ABSTRACT

VERTICAL INTEGRATION AND PERFORMANCE
OF THE TELEVISION NETWORKS

By

Barry Russell Litman

This dissertation examines the effect that network vertical integration into the production, station ownership, and affiliation spheres has on various criteria of programming performance as well as on diversity in the market place of ideas. The major conclusion is that such integration was in the past and continues to be an important cog in the engine of power and control that has been amassed by the three networks.

The first area of concern is the affiliation agreement which is really vertical integration by contract. This all or nothing contract has perpetrated an industry structure comprised of very profitable VHF affiliates and a group of independent stations which are relegated to the fringes of the market and as a group suffer net losses. It is shown in this thesis how independent stations, whether VHF or UHF, can more easily compete during the non-network hours when the advantage of affiliation is reduced. A plan is suggested to eliminate affiliation ties and substitute a program by program bidding process. This plan would allow all stations to compete on a more equal footing and also stimulate the entry of new networks.

The second concern involves network ownership of television stations. Evidence is presented showing that whenever an entity wears both a network and station owner's hat, inevitable conflicts of interest occur which are inimical to the public interest. The network owned stations do not exercise their fiduciary responsibility to choose those programs best suited to their local constituency; rather, they simply clear 100 percent of their parent network's programs. In a similar light, the network owned stations as a group have significant buying power in the syndication industry and have used this power at the station level to protect the viability of the network organization. Also, the affiliation agreement between a network and its owned stations is forever sheltered from the forces of competition and this may cause stagnation in the management of these stations as well as the other stations excluded in this manner. Because of all of these anti-competitive practices, the effects of a divestiture order of these stations is measured. The results of multiple regression analysis demonstrate that such a policy would cause no deterioration in the programming performance categories important to the Commission.

Finally, evidence is presented which shows that the networks' vertical integration into the production sphere tended to exacerbate the oligopsony power of the networks. Contrary to the Spengler theory of vertical integration, there is no increase in output, decrease in price, nor increase in quality arising from such integration. Rather, the dividend accrued to the networks in the form of increased rent. Integration into the production sphere also creates the power of self-preference, and if this power is used, it may significantly influence the flow of ideas through the market place of discourse. Using a

discrimination model, it is shown how the networks have preferred their own product over similar fare from independent producers. It is then concluded that the public interest would best be served if the networks were not allowed to produce their own programs.

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CHAPTER I

INTRODUCTION

The American broadcasting system is founded on the First Amendment principle that the American people have a paramount right to be informed,[1] that the dissemination of news and other information should emanate from "as many different sources and with as many different facets and colors as is possible."[2] Yet, this lofty ideal must be confronted with the real world situation, where for the last twenty years, only three network organizations have determined to a great extent what would flow through this important marketplace of ideas. This dissertation not only explores the reason for the discrepancy between the promise of television to create a multitude of tongues and the resultant tendency toward imitation and repetition (what Minnow calls the vast wasteland) but also how entrenched and powerful these three networks are within the television industry. The major focus of this dissertation will be to measure the effect of a vertically integrated network structure upon various programming indices of performance.

While traditional economic theorists would predict that vertical integration cannot hurt and oftentimes can improve the allocation of resources and reduce prices to consumers, the television industry has many unique characteristics which modify these traditional

theories and make economic analysis much more complex. The American broadcasting industry does not fit neatly into one of the ideal market structures of economic theory. Its product has attributes of a public good in the sense that exclusion is very difficult and/or costly; one person's consumption does not crowd out another's; and the marginal cost of an additional viewer approaches zero. While such products normally are provided by a government bureaucracy funded through tax dollars, television programs are provided freely to consumers and access to this vast audience is sold on the market to advertisers.

Secondly, there is a short circuiting of the market for television programs in the sense that consumers may only express their preferences for programs through the ballot box of ratings rather than the intensity of their preferences through dollar votes in the market. This may cause a discrepancy in the types of programs produced and the types desired especially by the minority of viewers whose potential reservation price for specialized fare is neglected in favor of the advertiser's appeal to the lowest common denominator.

