Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Amendment of Section 73.658(g) of	)	
The Commission's Rules – The Dual Network	)	MM Docket No. 00-108
Rule.	)	
	)	
	)	
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REPORT AND ORDER

Adopted: April 19, 2001 **Released:** May 15, 2001

By the Commission: Chairman Powell and Commissioner Ness issuing separate statements; Commissioner Tristani dissenting and issuing a separate statement.

I. INTRODUCTION

1. In this Report and Order we amend Section 73.658(g) of our Rules, the "dual network" rule, to permit one of the four major television networks – ABC, CBS, Fox and NBC - to own, operate, maintain or control the UPN and/or the WB television network.[1] By this action, we recognize that the economics of the broadcast television network industry have changed to the point that retention of the rule in its current form is no longer in the public interest.

II. BACKGROUND

2. The dual network rule goes back some sixty years. The Commission first adopted a dual network rule in 1941, following its investigation of "chain" broadcasting.[2] The rule adopted then mandated a flat prohibition on an entity maintaining more than a single radio network. As we noted in the Notice of Proposed Rule Making in this proceeding,[3] when the Commission extended the rule to television networks in 1946,[4] it determined that permitting an entity to operate more than one network might preclude new networks from developing and affiliating with desirable stations. These stations might already be tied up by the more powerful network entity and might provide the commonly owned networks with too much

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[1] The rule already permits any of the four major television networks to own any television network created subsequent to the date that the Telecommunications Act of 1996 (Pub. L. No. 104-104, 110 Stat. 56 (1996))("1996 Act") was enacted. It was signed into law on February 8, 1996.

[2] 6 FR at 2282 (Tuesday, May 6, 1941).

[3] Notice of Proposed Rule Making in MM Docket No. 00-108, 15 FCC Rcd 11253(2000)("Notice").

[4] Amendment of Part 3 of the Commission's Rules, 11 FR 33 (Jan. 1, 1946).

market power.[5]

3. Section 73.658(g) sets forth the Commission's current version of the dual network rule. It reflects the provisions of Section 202(e) of the 1996 Act. That section directed the Commission to modify its dual network rule to prohibit a television station from affiliating with any entity that owns more than one of the four major networks (ABC, CBS, Fox, or NBC) or one of the four major networks and an emerging English-language network which, on the date of the 1996 Act's enactment, "provides 4 or more hours of programming per week on a national basis pursuant to network affiliation arrangements with local television broadcast stations in markets reaching more than 75 percent of television homes…." The legislative history of this provision indicated that it was intended to apply to only the UPN and WB television networks.[6] Moreover, these two networks were the only two entities other than the four major networks that met this definition of a network on the relevant date.[7]

4. The current dual network rule differs markedly from the dual network rule that existed from 1946 to 1996. The earlier rule prohibited a broadcast station from affiliating with a network organization that maintained more than one broadcast network. As such, the old rule effectively prevented network organizations from creating a new broadcast network or merging with an existing broadcast network. In contrast, the current dual network rule permits a broadcast station to affiliate with a network organization that maintains more than one broadcast network. Such affiliation is prohibited, however, if the multiple network combination is created by a merger among ABC, CBS, Fox, or NBC, or a merger between one of these four networks and UPN or WB.[8] While the current rule gives all network organizations the opportunity to pursue any economic efficiencies that may arise from the maintenance of multiple broadcast networks, it restricts the manner in which specific network organizations become

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[5] Notice, supra at 11254. We further noted that the dual network rule did not apply if the networks were not operated simultaneously or if there was no substantial overlap in the territories served by each network. The rule was directed at NBC, the only company then with two radio networks. The Commission found that operation of the "Red" and "Blue" networks gave NBC excessive control over its affiliates because their contracts did not specify whether a station was part of the "Red" or "Blue" Network. Further, the Commission concluded that operation of two networks gave NBC an unfair competitive advantage over other networks and protected it against future competition. Commission Order No. 37, Report on Chain Broadcasting at 70-73. The Commission indefinitely suspended the rule in 1941 noting that voluntary separation of the Red and Blue networks would soon occur. FCC, Supplemental Report on Chain Broadcasting 14 (1941). After NBC sold its Blue network in 1943, the prohibition was readopted. 8 Fed. Reg. 16,005 (1943).

[6] S. Rep. No. 230, 104th Cong., 2d Sess. At 163.

[7] Both UPN and WB argue that they did not meet the legislative definition of a network for these purposes. We rejected UPN's argument in this regard in considering the Viacom/CBS merger. See Memorandum Opinion and Order, Applications of Shareholders of CBS Corporation and Viacom, Inc., 15 FCC Rcd 8230, 8233 (2000). We need not reach the merits of The WB Network's argument in this regard given our resolution herein, which renders its argument moot.

[8] Under the current rule, all existing network organizations, and all new network organizations, may create and maintain multiple broadcast networks. There are no limits on the number of broadcast networks that may be maintained by a network organization, or the number of television stations that may affiliate with a network organization. As such, it is theoretically possible for a network organization with sufficient programming to enter into affiliation agreements with every broadcast television station, in every market, and supply all of their programming. The opportunity to create and maintain multiple broadcast networks places broadcast networks on more equal footing with cable, satellite and other multichannel video programming distributors.

multiple broadcast networks. The current rule facilitates the maintenance of multiple broadcast networks created through internal growth and new entry.[9] In addition, the current rule facilitates the creation of multiple broadcast networks by permitting (1) mergers between a broadcast network created before the 1996 Act (i.e., ABC, CBS, FOX, NBC, UPN, and WB) and broadcast networks created subsequent to the 1996 Act (e.g., PAXtv); (2) mergers between broadcast networks created subsequent to the 1996 Act; and (3) a merger between UPN and WB.

5. Section 202(h) of the 1996 Act also requires the Commission to review its broadcast ownership rules, including rules such as the instant rule that were amended pursuant to Section 202, every two years beginning in 1998 and to "repeal or modify any regulation it determines to be no longer in the public interest." In our first biennial review proceeding we examined, among other broadcast ownership rules, the dual network rule.[10] Section 202(h) requires us to determine whether any of these rules remained "necessary in the public interest as the result of competition."[11] As a result of our analysis according to that standard we tentatively determined that the component of the dual network rule that currently prevents the UPN or WB networks from being owned by one of the four major networks may no longer be necessary in the public interest as a result of competition

6. In the Biennial Review Report, we stated that both UPN and WB are "nascent subsidiaries" of "large, well-established program producers." Thus, the merger of one of the four major networks with UPN or WB would yield economic efficiencies resulting from vertical integration. Allowing a merger between one of the four major networks and UPN or WB, we stated, "may permit realization of substantial economic efficiencies without undue harm to our diversity and competition goals."[12]

7. As a result of the findings made in the Biennial Review Report, we issued the Notice of Proposed Rule Making initiating the instant proceeding.[13] In the Notice, we analyzed the dual network rule pursuant to a framework that involved concepts developed in the transaction cost economics ("TCE") literature. From a TCE perspective, the economic organization of firms and industries reflects specific attributes of the contracting process between buyer and seller. We stated that application of TCE concepts suggests that vertical integration between program suppliers and major networks may produce substantial economic efficiencies that might benefit both advertisers and viewers. We also stated that horizontal mergers between a major network and an emerging network may produce efficiencies that might benefit both advertisers and viewers. Moreover, we found that there should be little or no adverse effect on the price for network advertising as the result of such a merger. Therefore, we proposed to eliminate the major

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[9] A broadcast network may develop multiple broadcast networks by creating new broadcast networks from scratch, or acquiring video networks from nonbroadcast media (e.g., cable or satellite) and moving them to broadcast.

[10] Notice of Inquiry in MM Docket No. 98-35, 13 FCC Rcd 11276 (1998); Biennial Review Report in MM Docket No. 98-35, 15 FCC Rcd 11058 (2000)("Biennial Review Report").

[11] The Section 202(h) analysis of broadcast ownership rules is a part of the Commission review required pursuant to Section 11 of the Communications Act of 1934, as amended. That section requires biennial reviews to "determine whether any such regulation is no longer necessary in the public interest as a result of meaningful economic competition. 47 U.S.C. § 161.

[12] Id. (footnote omitted).

[13] Notice, supra.

network/emerging network merger prohibition from our dual network rule.

III. DISCUSSION

8. In this Report and Order, we consider our proposal to relax the dual network rule by eliminating the restriction on mergers between the top 4 broadcast networks and UPN or WB. Our focus, pursuant to section 202(h), is whether this aspect of the rule remains "necessary in the public interest as the result of competition." Accordingly, we first identify several competitive changes and trends in the video services market that we consider relevant to the continued necessity for the rule. We then apply the framework, developed in the Notice, for analyzing both the vertical and horizontal competitive impacts of the potential combinations that are currently prohibited by the rule. After addressing the impact of the rule on competition, we turn to the impacts of maintaining or changing the rule on diversity, the other primary public interest concern.[14] Weighing these factors, we decide, as proposed in the Notice, to eliminate that portion of the rule that effectively prohibits mergers between UPN or WB and one of the four major networks. We conclude that this change will not harm, and indeed is likely to promote, both competitive efficiency and diversity. Although some commenters also urged us to go beyond the tentative conclusions of the Biennial Review Report and the Notice and to eliminate the dual network rule in its entirety, we note that the questions presented in the Notice related solely to the emerging networks portion of the rule. We therefore decline to eliminate the dual network rule in its entirety at this time, finding that more information and analysis would be necessary to address the more complex issues that action would involve.

