100 billion market is much better than a similar share of a $23 billion market). Duopolies are not noted for fierce price wars and seem to engage more in marketing strategies. Of course, the duopoly might face growing competition from DBS and other wireless broadband operations.

B. The MFJ.

The 1982 MFJ imposed three restrictions on the divested Regional Bell Operating Companies (RBOCs): they could not engage in manufacturing of telecom equipment; in interexchange (IX) long distance service; or in information services. The latter restriction was removed as a result of judicial actions, chiefly at the appellate level.[91] The Senate bill, S. 652, provides that the manufacturing restriction would be lifted, at the time when

---

[91] U.S. v. Western Electric Co., 993 F.2d 1572 (D.C. Cir. 1993).

the RBOC is permitted to engage in IX operations.[92]

The most contentious issue involves relief as to the IX restriction. The legislation would afford such relief as part of a letting in-letting out process, that is, competition to the RBOCs (indeed all LECs) would be enabled and facilitated through a series of conditions that would have to be met on a specified time schedule, and the RBOCs would then be allowed fully to enter the IX field. The new Congress has indicated that it will probably follow the same path, with the addition, at least based on the Senate bill, S.652,[93] that the letting in process will have a definite time-table ending in roughly two years (and this in turn should affect the time table for the letting-out process).[94] The IX carriers strongly oppose this approach, and argue that the RBOCs should have to demonstrate the existence of significant local competition before such relief is granted. While the aim is to pass the telecom reform legislation in the summer or fall of 1995, it is not clear whether the breakthrough will occur in light of the strong opposition. If legislation is not passed in 1995, passage in 1996, an election year, is dubious.

V. Foreign ownership restrictions.

Since the Radio Act of 1927, there has been an ownership restriction limiting aliens to no more than 20% ownership of

---

[92] S. 652, Sec. 222.

[93] S. 652, Sec. 221.

[94] See S. 652, Sec. 221.

radio licenses. The 20% alien ownership benchmark was continued in Section 310(b) of the Communications Act of 1934. The provision was fashioned at the behest of the military in order to curb alien activities against the nation in light of possible hostilities. There is a provision in Section 310(b)(4) permitting an alien holding company to own more than 25% of a radio licensee, if the FCC does not find that such a holding is inconsistent with the public interest.

This latter provision has never been explicitly utilized in fields like broadcasting.[95] In my view, the FCC should have responded to the great changes, especially in the global communications market, by adopting a new policy, namely, that the Commission would allow alien ownership under Section 310(b)(4) provided that the foreign country involved afforded comparable reciprocity to our U.S. entities. Such reciprocity has been required in allowing holdings meeting the 20% benchmark, such as in the case of British Telecom and MCI.

---

[95] There is now an extraordinary controversy pending at the FCC involving this section and the acquisition by the Australian News Corporation in 1985 of the Metromedia stations (now the Fox Network). There is no question but that the News Corporation, which also supplied all the money for the acquisition, has de jure control of the Fox stations. Fox argues that Rupert Murdoch, who became an American citizen at that time, has de facto control, and that this consideration, plus the public interest in promoting a fourth network, established the necessary public interest basis for permitting the acquisition under 310(b)(4). But while the FCC did approve the transfer, it never made any finding that it was acting under the public interest standard of 310(b)(4). There was then no precedent for such an action, and it is not clear today whether the Fox transfer constitutes such a precedent. The FCC investigation is not yet concluded, so no conclusion can be drawn at this time.

On February 7, 1995, the FCC did propose new rules to govern cases such as the pending application of Sprint to sell a 20% ($4.2 billion) stake in its company to France Telecom and Deutsche Telekom. The FCC asked whether, when deciding under Section 310(b)(4) if the public interest justifies an indirect foreign ownership in excess of the 25% benchmark, it should consider the availability in the foreign applicant's markets of effective opportunities for U.S. entities to provide the same or similar communications services sought to be provided by the foreign applicant.[96] The Commission also asked for comment on other factors, such as the openess of the country's other communications markets, that it should consider in its Section 310(b)(4) public interest analysis. And it specifically noted that it traditionally has a heightened concern for foreign influence over or control of broadcast licensees.