> Advertisers are interested in selling things not in entertainment, not in edification. And selling although it's a large occupation and an honorable one in this society of ours, is not the best criterion of what makes for opinion and what makes for literature or drama.[3]

Finally, not every person has an inalienable right to broadcast as he does to speak, write, or publish[4] because the electromagnetic spectrum (the airwaves) is limited and part of the public domain; hence, broadcasters who are granted a license for part of this

spectrum must accordingly conform to the "public interest" as determined by the Federal Communications Commission.

The Commission and courts have recently decided that the limited spectrum means that broadcasters have a special responsibility to insure a balanced or "fair" presentation of all controversial questions.[5] They are in essence the custodians of the marketplace of discourse. In another light, the Commission has sought to diminish some of the power of the three networks by forcing them out of the syndication business and forbidding them access to one hour of prime time in the top 50 markets.[6] The hope of these latter actions was to dissipate the networks' stranglehold on prime time and encourage new networks (e.g., new voices) to enter the industry. Hence, the idea persists that the broadcasting industry must remain open and free to as many different sources as is economically possible, and this is the central theme which runs through this dissertation.

In more specific terms, this dissertation is really an extension of the Commission's findings in the Prime-Time Access Rules[7] in which it became alarmed at the increasing trend toward vertical integration by contract and the allegations by program producers that without surrendering subsidiary rights and profit participations, they were denied access to network prime time. This self-preference takes on a greater meaning when it is realized that such preference is contrary to the fiduciary responsibility of broadcasters to be impartial judges of what is best for the American people to view during the crucial nighttime hours. This dissertation will examine vertical integration by the networks through affiliation contracts, ownership

of television stations, and production of television programs. It will concentrate on the following four important questions:

1. Does ownership of fifteen television stations in the most lucrative markets allow the networks to have a double powered sword by which they can determine access not only to network time but also to non-network hours? Furthermore, do they use their power as station owners to buttress their position in networking?

2. Does such ownership of stations result in inevitable conflicts of interest between the business of networking (and the necessity to clear local stations' time) and the fiduciary responsibility of local stations to choose those programs best suited for their local market? In this context, what would be the result of a divestiture policy of such network owned and operated stations?

3. Does the affiliation contract unnecessarily deter entry of new networks or producers of syndicated programs? And if so, what type of structural reforms can be instituted which will take advantage of the economies of scale inherent in networking yet at the same time increase the degree of competition within the industry?

4. What is the effect of the networks' entrance into the production of their own programs especially theatrical motion pictures and made-for-television movies? Does such production cause unnecessary foreclosure in the marketplace of ideas and solidify the buying power of the networks vis-a-vis their suppliers?

Chapter II examines the various theories of vertical integration and sorts out those theories which may have significance within the context of the television broadcast industry. Chapters III and IV provide a general institutional background to the industry as well

as a history of Commission actions which bear on the question of the vertical aspects of structure within the industry. These chapters are necessary not only to give an historical perspective to the current questions but also to provide a framework for the remedy suggested in Chapter IV.

Chapters V, VI, VII, and VIII are the real heart of the dissertation. They test some of the hypotheses arising out of the four basic questions presented in this chapter and reformulated in Chapter II. Chapter V analyzes the issue of network ownership of television stations and tests the hypothesis that such stations act differently (and in ways inimical to the public interest) than similarly situated stations owned by non-network entities. The effect of divestiture of such stations on the "quality" of programming is also measured using multiple regression analysis. Chapters VI and VII analyze the theory that the networks have entered movie production in order to perfect a buying cartel and exercise monopsony power. In these chapters, the effect of such integration is measured in terms of various quality components of programming testing whether there has been any change in quality or price as conventional theory predicts. Chapter VIII presents the evidence on self-preference using a discrimination model. The basic hypothesis is that the network executives have either a utility function or a long-run profit incentive which causes them to sacrifice short-run profits for inclusion of programs in the television schedule in which they have creative control. The resulting self-preference is not in the public interest. Chapter IX is a summary of the results of the

previous chapters and also provides a brief glimpse of the future of broadcasting.

FOOTNOTES FOR CHAPTER I

1. "In the Matter of Editorializing by Broadcast Licenses," 13 *F.C.C. Reports* 1246, 1247 (1949).

2. *U.S. vs. Associated Press* (52 F. Supp. 362, 372 [1943]).