A. Marketplace Developments

9. Since the enactment of the 1996 Act, significant changes have occurred to the competitive environment in which networks, including emerging networks, operate. These changes, which have occurred both within the television broadcast industry and throughout the multichannel video programming distribution (“MVPD”) industry, have substantial implications for both the competition and diversity concerns that underpin the dual network rule. We will first detail some of these developments and then turn to an analysis of the components of the rule in light of these changes.

10. Within the broadcast industry, the number of commercial and noncommercial television stations has increased from 1550 in August 1996 to 1663 as of September 2000.[15] This represents an increase of over 7% in 4 years. During roughly the same time, prime time viewership among the top six broadcast networks declined from 71% in 1996 to 58% in 2000.[16] Thus, within the last 4 years, there has been both a small but significant increase in the number of television broadcast outlets available to viewers (and potentially to new broadcast networks such as PAXtv) and a substantial decrease in the dominance of broadcast networks in terms of viewership.

11. Accompanying, and largely causing, the reduction in broadcast network viewership during

[14] Notice of Proposed Rule Making, In the Matter of Review of the Commission’s Regulations Governing Programming Practices of Broadcast Television Networks and Affiliates, 10 FCC Rcd 11951, 11967 (1995). (Diversity was one of the goals of the dual network rule.)

[15] See Third Annual Report on Competition in Video Markets, 12 FCC Rcd 4358, 4407 (1997) (“Third Cable Report”); Seventh Annual Report on Competition in Video Markets, CS Docket No. 00-132, FCC 01-1, at ¶ 98 (adopted Jan. 2, 2001) (“Seventh Cable Report”).

[16] See Third Cable Report, 12 FCC Rcd at 4407; Seventh Cable Report at ¶ 99.

the last 4 years has been the steady expansion of the cable industry. At the end of 1995, the cable industry had a penetration rate of 67.8% of homes passed.[17] By 2000, the penetration rate had grown slightly to 69.7%.[18] While this represents only an incremental increase in penetration, the increase is significant when viewed in connection with the increase in channel capacity on cable networks. As of October 1995, 15.6% of cable systems offered 54 or more channels of video programming, and 63.8% of cable systems offered between 30 and 53 channels, indicating that 79.4% of systems provided 30 or more channels of programming.[19] In 2000, the number of high capacity cable systems was significantly higher. By 2000, 24.2% of cable systems offered 54 or more channels of programming.[20] With the percentage of cable systems offering 30-53 channels virtually unchanged since 1996, the increase in high capacity cable systems means that in 2000 86.6% of cable systems offered 30 or more channels of programming to subscribers. We anticipate that channel capacity on cable systems will continue to expand as more cable systems adopt digital technology.

12. Because each additional channel of capacity on a cable system represents a distinct avenue that may be used to deliver video programming, the increase in channel capacity provides video programming producers a greater opportunity to distribute their programming to consumers. Many cable networks have been formed to take advantage of this opportunity, and, as a whole, they appear to have been successful in capturing a significant portion of viewers over the last 4 years. In 1996, there were 162 cable programming services;[21] by 2000, the number had increased to 214.[22] In 1996, cable networks had a 30% full-day audience share;[23] in 2000, cable networks' share was 45.5%.[24] As channel capacity grows, we expect that new cable networks will be formed and the reach of existing cable networks will be extended.

13. Perhaps the most significant competitive change over the last 4 years has been the rapid growth of the Direct Broadcast Satellite ("DBS") industry. When the 1996 Act was enacted, DBS service had been available to consumers for less than 2 years. Although the DBS industry had garnered 3.82 million subscribers by October 1996,[25] this represented only 5% of MVPD subscribers,[26] and many of these subscribers were located in rural areas not served by cable.[27] DBS also suffered from certain competitive disadvantages, such as the inability to offer subscribers access to local broadcast signals via

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[17] Seventh Cable Report, at Table B-1.

[18] Id. at ¶ 19.

[19] Third Cable Report, 12 FCC Rcd at 4467.

[20] Seventh Cable Report at ¶ 20, Table B-3.

[21] Fourth Annual Report on Competition in Video Markets, 13 FCC Rcd 1034, 1178 (1998)

[22] Seventh Cable Report at Table B-5.

[23] Third Cable Report, 12 FCC Rcd at 4369.

[24] Seventh Cable Report at ¶ 22.

[25] Third Cable Report, 12 FCC Rcd at 4377.

[26] Id. at 4495.

[27] Sixth Annual Report on Competition in Video Markets, 15 FCC Rcd 978, 1016 (2000).

the satellite signal.[28] Over the last 4 years, the industry has significantly matured. By 2000, the DBS industry had almost 13 million subscribers, representing more than 15% of MVPD households.[29] Moreover, bolstered in part by the new statutory right to provide "local-into-local" broadcast service,[30] DBS has grown from a predominantly rural service to a viable alternative to cable in all parts of the country.[31]

14. The growth of the DBS industry since 1996 significantly affects the opportunities available to network programming producers and consumers. Currently, the two operating DBS providers, DirecTV and EchoStar, each offer subscribers access to hundreds of channels of video programming. As with a cable channel, each DBS channel provides an independent avenue through which producers of video programming can distribute, and viewers may access, video programming. Although a certain number of DBS channels are used to provide the same network programming found on cable channels, a DBS operator could choose, except where must carry obligations are involved, to provide regional or local programming in response to market demand. [32]

B. Competition

15. Mergers Between A Major Network and UPN or WB. The developments in the broadcast, cable, and DBS industry have had a significant effect on the competitive landscape in which broadcast networks operate.[33] Where almost 84 percent of households subscribe to an MVPD service,[34] and as television broadcast stations and MVPDs, because of the increase in the number of available channels, seek a greater number of attractive programs to offer their viewers, new opportunities are created for producers to obtain distribution channels. Moreover, non-broadcast networks, whose niche programming can provide advertisers with more focused demographics, may continue to erode the audience share of broadcast networks and compete for advertising revenue, especially with the emerging networks. While we cannot

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[28] See, e.g., Third Cable Report, 12 FCC Rcd at 4384.

[29] Seventh Cable Report at ¶ 61.

[30] Satellite Home Viewer Improvement Act of 1999, Pub. L. No. 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545.

[31] Id. at ¶¶ 66, 68.

[32] We expect that the ability and incentive of DBS providers to carry regional or local programming will be enhanced as these providers develop spot beam technology, which permits DBS satellites to deliver programming to a discrete geographical location and has the potential to increase satellite system channel capacity through the re-use of transponders. Implementation of the Satellite Home Viewer Act of 1999: Broadcast Signal Carriage Issues, CS Docket No. 99-363, FCC 00-417, at para. 42 (rel. Nov. 30, 2000). When fully implemented, spot beam technology has the potential to provide regional and local program producers greater access to DBS as an alternative distribution medium.

[33] Viacom urges us to consider the development of Internet video in our analysis of the competitive landscape affecting broadcast networks. Viacom Comments at 15. Given the nascent stage of the Internet video industry, we believe it is premature to give decisional significance to Internet video at this juncture. Similarly, while the transition to digital television ("DTV") promises to unleash new competitive video channels in the market, it is too early to predict how the DTV industry will develop.

[34] Seventh Cable Report at Table C-1.

definitively predict how these competitive forces will play out, we believe that competitive developments since the enactment of the 1996 Act have diminished the importance of obtaining broadcast affiliates to establish a successful video programming network.[35] We believe that these developments require us to consider whether the dual network rule should be modified.

16. As discussed above, markets for video services have broadened and grown, reflecting shifts in market demand and supply in recent years. Competitive rivalry between and among suppliers of video services has intensified as consumers find increased choice of video programming and new vendors that supply video programming and video delivery services. Increased competitive rivalry intensifies the pressure on management to (1) improve internal operating efficiency by using inputs of production more effectively and organizing the firm to reduce redundancy in staffing or business functions;[36] and (2) reorganize the firm through horizontal and vertical mergers to achieve economies of scale and scope. We focus here on the effect our rules may have on the networks' ability to achieve economic efficiencies through vertical and horizontal integration. As explained in the Notice, TCE provides a conceptual framework for assessing possible gains and losses in organizational efficiency that may result from the intensified pressure on firm management to improve operating efficiency induced by the greater competitive rivalry confronting the firm.[37]

17. In the Notice, the Commission noted that the commercial television broadcast network industry today consists of a number of vertically-integrated firms.[38] For example, ABC (a broadcast network) is vertically integrated with Disney (a program supplier), Fox (a broadcast network) is vertically integrated with 20th Century Fox (a program supplier), UPN (a broadcast network) is vertically integrated with Viacom (a program supplier), and WB (a broadcast network) is vertically integrated with AOL Time Warner (a program supplier). In addition to these well-know examples, NBC produces programs through NBC Studios and CBS produces programs through CBS Enterprises (formerly Eyemark Entertainment and King World Productions). Because mergers between broadcast networks may involve mergers between vertically-integrated firms, the Commission examined and sought comment on (1) the potential efficiencies of vertical integration between a program supplier and a broadcast network and (2) the effects of a

[35] We recognize that, even with the increase in the number of video programming distribution channels, other factors may cause programming production, programming distribution, and television advertising markets to become or remain concentrated. For the reasons provided in this order, we do not believe that the relief we grant to emerging networks today implicates those other factors. We decline to prejudge the competitive implications of any future review that we may undertake of the dual network rule or any other media ownership restriction.