The Senate bill, S. 652, provides in Section 106 that in the common carrier field, the restrictions in Section 310(b) would not apply if the FCC determines that the foreign country provides "equivalent market opportunities" to U.S. companies; if reciprocity in the foreign market failed to materialize, there would be a "snapback" procedure calling for termination of the U.S. license. Questions have raised as to this recission (which might really deter foreign investment).[97]

---

[96] Public Notice Report No. DC-95-27, released Feb. 7, 1995, proposing news rules in IB Docket No. 95-22.

[97] See Telecommunications Reports, Feb. 6, 1995, at 26-27.

On the House side, the telecom subcommittee Vice Chairman Oxley has introduced a bill to repeal 310(b), and the Chairman Jack Fields has indicated that revision of the section will be included in the House legislation. Id. It is clear, therefore, that there is a good chance for very substantial reform of Section 310(b). As stated, I believe that such reform is sound and long overdue, and indeed, would extend it to the broadcast area.

Conclusion

Because of the extraordinarily dynamic technology and the market responding to the technology, government policy, especially as to ownership restrictions, must be in flux, subject to adjustment to meet the changed market conditions. See, e.g., the Crandall article, n.54. The convergence of industries in this digital information age will continue, and with that, there will be the merger proposals, some with enormous scope such as the failed Bell Atlantic-TCI merger, some more modest like the U.S. West-Time Warner consortium. In addition to the merger option, the present uncertainties lead to many strategic alliances or joint ventures involving multimedia companies, chiefly to share financial risk, gain implementing know-how or technology, or enhance opportunities for faster or more assured entry to new markets. The joint ventures between the telcos and the film producers fall in the latter category. The list of mergers, alliances, and joint ventures stemming from this

convergence pattern is large and grows larger each month.[98]

Government policy is based on fostering open entry and all-out competition, and certainly recognizes the value of alliances,[99] joint ventures, or mergers in well positioning U.S. companies in this era of global competition. But clearly antitrust standards must be met, and there can be anticompetitive detriments, some large enough to block the merger or combination. Generally, however, the pattern that has emerged is for Justice (or the FTC) to allow the combination to go forward because of the overall greater competitive thrust it provides, but with conditions to ameliorate any detriments (such as divestiture of one of the partner's holdings in the same region as the other partner).[100] In the communications field, FCC competitive and diversity policies, the latter especially at the local level, are pertinent and will continue to be applied.

The foregoing discussion has focussed on policies in this area for the next five to ten years. At some point early in the next century, all these policies will, of course, require drastic

---

[98] For a recent partial list, see Richard P. Adler, op. cited n.54, at xiii-xiv.

[99] Indeed, the FCC, through pushing the process, did much to foster a "grand alliance" among the contestants to establish an HDTV (advanced digital television) standard. See The New York Times, Jan. 22, 1995, Sec.3, 1,6 ("The Fight for Digital TV's Future).

[100] See, e.g., Telecommunications Reports, Oct. 31, 1994, 36; Jul. 18, 1994, 18; May 2, 1994, 22.

revision or repeal in light of the digital revolution.[101] With the inevitable digital revolution and its convergence of media ("bits are bits"), there will be no way to distinguish between the media.[102] A newspaper, a broadcast station, or a cable programmer will all be engaged in electronic publishing. But the transition period to that digital future must reflect sound multiple ownership policies.

---

[101] As Moore's Law continues to operate (the number of transistors on a chip doubling every 18 months), the computer (or telecomputer) will become the dominant means of receiving all information, including video. N. Negroponte, BEING DIGITAL, Knopf, New York (1995), at 37-57. We will then have the great convergence of previously separate industries. See CROSSROADS ON THE INFORMATION HIGHWAY, Institute for Information Studies, 1995.

[102] See Negroponte, op. cited n.98, at 54-58.