3. Federal Communications Commission, *Television Network Program Procurement,* Part II, Second Interim Report by Office of Network Study (Washington, D.C.: Government Printing Office, 1965), p. 625.

4. *Red Lion Broadcasting Co. v. F.C.C.* (395 U.S. 367, 388 [1969]).

5. *Ibid.*

6. Federal Communications Commission, "Prime-Time Access Report and Order," Docket 12782, May 4, 1970, 23 *F.C.C. Reports* 2d, 387, 8.

7. *Ibid.*

CHAPTER II

THEORIES OF VERTICAL INTEGRATION

2.1. Introduction

Like many other practices of a firm such as its pricing structure or its outlays on advertising or research, vertical integration may reflect the essence of competition or the worst features of monopoly. It may be a strategy for accomplishing more efficiently what the market does inadequately or one of attempting to control the market against competitive excesses.

> The statement that a firm is vertically integrated says nothing about its relationship to the outside world; it tells nothing about power or abuse of power. Hence it implies neither monopoly or absence of monopoly... it is a neutral term.[1]

For these reasons, it is necessary to examine the structure of each individual industry and weigh the costs, in terms of less competition, alongside the possible benefits, in terms of greater efficiency, arising from such practices as vertical integration. Casual empiricism or abstract theorizing no doubt has led many down the path of least resistance. This chapter examines in detail both of the leading schools of thought on vertical integration focusing on the predictions of each side in the context of the television broadcasting industry.

2.2. The Efficiency Arguments

The question of vertical integration deals with the mechanics of production-distribution. It is not a theoretical question so much as it is an empirical one. Vertical integration may have beneficial consequences to the extent it improves the efficiency of the production process. When the market mechanism fails to deliver the goods according to proper specifications, firms often organize internally to provide the functions at a lesser cost or greater control. According to Mueller, several possible efficiency gains may arise from vertical integration: (1) Production costs may fall because of technological considerations--the total cost of operating two stages being less under combined than separate ownership. (2) It may result in coordinated control of the combined production process. (3) A firm may avoid selling costs by developing captive markets.[2] Williamson[3] sees in vertical integration the means for settling dispute by fiat rather than undergoing a costly series of negotiations with the supplier resulting in joint profit drains. While such internalization does not eliminate the need for input cost evaluation, it facilitates the planning and policing problems and reduces the uncertainty attendant with both short and long term contracts. Buying in has always been a risky business. Hence, for Williamson and Mueller the elimination of market transactions or the economies inherent in integrated production may necessitate the joining together of two separate stages of production. Rather than being anticompetitive, this increase in efficiency reflects the essence of competition in an economy.

On the other hand, Stigler in reexamining the work of Adam Smith in light of modern industrial society, admonishes those proponents of the "make" and not "buy in" persuasion:

> Those too numerous people who believe that transactions between firms are expensive, those within firms are free, will do well to study the organization of England during this period of eminence....Consider the small-arms industry in 1860, when Birmingham was still the leading production center of the world....The division of labor is not a quaint practice of the eighteenth century pin factories, it is a fundamental principle of economic organization.[4]

Stigler (and Kahn) also consider the question of how vertical integration fits into the evolutionary organization of industries. They claim that vertical disintegration should dominate if one considers the full life of an industry. In their infancy, industries must overcome technical problems of production themselves. They must design their specialized equipment and often manufacture it themselves. After the industry has reached a certain maturity, many of the processes are important enough to be farmed out to specialists. Finally, when the industry starts to decline, it affects those auxiliary and dependent industries, and they no longer find it profitable to supply the parent industry. Hence, the parent industry must reappropriate those functions which are no longer viable for specialized industries.[5]

Contrary to this evolutionary theory is one which claims that integration may be historically cumulative:

> If insiders develop technology and embrace new ideas ....The die is more likely to be cast for retention of integration and correction of emergent imbalances by further integration than lopping off awkwardly protuberant parts....Where the dominant position is established, costs are sunk and the cost of additions is estimated incrementally.[6]

There is then no easy answer to those critics of the present anti-trust policy who bewail the absence of any general theory or definition of vertical integration. No two industries evolve and mature alike and at predictable time periods. The degree of vertical integration is often a result of historical accident or government favors.