[36] The formal economic analysis of the pressures brought on by intensified competitive rivalry to increase a company's internal efficiency is addressed in the theoretical and empirical literature on "X-efficiency." The seminal idea is provided by Harvey Leibenstein, "Allocative Efficiency vs. 'X-efficiency'," American Economic Review 56 (1966): 392-415. A useful survey of much of the literature is provided by Roger S. Frantz, X-Efficiency: Theory, Evidence and Applications, (Dordrecht: Kluwer, 1988).

[37] The elements of TCE are developed in Oliver E. Williamson, *The Economic Institutions of Capitalism* (New York: The Free Press, 1985) and Oliver E. Williamson, *The Mechanisms of Governance* (New York: Oxford University Press, 1996). A survey of recent neo-institutional economics, inclusive of TCE, is provided by Eirik G. Furubotn and Rudolf Richter, *Institutions and Economic Theory: The Contribution of the New Institutional Economics* (Ann Arbor, Michigan: University of Michigan Press, 1997).

[38] Notice, supra at 11255-56.

horizontal merger between two broadcast networks.[39]

18. Our analysis of the economic effects of the dual network rule decomposes a hypothetical merger between two vertically-integrated broadcast networks into two parts.[40] First, the relationship between a program supplier and a broadcast network is examined to determine whether vertical integration is either more or less efficient than simply negotiating an arms-length contractual relationship between the program supplier and the broadcast network. The comparative assessment of the efficiency of contracting versus vertical integration relies on TCE concepts. Second, the effects of a horizontal merger between two broadcast networks is assessed by relying on measures of market concentration and an analysis of price competition in the national market for network television advertising. Finally, the economic gains or losses resulting from the analysis of vertical integration are combined with the expected economic gains or losses resulting from the horizontal merger to determine the overall benefits and costs of a merger between two vertically-integrated firms.

19. As explained in the Notice,[41] our economic analysis focuses on the contemporary contracting environment between television networks and program producers. We have concluded that specific attributes of television network output and the complexities of contract negotiations between a television network and a program supplier tend to favor the replacement of market contracting with a vertical organizational relationship between the network and the program supplier. Applying TCE concepts, we further conclude that this substitution of vertical integration for a contractual relationship is most likely an economically-efficient response to the hazards of market contracting rather than the exercise of market power by the television network. Thus, the vertical integration of program suppliers and television networks (1) reflects competitive pressures induced by more intense competition for viewers that now enjoy greatly expanded video programming choices compared to a decade ago; and (2) minimizes transaction costs by eliminating the costly adverse effects of negotiating contractual relationships between the programmers and the networks. We conclude that the merger of a program supplier with a broadcast network would result in transaction efficiencies compared to a contractual relationship between the network

[39] Id. at 11255-11265.

[40] The merger of two vertically-integrated enterprises may have both horizontal and vertical economic effects. Horizontal effects refer to the economies or diseconomies resulting from enlarging the *size* of the firm post-merger and include effects on consumers, such as higher or lower prices and changes in the quantity and quality of output produced. These effects can be assessed at each stage of production of the vertically-integrated firm. For a television network vertically-integrated into the production of network programming, the assessment of horizontal effects would include assessing the economies or diseconomies of increasing the size of the network and the economies or diseconomies of increasing the size and scale of program production, assuming that the network that is being acquired is also vertically-integrated into program production. The effects of the merger of two program production enterprises on competition in the network television program production market would also be included in the analysis of horizontal effects. Growth in the size of the vertically-integrated firm post-merger may either accentuate the economies of vertical integration post-merger or diminish the efficiencies of vertical integration as organizational complexity increases and coordination of decisionmaking within the larger firm becomes more difficult and costly. In the current context, vertical effects refer to the economies or diseconomies of integrated production as the size of the vertically-integrated firm increases. The analytical framework suggests a way to assess the relative significance of some of these horizontal and vertical effects that may result from the merger of two television networks that are both vertically integrated into the production of network television programming.

[41] Notice, supra at 11255-63.

and the program supplier.[42] Given the growing competition for viewers of video programming, we anticipate that the efficiencies of vertical integration between the programming assets of an emerging network and a major network could accrue to the benefit of consumers.

20. We also explained in the Notice how our analytical framework allows us to assess the horizontal effects of the merger of an emerging network with a major network[43] on the national market for network advertising.[44] We explained that within the national television advertising market, which includes national spot sales by affiliated and independent stations, a *strategic group* consisting of the major networks, i.e., ABC, NBC, CBS, and Fox, can be identified.[45] At present, the network firms comprising

[42] Viacom was the only commenter to address specifically the potential efficiencies associated with vertical integration, and Viacom's pleadings support the Commission's findings. Comments of Viacom at 10 – 11 and Declaration of Robert W. Crandall at 14 – 15. The Declaration was submitted by Viacom and is attached to Comments of Viacom.

[43] Notice, supra at 11261-62.

[44] The Commission has historically viewed the economic performance of national and local markets for radio and television advertising as pertinent to fulfilling its statutory mandate ". . . to make available, so far as possible, to all the people of the United States. . . a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . ." Unlike telephone or cable television services, over-the-air commercial television service is made available to consumers at no charge; the full cost of supplying over-the-air commercial television service to consumers is borne by advertisers that gain access to, and attention from, television viewers in order to promote the sale of consumer products and services. In effect, advertisers become the "agent" of consumers in deciding what programs that television broadcasters actually supply to consumers. In general, advertisers wish to sponsor programming that maximizes the advertiser's target audience. Other things remaining the same, vigorous competition among broadcast networks to attract advertisers is likely to benefit consumers by making available television programming that meets the programming preferences of consumers. As a result, the Commission has historically viewed vigorous competition in broadcast advertising markets as furthering the welfare of viewers and the goal of efficient and ubiquitous communications services. For examples of the Commission's interest in the performance of broadcast advertising markets, *see* generally, Gen. Docket No. 83-1009, 100 FCC 2d 17; Memorandum Opinion and Order in Docket No. 91-140, 7 FCC Rcd 6387; Report and Order in MM Docket No. 91-221, 14 FCC Rcd 12903; and Notice of Proposed Rulemaking in MM Docket No. 95-90, 10 FCC Rcd 11853. Whether, in a market where the significant majority of Americans subscribe to a video service provider, the linkages between advertising and broadcast television will remain a vital concern is a question the Commission may review in future proceedings.

[45] A strategic group refers to a cluster of independent firms within an industry that pursue similar business strategies. For example, the major networks supply programming to their affiliated local stations that is intended to attract mass audiences and advertisers that want to reach such large, nationwide audiences. By contrast, the emerging networks target more specialized, niche audiences similar to cable television networks. The conceptual basis for a strategic group is developed in R. E. Caves and M. E. Porter, "From Entry Barriers to Mobility Barriers: Conjectural Decisions and Contrived Deterrence to New Competition," *Quarterly Journal of Economics* 91 (May 1977): 241-261. Also see Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competition* (New York: The Free Press, 1980), Chapter 7. For additional references on the application of the strategic group concept, see F. M. Scherer and David Ross, *Industrial Market Structure and Economic Performance,* 3rd ed. (Boston: Houghton Mifflin, 1990), pp. 284-85. When properly applied, the concept of a strategic group ordinarily implies that only a relatively few firms will be included within its boundaries so that competitive rivalry will be oligopolistic in nature, although the number of firms actually populating the industry aggregated over all strategic groups may be quite numerous.

this strategic group provide the greatest reach of any medium of mass communications.[46] Since delivering a mass audience is becoming more difficult for all media with the proliferation of media outlets, media that can still produce mass audiences have become more valuable. As a result, notwithstanding some recent erosion in revenue growth, broadcast networks have achieved substantial gains in revenues in recent years despite their loss of audience relative to years past. The major mobility barrier impeding entry into the major network strategic group is the availability of affiliated stations.[47] Notwithstanding some growth in the number of stations over the last decade, obtaining sufficient affiliated stations remains a major obstacle to developing a new broadcast network that can achieve sufficient national reach to be attractive to national advertisers seeking to reach a mass audience.

21. With respect to our analysis of the potential benefits of vertical integration of a program producer and a television network, Viacom was the only commenter to specifically address the potential efficiencies associated with vertical integration, and Viacom's pleadings support the Commission's findings.[48] With respect to our analysis of the effects of horizontal integration of an emerging network with a major network, no commenter disagrees with our finding that a horizontal merger between a major network and an emerging network (e.g., UPN or WB) would generate net economic benefits.[49] With respect to efficiencies associated with horizontal mergers between broadcast networks, Viacom states that "[d]eveloping expertise in program selection and in program and advertising brokerage is likely to require substantial fixed costs that could be exploited more economically across a larger number of program hours than are available to a single national network."[50] Viacom explains that operating a single network requires a large number of people with knowledge of current entertainment trends, program procurement, execution of contracts, affiliate relations, advertising markets, and technology. According to Viacom, a substantial

[46] Major broadcast networks (i.e., ABC, CBS, NBC, and FOX) attract much larger audiences than emerging broadcast networks (i.e., PAXtv, UPN, and WB). The differences are apparent in the season-to-date average prime time ratings for broadcast networks. While the average prime time rating for ABC, CBS, NBC, and FOX is 8.7, 8.6, 8.1, and 6.3 percent of TV households, respectively, the average prime time rating for PAXtv, UPN, and WB is 0.9, 2.5, and 2.6 percent of TV households, respectively. Source: Nielsen Media Research, reported in Broadcasting & Cable, April 2, 2001. Relative to emerging networks and cable networks, the ability of major broadcast networks to attract large audiences is also apparent in the number of prime time programs viewed by more than ten million TV households. During the week of January 29 – February 4, 2001, the major networks aired 25 programs that attracted more than 10 million TV households. In contrast, PAXtv's most watched program attracted 1.6 million TV households, UPN's most watched program attracted 4.0 million TV households, WB's most watched program attracted 5.5 million TV households, and the most watched program on a cable network attracted 4.9 million TV households. Source: Nielsen Media Research, reported in Broadcasting & Cable, February 12, 2001.

[47] Mobility barriers are barriers to entry that deter the movement of a firm *within* a given industry from shifting from one strategic group to another. Different strategic groups will be defended by different mobility barriers that vary in their effectiveness in restricting entry into a given strategic group. In general, firms protected by high mobility barriers will have greater profit potential than firms in other strategic groups protected by low mobility barriers.

[48] Comments of Viacom at 10 – 11 and Declaration of Robert W. Crandall at 14 – 15. The Declaration was submitted by Viacom and is attached to Comments of Viacom.

[49] United Church of Christ, et al., opposes modification of the dual network rule on diversity grounds, not on the modification's potential impact on competition.

[50] Declaration of Robert W. Crandall at 4 –5.

amount of overall network costs is invariant with respect to the number of programs procured and aired. Viacom concludes that spreading these fixed costs across multiple networks can be an important source of efficiency.[51] For example, Viacom asserts that CBS could offer UPN substantial savings by combining accounting, traffic, business affairs, financial reporting, and engineering.[52] Fox also mentions that mergers between broadcast networks could facilitate economically efficient arrangements.[53] Minority Media Telecommunications Council ("MMTC") remarks that "UPN can only be preserved by an established network with O&Os [owned and operated stations] and efficiencies from duopoly [i.e., the horizontal merger] and vertical integration."[54]

22. Viacom maintains that the potential effect of a merger between a major network and an emerging network on national television advertising is overstated when programs from a second network appeal to different demographic groups. According to Viacom, both WB and UPN appeal to a much younger audience than those attracted to ABC, CBS, and NBC. With respect to a CBS/UPN dual network, Viacom contends that there is relatively little direct competition in advertising sales between these two networks. Viacom explains that UPN's programming delivers viewers who are younger, more urban, and male, while CBS's programming delivers viewers who are older, more suburban, and female. Viacom maintains that UPN competes most directly with WB and to a lesser extent with Fox, networks that target younger urban viewers, while CBS competes more directly with the broader-based, traditional networks operated by NBC and ABC that target older viewers and a more general cross-section of the U.S. population. Viacom concludes that because of the differences in size and audience demographics, CBS and UPN are viewed by advertisers as distant substitutes for one another.[55]

23. Even if the CBS and UPN networks targeted the same audience, Viacom argues that a CBS/UPN combination represents a relatively small change in concentration that will not result in any significant alteration in the competitive landscape as it relates to the sale of national network advertising time. According to Viacom, UPN is the smallest of the six television broadcast networks and accounted for approximately two percent of the 1999-2000 television season upfront primetime broadcast network advertising revenues. CBS is ranked first in ratings, third in advertising revenues and accounted for approximately 18 percent advertising revenue share.[56]

24. We conclude that a merger between an emerging network, such as WB or UPN, and a major network is likely to produce net benefits to network advertisers and viewers of network television. With respect to vertical integration, such a merger may produce significant efficiencies by internalizing the contentious issue of program production risk-sharing within a vertical relationship. For example, an emerging network acquired by a major network provides the major network with an additional "window" for the distribution of network programming. In effect, this additional window allows the merged network to broadcast the same program in different time slots in the same market if both the major and emerging

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[51] Id. at 5, n. 3.

[52] Comments of Viacom at 36.

[53] Comments of Fox at 8.

[54] Comments of MMTC at 6.

[55] Comments of Viacom at 47 – 49 and Declaration of Robert W. Crandall at 15 – 16.

[56] Id.

networks have affiliates in the same city. Alternatively, if the emerging and major network do not have affiliates in the same city, then the merged network entity will now reach more households than before the merger. In either case, the fixed costs of program production are spread over additional viewers in different time slots or additional cities. As a result, the effective program cost per viewer is reduced in either case. Similarly, a network program that fails, or is only marginally successful, on the major network's affiliated station might succeed when broadcast to the niche audience reached by the affiliates of the emerging network. The risks of network program development are clearly attenuated for the merged networks as a consequence of reaching additional viewers at different times or in additional cities or with audience attributes that may differ from the mass audience ordinarily targeted by a major network.

25. With respect to horizontal integration of a major and emerging television network, the merger should have little or no adverse effect on competition or pricing in the market for television network advertising, since major and emerging networks compete in different strategic groups. To the extent that the emerging network continues to offer programming following the merger that targets niche or special interest audiences, then the welfare of viewers of both mass audience and niche programming should not be adversely affected by the merger and may indeed be advanced by the resulting efficiencies.

26. Mergers Among the Four Major Networks. After the rule change we are making herein, the only multiple network operations that will be prohibited by our dual network rule will be the common ownership of multiple broadcast networks created by mergers between ABC, CBS, Fox, or NBC. Although the questions presented in the Notice related solely to the emerging networks portion of the dual network rule, Fox, Viacom, and WB argue for elimination of the rule in its entirety.[57] They contend that the rule, established over fifty years ago, is no longer justified in light of prevailing conditions.[58] They argue that new competitors -- both broadcast and nonbroadcast – have entered and attracted large portions of the market formerly controlled by the networks.[59] They also argue that developments over the past 20 years have increased competition, reduced the networks' share of television viewership, and reduced the networks' share of television advertising revenue.[60] These developments, they conclude, support elimination of the dual network rule.

27. We note that commenters were divided on whether a merger of two major networks would create or enhance market power. Fox states that the Commission's NPRM in this proceeding "errs by suggesting that the retention of some ownership restrictions on the top four broadcast networks may be warranted because they constitute a 'strategic group' or 'oligopoly' that possess characteristics and pursue objectives that are somehow materially distinct from other television programming providers."[61] Fox contends that broadcast networks face competition from a plethora of non-broadcast entities that are also capable of producing a mass audience.[62] Fox states that "the Commission errs by suggesting that mobility barriers inhibit the development of new networks" and argues that "the number of national television

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[57] Comments of Fox, Comments of Viacom at 49-50, and Comments of WB at 7-11.

[58] Comments of Fox at 2, Comments of Viacom at 13, Comments of WB at 7.

[59] Comments of Fox at 2., Comments of Viacom at 13, Comments of WB at 10.

[60] Comments of Fox at 2 - 5, Comments of Viacom at 13 - 17, Comments of WB at 7 – 11.

[61] Comments of Fox at 6.

[62] Id.

broadcast networks has more than doubled in just a little over a decade."[63] Viacom states "the contemporary video marketplace is extremely diverse and highly competitive and is expanding at an astounding rate as cable and satellite networks, and now the Internet, have emerged to challenge the over-the-air broadcast program services. Thus, a merger even of two of the established Big Four networks would not unduly affect the level of diversity and competition at the national level."[64] WB states that "[g]iven the presence of at least eight mainstream broadcast television networks and scores of cable networks, there can not be any valid concern about domination of programming by only one or two national networks."[65] WB concludes that "broadcast networks no longer can or do dominate programming distribution."[66]

28. Other commenters suggest that major networks may already have market power. Paxson Communications Corporation ("Paxson") disagrees with the idea that encouraging the entry of new, over-the-air broadcast networks may have diminished in importance relative to twenty years ago due to the growth of video program substitutes (e.g., cable television networks and direct broadcast satellite services).[67] Paxson contends that fostering the creation of emerging broadcast networks "allows critical marketplace pressures to constrain the adverse impact major networks may have on market advertising and programming costs."[68] The Network Affiliated Stations Alliance ("NASA") supports retaining "the portion of the rule that prohibits common ownership of two or more of the big four networks."[69] NASA states that "[a]udience fragmentation has not diminished the market power of the broadcast networks, nor has it diminished the leverage the networks have over their affiliates. Despite the emergence of new media, the big four broadcast networks still have, by far, the largest concentration of viewers and television economic power."[70] NASA maintains that "[t]he market power of the television networks is demonstrated by their continued ability to charge high advertising rates."[71] NASA argues that the Commission's analysis in the Notice "demonstrates that the networks continue to have market power unmatched by any other segment of the television industry."[72] NASA argues that "[r]elaxation of the dual network rule will, indeed, increase the networks' economic leverage over affiliates."[73]

29. The questions presented in the Notice related solely to the emerging networks portion of

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[63] Id. at 6 – 7.