> The boundaries between the stages are usually traditional rather than logical. While all businesses partake of vertical integration....Nevertheless there are differences in degree so great as to amount to differences in kind.[7]

2.3. Cost Savings for the Networks

In terms of the television broadcast industry, the networks claim that their television stations act independently and negotiate at an arm's length distance with the network. If this is true, then one can easily dismiss the efficiency argument in this sphere because economies supposedly arise from either the joint operation of the two stages or the elimination of the market transactions. However, Chapter V will show that the network hierarchy does indeed control the entire networking-owned and operated station sphere, and in this regard there may be some transactions savings arising out of an entity wearing both its network and station owner hats.

Since programs are not really being transformed by the stations in a physical production process but the relationship is more a wholesaling-retailing one, there are no cost savings arising from the joining together of the production process. How much of a transaction cost savings does the network realize from owning some stations? Not very much, since the only transaction occurs

when networks are seeking clearances prior to the season. The stations either clear or do not clear, and the clearance price is fixed for every program regardless of quality; hence, the number of transactions between a network and its affiliates is minimal, and thus vertical integration into station owning cannot be justified on efficiency grounds.

Secondly, the networks also integrated into the production of their programming requirements. To the extent that the networks are able to produce similar quality fare at lesser cost than their former suppliers, one could justify such integration on efficiency grounds. Although there is no concrete evidence available on this question, one frequently hears tales of the very high overhead expenses of the major movie companies due mainly to excess and outdated facilities. On the other hand, it is known (and will be shown in Chapter VI) that the networks also maintain excess capacity. Hence, without more evidence, one cannot make a judgment on this question; but if there is a difference between the efficiencies of the networks and their suppliers, it is probably minimal in any regard. Therefore, in the television industry, one cannot expect vertical integration to lead to significant cost savings in terms of either decreased transactions costs or increases in productive efficiency.

2.4. The Spengler Effect

In his classic article, Joseph Spengler sets out a very simplistic model which purportedly shows the "irrationality" of the present antitrust emphasis on forestalling vertical integration.

For Spengler (and Bork), if vertical integration is associated with any anticompetitive abuses, the real problem lies in the seeds of previously existing horizontal power which is supposedly curable under the antitrust acts. In an imperfectly competitive world, vertical integration enables the higher stage producers to evade pyramiding monopolistic surcharges imposed by lower stage suppliers. The integrated firm finds it advantageous and profitable to increase output and lower prices to consumers.[8]

Spengler begins his analysis with the case of a firm with no horizontal power which considers integrating into another stage of production characterized by perfectly competitive firms. He confirms the obvious that there is no rationale save greater efficiency to be gained by vertical integration. Under such circumstances, vertical integration would neither reduce cost per unit in any stage nor make possible the realization of greater profits. Accordingly, it is a matter of indifference to consumers as well as producers. More important is the second case of three successive stages of monopolists. Crucial to this model are the following four assumptions: (1) A completely closed vertical relationship exists (each of the lower stage monopolists provides exactly the amount necessary for the higher stage). (2) The monopolists practice short-run profit maximization. (3) Constant costs are present across all three stages of production. (4) Each succeeding stage myopically takes the price of the preceding stage as a given. It can now be demonstrated that if vertical integration took place across all three stages, the firm would transfer intermediate goods at cost and extract only one monopoly profit. The saving of the

monopoly surcharges would enable the firm to produce more of the final product at a lower cost to consumers.[9] Using such a theory of vertical integration, it is easy to understand why this school of thought feels that the tough antitrust stand against vertical integration is an unsound one based upon faulty economic logic.

2.5. Adams-Dirlam-Kahn School

In opposition to the Spengler theory on vertical integration is a school of thought headed by Adams, Dirlam, and Kahn. In essence, these people believe that the assumptions upon which the Spengler model are based are unrealistic and too simplistic in the context of complex real world industries. A look will be taken at some of their criticisms and then an attempt is made to apply both schools of thought to the problem at hand in the television broadcasting industry.