[64] Comments of Viacom at 49.

[65] Comments of WB at 10.

[66] Id.

[67] Notice, supra at 11254-65.

[68] Comments of Paxson at 4.

[69] Comments of NASA at 2.

[70] Id. at 4.

[71] Id. at 5.

[72] Id.

[73] Id. at 6.

the dual network rule; the question of eliminating the rule in its entirety was not squarely presented to this Commission for review. Therefore, we will not address that issue in this proceeding.[74]

C. Diversity

30. In addition to the competitive concerns discussed above, the modification of the dual network rule involves diversity issues. In fact, the only commenter urging retention of the entire current dual network rule did so on the basis that the proposed modification would undermine traditional Commission diversity concerns. In this regard, UCC argues that the Notice in this proceeding ignored the "vital first amendment issues that animate the dual network rule."[75] Both UCC and the Network Affiliated Stations Alliance ("NASA") argue that a diminution in the number of independent networks would reduce the number of independent voices available in the broadcast television medium.[76] Moreover, UCC argues that the NPRM asserts without support that alternate multi-channel video programming providers have diminished the importance of diversity in broadcast networks. To the contrary, UCC states, broadcast television remains the one true mass media, with the lowest rated broadcast network programs having ratings comparable to the highest rated cable network programs.[77] Nor, it contends, is the Internet a comparable substitute for broadcast programming. The Commission, it states, has come to this very conclusion in the Biennial Report.[78] Finally, UCC alleges that diversity has been adversely affected by the relaxation or elimination of other Commission rules over the past ten years (citing Commission actions regarding the financial interest and syndication and local television ownership rules) and it finds it difficult to imagine how relaxing the dual network rule will cause this situation to reverse itself.[79]

31. Allowing one of the top four networks to buy UPN and/or WB will, by definition, result in the elimination of one or more independently owned broadcast outlet at the national level. The record demonstrates that emerging networks make a significant contribution to diversity of programming at the national level and the stability of their affiliates, thus promoting outlet diversity at the local level. The record also demonstrates, however, that maintaining the dual network rule in its current form would actually jeopardize those contributions to diversity, rather than promote them.

32. In particular, the record shows that some form of relief from the dual network rule will promote the viability of the UPN network and thus promote diversity at the national level. Viacom now owns and operates both the CBS and UPN broadcast networks. Absent today's action, Viacom/CBS

[74] This issue was considered in the 1998 Biennial Review, which was completed in 2000. See Biennial Review Report, supra. At 11094-99.

[75] Comments of United Church of Christ, et al. ("UCC") at 10.

[76] Comments of UCC at 2-3; Comments of NASA at 7. NASA takes no position on the NPRM's proposal. Instead, it urges the Commission to avoid modifying the dual network in a way that would allow networks to exercise market power over independent program providers, emerging networks, or network affiliates. It also asks the Commission to avoid expressing any rationale that could later be argued to support the relaxation of the remaining part of the dual network rule or any other provision of the Commission's network rules. Comments of NASA at 4.

[77] Comments of UCC at 4.

[78] Id. at 4 (citing Biennial Review Report in MM Docket No. 98-35, supra.

[79] Id. at 5.

would have until May 4, 2001, to come into compliance with the rule, which, as a practical matter, would involve divestiture of UPN. The record reflects that UPN is a financially struggling network that has suffered losses in every year of its existence.[80] Viacom notes that UPN has accumulated losses of approximately $800 million and Chris-Craft (a 50 percent owner of UPN) turned down the opportunity to acquire Viacom's 50 percent share of UPN for $5 million.[81] MMTC also noted the difficulty of finding a buyer for UPN, stating that it approached several minority-owned companies regarding the purchase of UPN.[82] According to MMTC, some of the companies were interested but none were in a position to "shoulder about $150,000,000 a year in red ink for several years."[83] The reasons for UPN's financial struggles include competition from both broadcast and non-broadcast video sources, decreasing broadcast network viewership, and diversion of investment capital to other competitors partly as a result of the current dual network rule. These factors affect both UPN and the WB networks. Given these factors, there is substantial likelihood that the present level of independent network ownership would not be maintained absent the action we take herein.[84] In addition, as noted above, our analysis suggests that the UPN broadcast television network benefits from the efficiencies of vertical integration with Viacom's program production facilities. Divestiture would deprive UPN of these efficiencies. It may be possible for these efficiencies to be realized by combining UPN with another major program producer, but nothing in the record suggests that another program producer is looking to merge with or acquire UPN. Indeed, the record suggests that divestiture would deprive UPN of vertical efficiencies, and thus put at risk its survival as a broadcast television network.

33. Stating that it has never before endorsed an exception to the dual network rule, MMTC explains that "we are faced with the unusual situation in which the dual network rule may have an unintended consequence. If it were applied strictly the rule would leave the public one fewer over-the-air network."[85] MMTC explains, "[f]or all its faults, duopoly ownership would save a failing network whose survival is critical to minorities,"[86] and concludes, "the Commission should allow UPN to be owned by a major network."[87] The Board of Governors of the UPN Affiliates Association ("UPN Affiliates") states that "were the Commission's rule left unmodified so that it would continue to preclude the common ownership of CBS and UPN … continuation of the UPN network would be in great jeopardy, and, indeed UPN would be unlikely to survive."[88] LIN Television Corporation ("LIN"), a UPN affiliate, does not specifically argue that relief from the dual network rule is essential to the survival of UPN but maintains that the combination of Viacom, CBS and UPN "holds forth the promise that UPN will develop into a truly meaningful and enduring programming presence, significantly enhancing both competition and diversity in

[80] Comments of Viacom at 23.

[81] Comments of Viacom at 4. Viacom then paid $5 million to acquire Chris-Craft's shares of UPN.

[82] Comments of MMTC at 5.

[83] Id.

[84] See, e.g., Comments of UPN Affiliates at 3-4; Comments of Lockwood at 2.

[85] Comments of MMTC at 2.

[86] Id. at 1.

[87] Id. at 10.

[88] Comments of UPN Affiliates at 1 – 2.

the national programming marketplace."[89] Caroline K. Powley, owner of a UPN affiliate, believes that Viacom's continued ownership of UPN will ensure UPN's financial viability.[90] Lockwood Broadcast Group ("Lockwood") also suggests that Viacom's continued ownership of UPN is necessary to UPN's viability.[91] Holston Valley Broadcasting Corporation ("Holston") notes that UPN has struggled financially from its inception and although the network is still unprofitable "there is light at the end of the tunnel assuming its merger with the owners of the large CBS Television Network is allowed by the Commission."[92] Holston asserts that allowing UPN to be co-owned with a strong network partner like CBS assures UPN's survival.[93] Thus, the record demonstrates that our failure to relax the dual network rule would likely result in the elimination of a broadcast voice at the national level.

34. Retaining the current version of the dual network rule could also have cascading adverse consequences on diversity at the local level. Affiliates of a failed network, without network affiliation and the programming it brings, may not be able to sustain the increases in the cost of programming that they would have to bear should they have to purchase programming in the syndication market.[94] Additionally, such affiliates would be deprived of a recognized brand that is promoted locally by each affiliate and nationally by the network and of first run programming that affiliates would have to replace by purchasing programming in the syndication market.[95] Thus, the failure of a network could imperil the position of many of that network's affiliates and have a negative impact on diversity of outlets at the local level.

35. Again, the record evidence surrounding UPN provides a concrete illustration of the potential harm to local diversity that could result from retaining the dual network rule in its current form. UPN Affiliates states that "it is equally important to focus on the economic harm that would befall many of the UPN Affiliates were the Commission's rule left unmodified so that it would continue to preclude the common ownership of CBS and UPN."[96] Were UPN to terminate, explains UPN Affiliates, the large investment in branding would be lost and each affiliate would be required to invest in establishing a new identity.[97] UPN Affiliates maintains that these new investments "would greatly impair the economic viability of many UPN Affiliates particularly those in medium and small markets, and would divert funds that could otherwise be expended on programming."[98] UPN Affiliates explains that an analysis of the 130 UPN primary network affiliates shows that more than half of the affiliates are owned by single station

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[89] Comments of LIN at 2.

[90] Comments of Caroline K. Powley at 2.

[91] Comments of Lockwood.

[92] Comments of Holston at 1.

[93] Id. at 2.

[94] Comments of LIN 1.

[95] Comments of UPN Affiliates at 1-2.

[96] Comments of UPN Affiliates at 1 – 2.

[97] Id. at 2.

[98] Id.

owners or small group owners.[99] With reference to its television station in Grand Rapids, LIN explains that "[t]o replace UPN, the station would have to purchase ten more hours of primetime programming a week, as well as a block of children's educational /informational programming to replace the Disney programming made available by UPN, and engage in extensive additional promotion which UPN branding and marketing now makes unnecessary."[100] LIN states that, "UPN literally makes it possible for LIN to provide an additional programming voice in the Grand Rapids market."[101] Caroline K. Powley maintains that the UPN affiliation has improved the quality of programming her television station in Buffalo offers viewers and allowed the station to become financially viable.[102] Powley also contends the television station would not be able to survive without the UPN affiliation, and Viacom's continued ownership of UPN will ensure UPN's and the station's financial viability.[103] Lockwood states that Viacom's continued ownership of UPN "will ensure that small broadcasters like us will survive in an increasingly difficult climate."[104] Holston states that allowing UPN to be co-owned with a strong network partner like CBS assures UPN's survival and thus the survival and proliferation of UPN affiliates."[105] Holston contends that "[d]ozens of markets have an additional local free over-the-air television station thanks to the presence of UPN."[106] Thus, we conclude that eliminating the emerging network portion of the dual network rule will promote, rather than diminish, the diversity of voices at the local level.

36. As a more general matter, we agree with those that argue that the proliferation of video programming networks warrants relaxing the rule. At present, some 83.8 percent of television households obtain their service from an MVPD such as cable, direct broadcast satellite or Multichannel Multipoint Distribution Service.[107] Most of the subscribers to such systems have available to them a cornucopia of video services. As discussed above, nearly 87 percent of cable television systems have 30 or more channels.[108] These systems serve 99 percent of cable subscribers.[109] Although many of the video programming networks presented on cable systems are vertically integrated with cable multiple system operators,[110] they nevertheless contribute to diversity by providing programming to most viewers that is

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[99] Id. at 3.

[100] Comments of LIN at 1.

[101] Id.

[102] Comments of Caroline K. Powley at 1.

[103] Id. at 2.

[104] Comments of Lockwood at 2.

[105] Comments of Holston at 2.

[106] Id.

[107] Seventh Cable Report, supra at ¶6 United Church of Christ, Office of Communication, Inc. Consumer Federation of America and the Center for Media Education.

[108] Id. at ¶20.

[109] Id. at ¶21. Over two-thirds (68.5%) of cable subscribers were served by systems with 54 or more channels as of October 2000. Id.

[110] Id. at ¶174.

from a source other than the six broadcast television networks covered by the instant rule. Such developments have diminished the importance of maintaining UPN and WB as independently owned network "voices."[111]

37. We also agree with commenters that a major network and an emerging network under common ownership would have a strong economic incentive to diversify their program offerings, particularly by increasing service to minority or "niche" tastes and interests.[112] A single broadcast network has the incentive to attract the largest possible audience with mass appeal programming (which is similar to the programming offered by its rivals). However, if two networks are owned by a single entity, the entity has an incentive to attract an array of viewers with differing interests to produce the largest combined audience for the overall enterprise.[113] This allows for the major network to pursue mass tastes, with the smaller network programming to minority and niche tastes. For example, MMTC argues that "[t]he viewing patterns of African-Americans are sharply different from those of White Americans"[114] and that the only two emerging networks subject to the second prong of the dual network rule are currently the only broadcast outlets for minority-themed programming.[115] A "duopolized" network, under these circumstances, would be preferable to no network, and allowing common ownership would protect, rather than hinder, existing program diversity.[116] Additionally, MMTC contends that allowing common ownership of a major network and an emerging network that programs to a minority audience can have beneficial diversity effects. It argues that the interaction between the staffs of a mass market network and a niche or minority oriented network could enable the former to better appreciate the importance of, and learn the means of, addressing issues of concern to minority communities.[117]

38. The record also supports the proposition that eliminating the emerging network portion of the dual network rule will not adversely affect the provision of news and public affairs programming. Viacom states that the emerging networks thus far have not been in a position to absorb the full costs of developing news departments offering regularly scheduled news programs. Accordingly, it continues, a combination of a major network with UPN or WB would not affect the independence of an existing news

[111] See, e.g., Comments of Viacom at 5. In this regard, WB notes that the level of diversity today in the television industry exceeds the diversity present in radio in 1977 when the Commission determined that, as to radio, the dual network rule "had little positive impact and may in the future hinder competition and restrict diversity." (Quoting Commission Rules and Regulatory Policies Concerning Network Broadcasting by Standard (AM) and FM Broadcast stations, Report, Statement of Policy and Order, 63 FCC 2d 674 (1977) at ¶34.) Comments of WB at 8-10. UCC's argument that network television still attracts more viewers than individual cable networks does not persuade us to discount the fact that a plethora of media options is widely available to viewers.

[112] Comments of Viacom at 28-29; Comments of WB at 12-15. Holston asserts that allowing the partnering of an emerging network with a strong network partner assures programming diversity by ensuring their very survival. Comments of Holston at 2.

[113] Comments of Viacom at 29 and 32.

[114] Comments of MMTC at 3, n.8. (Citation omitted.)

[115] Comments of MMTC at 3.

[116] Id.; see also Comments of Viacom at 30, n. 90.

[117] Comments of MMTC at 7-9.

organization or cause a reduction of diversity in news or public affairs programming.[118] Indeed, Viacom argues, common ownership may offer the only realistic potential for the carriage of a substantial amount of news and public affairs programming by affiliates of the emerging network by allowing the resources of the larger network to be re-deployed in ways that serve the viewers of the emerging networks by providing them with news and public affairs.[119]

D. Additional Matters

39. The WB Network argues that if we relax the dual network rule we are obligated to also eliminate the cable/television cross-ownership rule. Otherwise, it contends, we will actually be allowing only the UPN Network to be merged with a major network because the cable/television cross-ownership rule precludes The WB from such a merger. It argues that the Commission cannot, as a matter of law, grant regulatory relief to certain competitors but not equivalent relief to others. Since the cable/television cross-ownership rule "stands in the way of similar creative business arrangements with an established network, The WB cannot be part of a corporate family with any attributable interests in licensed broadcast stations in numerous major DMAs. This, it asserts, violates fundamental fairness and administrative law that requires the Commission to accord comparable treatment to similarly situated parties.[120]

40. Modification or elimination of the cable/television cross-ownership rule is not within the scope of the Notice of Proposed Rule Making issued in this proceeding. We will consider it again in a future proceeding or our next biennial review of our broadcast ownership rules. WB network is receiving equal treatment by reason of the modification of the dual network rule we are making herein.

41. Additionally, the UPN and WB Networks have each raised arguments that the provision of the 1996 Act that defines an emerging network does not include it.[121] Given our decision herein, this issue is moot.

42. Finally, we have previously granted Viacom, Inc., a period of twelve months, commencing May 3, 2000, within which to come into compliance with the dual network rule.[122] Given our action herein, we will extend that temporary waiver of the rule until the effective date of the instant rule amendment.

IV. CONCLUSION

43. Based upon the record and our own analysis, we find that the benefits of vertical integration between a program producer and television networks will not be lost and may well be augmented by a merger of one or more emerging networks with a major network. Additionally, the

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[118] Id. at 41-42.

[119] Id. at 34-35.

[120] Comments of WB at 7, 11-32 (citing Melody Music Inc. v. FCC, 345 F.2d 730, 732 (D.C. Cir. 1965)).

[121] Comments of Viacom Inc. (in MM Docket No. 98-35) at 39; Comments of WB at 6. We stated that the Viacom comments that were late filed in the 1998 Biennial Review, together with the late filed comments of The WB Television Network, would be considered in this proceeding. Biennial Regulatory Review 2000, Updated Staff Report, Appendix IV, Part 73, notes 419 and 428 (January 17, 2000).

[122] Memorandum Opinion and Order, Applications of Shareholders of CBS Corporation and Viacom, Inc., supra at 8235 and 8246-47.

horizontal integration of an emerging and major network should not adversely affect competition or pricing in the relevant television advertising markets and may produce merger-specific efficiencies that provide new benefits to viewers and advertisers not otherwise available prior to the merger. The aggregation of the possible efficiencies of both vertical and horizontal integration that provide the resources for viewer and advertiser benefits support our decision to abolish today that part of the dual network rule that prohibits the merger of one or more emerging network with a major television network.

44. With regard to diversity, we do not believe that the loss of up to two independently owned networks that potentially could result from our modification of the dual network rule would seriously compromise our diversity concerns. On the contrary, diversity of programming will be fostered at the national level as a result of our permitting struggling emerging networks to combine with major networks, thereby allowing them to continue serving their current niche and minority audiences. At the local level, our action will contribute to outlet diversity by strengthening the emerging networks and thus promoting the stability of their affiliated stations. Therefore, on balance, we believe that the modification of the dual network rule is warranted on diversity grounds, as well.

45. We do not believe that a waiver is the better approach to this issue and so do not reach those arguments of commenters favoring such relief.[123] The subject portion of the dual network rule is unusual because, while in form it is a rule of general applicability, in effect it only applies to one entity other than UPN (i.e., the WB Network). Thus, the rule is so narrow that the specific facts concerning one of the only two parties to which the rule applies are quite relevant. Also, the two networks are similarly situated from the standpoint of economic analysis. Both UPN and WB are nascent broadcast networks that target younger audiences compared with the major networks. In addition, both networks use UHF stations and LPTV facilities that result in a substantial coverage disadvantage compared with the major networks. Our foregoing analysis pertains equally to UPN and WB and demonstrates that distinct benefits for either or both of them can be derived generally from elimination of that section of the rule that prohibits these two entities to merge with a major network. Accordingly, elimination of that provision of the rule itself, rather than grant of waiver relief to only one of the two parties affected by that portion of the rule, is appropriate.