2.5.1. Technical Criticisms

First, there is a technical error in the formulation of this model. Spengler has assumed that the firms in the three stages produce an output exactly equal to that of its supplier/customer; "yet he drew the factor cost curves perfectly horizontal as if they were buying as pure competitors." Moreover, the demand curves for the intermediate product are not derived from the final product's demand as they should have been.[10] Similarly, the Spengler theory assumes a myopic behavior on the part of downstream producers with regard to the prices of the upstream producers. Without this assumption, it seems equally valid to assume that both monopolists might agree to produce the identical output that occurs

"automatically" after integration. If this is true, then the consumer reaps no extra output, price, or consumer surplus dividend from the joining together of the two stages of production.

Thirdly, it is crucial to Spengler's argument that the final stage monopolist *perceive* that his costs have fallen--that the internal transfer price is less than the former market price. Only then will he make the correct decision, only then will he "understand" that a new incentive has appeared for him to lower prices and increase output. But many commentators do not believe that this scenario will indeed be played out:

> There is little to show that transfer prices within a vertically integrated firm would in actuality be set at a lower than market price. Hence we would not anticipate that a shift to vertical integration...would be reflected in appreciable price reductions because of elimination of interstitial profits. In fact, the probabilities would seem to lie in the opposite direction.[11]

Ironically, even Bork realizes that vertically integrated firms do not obtain their product at cost:

> The A&P court moreover thought that vertical integration enabled A&P to get its supplies at cost while its competitors paid the market price. *This is a recurrent fallacy*. A&P had to charge itself for the products of its manufacturing subsidiaries *what those producers would have brought on the market*. The real costs remained whatever bookkeeping stunts were performed.[12] [italics mine]

A more serious problem which is likely to occur is that the optimum plant size at each level of production is not likely to coincide at one profit maximizing output. Hence, while some plants are producing at capacity, others may have idle resources. The net result may be higher rather than lower operating costs and efficiency after vertical integration occurs. And this is in addition to

possible diseconomies of management control inherent in running a larger enterprise.[13]

In a broader attack, Mueller[14] suggests that "great care" must be used in generalizing from idealized market structures to real world ones. It is inappropriate to use the monopoly model to evaluate the performance of oligopolists. While a monopolist might not have an incentive to integrate into a perfectly competitive industry, it might be worthwhile for oligopolists if it raises entry barriers and strengthens a previously weak cartel. Under this latter scenario, the strengthened selling cartel may then be in a position to raise prices and restrict output to the level foretold by monopoly theory, even with the attendant cost reduction. Chapter VI explores this question with respect to the networks' entrance into the production of regular fare and made-for-television movies. It is hypothesized that such vertical integration may be used to strengthen the network buying cartel and enhance their monopsony power.

> Similarly, although theory shows that vertically integrated related industries perform better under single control, we can't use this model to argue that two successive industries would perform better if both were under the control of one group of oligopolists than if under its own group of oligopolists.[15]

Finally, assuming arguendo that Spengler's theory is correct, it is nonetheless a short-run rather than a long-run model and totally neglects the fact that vertical integration may heighten the barriers to entry. Once these two facts are incorporated into the Spengler model, the analysis becomes even less secure. Remember

that the final stage price after integration is after all still a monopoly price although somewhat below the price without integration. If this lowered long-run price acts as a deterrent to entry or it now becomes impossible to enter the industry except at all stages of production, then the vertical integration may perpetuate a higher long-run price than would have prevailed had not the barriers to entry been increased. Therefore, while it is true that the consumer may initially realize some short-run price reductions due to vertical integration, the present value of the price he pays over a stream of time may be greater than if there had been no vertical integration and entry had occurred sooner and driven down prices below the vertically integrated one. Thus, the Spengler short-run phenomenon may overstate the allocative effect of vertical integration.[16]

Dirlam and Kahn's summation of the Spengler argument exemplifies the essential difference between the two schools of thought:

> Spengler's prescription is one of ideal or perfection. Were it possible to have an unlimited number of taxi franchises, first-run movie houses, or telephone companies, the exclusive arrangement would be non-objectionable....Were there no scarcity in the supply of Bing Crosby movies, pipelines, iron ore, or desirable sites for generating electric power, the exclusive link of a purchaser with a supplier would not impair competition at the buyer's level. *But given such imperfections, it is the vertical integration which may extend them to otherwise competitive strata*.[17] [italics mine]

In Chapter VIII, this entire question of whether vertical integration by the television networks can indeed expand output and decrease prices will be examined in great depth. Because of natural scarcities in the electromagnetic spectrum and hours in the

broadcast day as well as man-made scarcities in the number of advertising minutes, the supply of product is perfectly inelastic in network broadcasting and such a wrinkle significantly affects the predictions of the Spengler theory.