46. In view of the foregoing, we conclude that the dual network rule should be amended by eliminating the provision prohibiting the common ownership of one of the four major networks and the emerging networks. We will reexamine that part of the dual network rule that prohibits mergers between the major networks in a future proceeding, possibly our next Biennial Review. At that time we will explore in greater detail how repeal or modification of that part of the rule may affect diversity and consider whether the rule remains necessary in the public interest as the result of competition.

V. ADMINISTRATIVE MATTERS

47. Paperwork Reduction Act of 1995 Analysis. This Report and Order has been analyzed with respect to the Paperwork Reduction Act of 1995 and found to impose no new reporting requirements on the public.

48. Regulatory Flexibility Analysis. Pursuant to the Regulative Flexibility Act of 1980, as amended, 5 U.S.C. § 601 et seq., the Commission's Final Regulatory Flexibility Analysis in this Report and Order is attached as Appendix A.

[123] Reply Comments of UCC et al. at 6 - 7. We address - and accept or agree with - many of these arguments elsewhere in this Report and Order insofar as they are illustrative of the benefits of modifying the rule as opposed to granting a waiver to only one of the two parties subject to the rule.

49. Ordering Clauses. Accordingly, IT IS ORDERED that, pursuant to the authority contained in Sections 4(i) & (j), 303(r), 308, 310 and 403 of the Communications Act of 1934, 47 U.S.C. §§ 154(i) & (j), 303(r), 308, 310 and 403, as amended, Part 73 of the Commission's Rules, 47 C.F.R. Part 73 IS AMENDED as set forth in Appendix B below.

50. IT IS FURTHER ORDERED, that Viacom, Inc.'s, temporary waiver of Section 73.658(g) of the Commission's Rules, IS EXTENDED until the effective date of this rule amendment.

51. IT IS FURTHER ORDERED that, pursuant to the Contract with America Advancement Act of 1996, the amendment set forth in Appendix B SHALL BE EFFECTIVE 60 days after publication in the Federal Register.

52. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Report and Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

53. IT IS FURTHER ORDERED that this proceeding is terminated.

54. Additional Information. For addition information concerning this proceeding, please contact Roger Holberg, Mass Media Bureau, (202) 418-2134 or Dan Bring, Mass Media Bureau (202),418-2164.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

APPENDIX A

FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

As required by the Regulatory Flexibility Act (RFA),[124] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the Notice of Proposed Rule Making in this proceeding.[125] The Commission sought written public comment on the proposals in this Notice, including comment on the IRFA. The comments received are discussed below. This present Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA.[126]

I. Need For, and Objectives of, Report and Order

In February 1996, the Telecommunications Act of 1996 ("1996 Act") was signed into law. Section 202 of the 1996 Act directed the Commission to make a number of significant revisions to its broadcast media ownership rules. Section 202(h) also requires us to review our broadcast ownership rules every two years commencing in 1998. One of the rules reviewed in our first such biennial reviews was Section 73.658(g), the dual network rule. In our Biennial Review Report[127] we tentatively concluded that a portion of this rule was no longer necessary in the public interest. Accordingly, we issued a Notice of Proposed Rule Making proposing the elimination of this rule consistent with the goals of the 1996 Act.

II. Significant Issues Raised by the Public in Response to the Initial Analysis

No comments were received concerning the Initial Regulatory Flexibility Analysis.

III. Description and Estimate of the Number of Small Entities To Which the Proposed Rules Will Apply

The RFA directs agencies to provide a description of, and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.[128] The Regulatory Flexibility Act defines the term "small entity as having the same meaning as the terms "small business," "small organization," and "small business concern" under section 3 of the Small Business Act.[129] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of

[124] See 5 U.S.C. § 603. The RFA, (see 5 U.S.C. § 601 et. seq.), has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

[125] Notice of Proposed Rulemaking in MM Docket No. 00-105, 15 FCC Rcd. 11196 (2000).

[126] See 5 U.S.C. § 604.

[127] Biennial Review Report in MM Docket No. 98-35, 15 FCC Rcd 11058 (2000).

[128] 5 U.S.C. § 603(b)(3).

[129] Id. § 601(3).

operation; and (3) satisfies any additional criteria established by the SBA.[130]

Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency after consultation with the Office of Advocacy of the SBA and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register. A "small organization" is generally "any not-for-profit enterprise which is independently owned and operated and is not dominant in its field."[131] Nationwide, as of 1992, there were approximately 275,801 small organizations.[132] "Small governmental jurisdiction" generally means "governments of cities, counties, towns, townships, villages, school districts, or special districts with a population of less than 50,000."[133] As of 1992, there were approximately 85,006 such jurisdictions in the United States.[134] This number includes 38,978 counties, cities, and towns; of these, 37,566, or 96 percent, have populations of fewer than 50,000.[135] Thus, of the 85,006 governmental entities, we estimate that 81,600 (91 percent) are small entities.

Small TV Broadcast Stations. The SBA defines small television broadcasting stations as television broadcasting stations with $10.5 million or less in annual receipts.[136] According to Commission staff review of the BIA Publications, Inc., Master Access Television Analyzer Database, fewer than 800 commercial TV broadcast stations (65%) have revenues of less than $10.5 million dollars. Approximately 90 of these small TV broadcast television stations are affiliates of the WB or UPN networks and may be affected by our rule change. We note, however, that under SBA's definition, revenues of affiliates that are not television stations should be aggregated with the television station revenues in determining whether a concern is small. Therefore, our estimate may overstate the number of small entities since the revenue figure on which it is based does not include or aggregate revenues from non-television affiliated companies. It would appear that there would be no more than 800 entities affected.

IV. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

The Report and Order imposes no reporting, recordkeeping, or compliance requirements.

V. Steps Taken to Minimize Significant Economic Impact on Small Entities and Significant Alternatives Considered

The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives: (1) the establishment of

130 Id. § 632.

131 5 U.S.C. § 601(4).

132 1992 Economic Census, U.S. Bureau of the Census, Table 6 (special tabulation of data under contract to Office of Advocacy of the U.S. Small Business Administration).

133 5 U.S.C. § 601(5).

134 U.S. Dept. of Commerce, Bureau of the Census, "1992 Census of Governments."

135 Id.

136 13 C.F.R. § 121.201 (SIC Code 4833)

differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

As indicated above, the Report and Order allows licensees to affiliate with a network entity that maintains two or more networks unless such multiple networks consist of more than one of the "big four" networks (NBC, ABC, CBS and Fox). This eliminates the bar on affiliation with an entity that maintains one of the "big four" networks and the UPN and/or WB networks. All significant alternatives, *i.e.*, retention of the existing rule, modification of the existing rule, and elimination of the dual network rule altogether, were considered in the Commission's 1998 biennial review of its broadcast ownership rules (MM Docket No. 98-35) and herein. In the Biennial Review proceeding the Commission tentatively determined that elimination of the subject provision would be in the public interest. The Commission considered the results of this top-to-bottom review of the subject rule in its consideration of alternatives to the course proposed herein in the instant proceeding. The instant action provides television licensees, including those considered to be "small businesses," with increased flexibility with regard to the broadcast networks with which they may affiliate. It also may help small stations that are affiliated with the UPN or WB networks survive and prosper in an increasingly competitive media marketplace. Finally, it gives the four major and two emerging broadcast television networks, none of which are small businesses, more merger flexibility.

VI. Report to Congress

The Commission will send a copy of this Report and Order, including this FRFA, in a report to be sent to Congress pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996, see 5 U.S.C. § 801(a)(1)(A). In addition, the Commission will send a copy of this Report and Order, including FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this Report and Order and FRFA (or summaries thereof) will also be published in the Federal Register. See 5 U.S.C. § 604(b).

APPENDIX B

RULE CHANGE

Part 73 of Title 47 of the U.S. Code of Federal Regulations is amended to read as follows:

PART 73 – RADIO BROADCAST SERVICES

1. The Authority citation for Part 73 continues to read as follows:

AUTHORITY: 47 U.S.C. 154, 303, 307, and 554.

2. Section 73.658(g) is amended as follows:

§ 73.658 Affiliation agreements and network program practices; territorial exclusivity in non-network program arrangements.

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(g) Dual network operation. A television broadcast station may affiliate with a person or entity that maintains two or more networks of television broadcast stations *unless* such dual or multiple networks are composed of two or more persons or entities that, on February 8, 1996, were “networks” as defined in section 73.3613(a)(1) of the Commission’s regulations (that is, ABC, CBS, Fox, and NBC).

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APPENDIX C

LIST OF COMMENTERS

Fox Television Stations, Inc.

Holston Valley Broadcasting Corporation

LIN Television Corporation

Lockwood Broadcast Group

Minority Media and Telecommunications Council

Paxson Communications Corporation

UPN Affiliates Association

Viacom Inc.*

WB Television Network*

WNGS-TV

LIST OF REPLY COMMENTERS

Network Affiliated Stations Alliance

United Church of Christ, Office of Communication, Inc., Consumer Federation of America and The Center for Media Education

Viacom, Inc.

WB Television Network

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* Includes late filed comments submitted in MM Docket No. 98-35.

SEPARATE STATEMENT
MICHAEL K. POWELL, CHAIRMAN

Re: In the Matter of Amendment of Section 73. 658 (g) of the Commission's Rules—The Dual Network Rule (MM Docket No. 00-108).

Today, we take an important step in examining the Dual Network Rule in the context of the competitive landscape as it exists today. The *Order*: (1) examines the competitive changes in the video marketplace; (2) applies an economic framework for analyzing the competitive impacts of such a merger and; (3) examines the impact on diversity by maintaining or changing the rule. The *Order* concludes that diversity and localism are prospering as a result of the dramatic changes in the video marketplace and that any efficiencies gained through such mergers would likely make the emerging networks more effective competitors. Retention of the Rule in its current form is found to be no longer in the public interest. The *Order* further concludes that the change we make today will not harm, and indeed is likely to promote competitive efficiency and diversity.

The original dual network rule is over 50 years old.[1] It was adopted in the early years of television when three networks dominated the entire television market. Today, half a century later, we not only have alternative platforms for distribution – namely cable and DBS – we also have a plethora of new programming channels available to consumers. In 1946 there were only six television stations nationwide; today, there are over 1,600 television stations. Today, approximately 84 percent of all Americans subscribe to cable, DBS, or another multi-channel service provider. And with over 200 cable networks,[2] there are more sources of programming than at any time in history.

These dramatic changes in the video competition market serve as the backdrop for the Commission's review of that portion of the Dual Network Rule that prohibits the four largest networks-- ABC, CBS, Fox and NBC -- from merging with UPN or WB. The Commission has a responsibility to examine *all* of its rules in the modern context, and either validate or eliminate them. In fact, in the broadcast ownership area, Congress has *directed* the Commission to review its broadcast ownership rules and "determine whether any of such rules are necessary in the public interest as a result of competition."[3] The *Order* we adopt today affirms the tentative conclusion made by the Commission the Biennial Report;[4] that the Rule as it applies to UPN and WB no longer serves the public interest, and therefore should be repealed.

The record in this proceeding also demonstrates that maintaining the Rule in its current form would actually jeopardize diversity, rather than promote it. Uncontested in the record is the fact that continued ownership of UPN by CBS is essential to the continued viability of UPN and its local affiliated stations.[5]

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[1] Amendment of Part 3 of the Commission's Rules, 11 FR 33 (Jan. 1, 1946).

[2] Seventh Annual Report on Competition in Video Markets, CS Docket No. 00-132, FCC 01-1 (adopted Jan. 2, 2001).

[3] Section 202(h), Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

[4] Biennial Review Report, in MM Docket No. 98-35, 15 FCC Rcd 11058 (2000).

[5] *Order* at ¶¶ 32, 33.

The failure of this network would result in a loss of a diversity of programming at the national level; programming that makes an important contribution to minority and urban audiences. Furthermore, outlet diversity at the local level would also be jeopardized if the stability of the affiliates was put at risk.

SEPARATE STATEMENT
COMMISSIONER SUSAN NESS

In re: In the Matter of Amendment of Section 73.658(g) of the Commission's Rules – The Dual Network Rule, MM Doc. No. 00-108

It is important to point out what this Order does not do.

The Commission does not relax the existing prohibition on mergers among the top four broadcast networks. While the item points out that the issue of mergers between the top four networks was not raised in the *Notice*, I believe that a combination of any of the top four broadcast networks would dangerously diminish source and viewpoint diversity in the United States. As the item points out, the four major broadcast networks are unique among the media in their ability to reach a wide audience. Even though network ratings have declined over the last twenty years, those ratings still far outpace any other video platform. Moreover, the competition between network news operations serves an important First Amendment function by encouraging journalistic rigor and a relative variety of editorial priorities and viewpoints. Even in an era of 24-hour cable news networks, the ratings dominance of the broadcast networks should lead future Commissions to hesitate before diminishing competition and diversity among the top four broadcast networks.

This item also does not implicate other media ownership restrictions. As the competition analysis makes clear, the provision of the dual network rule at issue here identifies a very small universe of affected parties: UPN and the WB. By allowing mergers involving these two "weblets," the Commission willingly diminishes source diversity, something I ordinarily resist, in order to maintain outlet and viewpoint diversity, something I strongly support. The net benefit to diversity through the preservation of small, niche-oriented broadcast networks leads me to support this action.

Finally, the economic analysis in this item carefully avoids sweeping assumptions about possible public interest benefits accruing from post-merger economic efficiencies. While vertical integration tends to reduce transaction costs, and horizontal mergers tend to reduce redundancies, it is not at all clear to me that the resulting savings to the merged entity are, *ipso facto*, passed on to the consumer in the form of an improved product. That certainly is a theoretical possibility. But in the real world of media mergers, I believe it is a dangerous assumption that larger entities will, by virtue of their increased efficiency, produce better programming, more news, or wider arrays of editorial positions. Rather, the Commission should remain vigilant in preserving the vibrant and competitive media marketplace that will encourage media companies to channel their resources toward a better product.

DISSENTING STATEMENT
COMMISSIONER GLORIA TRISTANI

In The Matter of Amendment of Section 73.658(g)--The Commission's Dual Network Rule for Emerging Networks, MM Docket No. 00-108 [1]

In this *Report and Order* the Commission amends 47 C.F.R. §73.658(g) (dual network rule) to permit one of the four major television networks – ABC, CBS, Fox and NBC - to own, operate, maintain or control the UPN and/or the WB television network.[2] Because I believe elimination of the Commission's rule barring a major network from owning an emerging network is not supported by the record and does not protect the public's interest in maintaining a wide diversity of viewpoints on our airwaves, I dissent. Despite the lengths to which the majority goes to show viewers benefit from further consolidation in the broadcast industry, the decision will only further erode the already tenuous level of viewpoint diversity available to the public.

Following the *Biennial Review Report* the Commission issued *a Notice of Proposed Rule Making* utilizing transaction cost economics ("TCE") literature to suggest that horizontal consolidation between a major and an emerging network and vertical integration between program suppliers and major networks would produce economic efficiencies that benefit advertisers and viewers. No effort was made to describe how the Commission could measure whether these purported benefits reach viewers or advertisers.

Read closely, the Order states a result that is in search of a rationale. Commenters supporting the modification of this rule said: "A duopolized UPN is better than a dead UPN." [3] This, by itself, may be true. But the majority dresses up the same point with extensive, and pointless, reference to economic literature and ample parroting of Viacom's filings to conclude complete elimination of this portion of the rule, "suggests" economic efficiencies "may" arise that "might benefit" consumers.[4] I hope rather than believe the majority is correct.

As much as I might be concerned about the rule's impact on UPN, the question I have to answer is not whether the financial difficulties of a party subject to a rule justify eliminating the rule. I can only vote to change the rule if the public interest is served and when the grounds advanced support the change. [5] Here the most favorable construction of the record stated a case for a waiver of the rule rather than its elimination. With a waiver request the Commission would have been in a position to:

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1 *Notice of Proposed Rule Making* in MM Docket No. 00-108, 15 FCC Rcd 11253(2000)("*Notice*").

2 *See* Telecommunications Act of 1996 (Pub. L. No. 104-104, 110 Stat. 56 (1996)).

3 *See* Comments of Minority Media and Telecommunications Council at 1 (hereinafter "MMTC"); *see also* Report and Order at para. 33 (citing MMTC comments); *Id.* at para. 37 (same).

4 *See e.g. Report and Order* at para. 7.

5 *See* Telecommunications Act of 1996 (Pub. L. No. 104-104, 110 Stat. 56 (1996) at §202(h); 47 U.S.C. §310(d).

1. Obtain the necessary detailed financial data to ensure the financial woes of the network are in fact caused by the rule's application;

2. Determine on a complete record whether the financial woes are solved by removal of the rule's constraints;

3. Develop explicit conditions that ensure compliance with the terms of the waiver, and,

4. Protect the public interest by insisting that the alleged efficiencies achieved through the consolidation authorized by the waiver, *actually flow through* to the public in the form of better programming and greater viewpoint diversity.

Wholesale abandonment of well-settled rules is not the way to save a struggling network or promote the public interest. Decreasing the number of owners of broadcast networks is simply not a means to achieve greater viewpoint diversity.[6] Sadly, the train of consolidation continues to run on time.

[6] The U.S. Supreme Court has recognized diverse broadcasting viewpoints as a legitimate basis for the FCC, acting pursuant to its "public interest" statutory mandate, to adopt measures to increase the number of competing licensees and to encourage licensees to present varied views on issues of public concern. *See, e.g., FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775 (1978*); Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969); *United States v. Storer Broadcasting Co*., 351 U.S. 192 (1956); *Associated Press v. United States*, 326 U.S. 1 (1945); *National Broadcasting Co. v. United States*, 319 U.S. 190 (1943).