2.5.2. Parlaying Horizontal Power

Having dismissed away the Spengler theory, the Adams-Dirlam-Kahn school analyzes vertical integration as a tool for harnessing horizontal market power and transmitting or parlaying it across successive stages of production. This school does not generally claim that without the existence of horizontal power, a synergistic monopoly can be created where none existed before. They merely claim that when significant horizontal power is already present, this confers strategic advantages or leverage into newly integrated levels of production. Adams explains that vertical integration is not an optical illusion:

> It can be used as an instrument for parlaying horizontal power at one stage into strategic leverage over another....It is the very real power to decide whether nonintegrated competitors shall be tolerated, disciplined, coerced, or excluded. *It is the power to determine the conditions of entry and the rules for survival in the industry.*[18] [italics mine]

2.5.3. The Flexibility Arguments

A very important question left unanswered by the Spengler school is whether it is worthwhile for a monopolist to have more than one monopoly. Are there any advantages over and above the efficiency gains? Schumpeter warned monopolists against the "gale of creative destruction" which blows an ill wind for those bent on maintaining their position over time. Changing technology rather

than interfirm rivalry is the real meaning of competition, and Adams points out that monopolists seek storm shelters against these gales either through privately acquired protection or government favors. This explains why powerful firms continually invest in barriers to entry, surround their patented products with other patents, or tie one good with another. They want to lead the quiet life; yet, that nagging fear of a changing technology, a changing world, continually presses against their corporate minds. They never feel secure. They never have enough power.[19] As Alfred Marshall says, to have a double monopoly or to be vertically integrated in separate stages is a storm shelter against the possibility of a changing technology which may possibly shake one but is unlikely to weaken both sectors at the same time.

> For instance, if there be only one factory for spinning and weaving on a small isolated country, it may be for the time in the public interest that the two should be in the same hands. But the monopoly so established will be harder to shake than would either half of it separately.[20]

It is thus a strategy of reducing risks and raising the ante in the poker game.

In another light, possessing two monopolies or obtaining leverage through vertical integration may allow the firm a flexibility in extorting the monopoly toll. It can determine at which level to capture the monopoly profit, and this determination changes over time according to changes in technology, demand, laws, and public pressure.[21] Now, such a flexibility in extracting profits need not be a neutral move by the firm; it also may provide the

power to squeeze nonintegrated competitors at one of the stages of production. As Edwards notes:

> So long as the vertically integrated concern is self contained, its occupancy of successive stages in the process of production and distribution does not accord it additional power beyond that which springs from its proportion of the market at a particular stage or from its aggregate size. But where such a concern has been disproportionately integrated so that at one or more stages...it acts as a supplier or customer for enterprises with which it is in competition at later stages, *the existence of vertical integration may become the basis for a special type of power*. If a disproportionately integrated concern is big enough to be important to its competitors, *it has the power to squeeze them*.[22] [italics mine]

Most integrated companies are rarely in perfect balance because of disproportionate optimal plant sizes, recognition of managerial diseconomies of scale, historical accident, lack of capital, or strategic considerations. If such enterprises are suppliers or buyers from nonintegrated firms with which they compete at another stage, then the integrated firms can strategically and flexibly manipulate relative prices and compress the operating margins of those firms less fortunately situated. For the integrated firm, high input costs are simply accounting or bookkeeping transactions, but for the nonintegrated competitors, they are real costs which place him at a competitive disadvantage. It is frequently alleged that squeezes or other types of cross-subsidizing practices from secure to competitive markets are irrational acts of behavior since they only drain profits. The critics may be correct from a short-run time horizon, but to the extent that such practices stabilize prices and profits, and deter entry, they are clearly wise investments for those powerful firms which would rather lead

the worry-free easy life. These powerful firms have not taken the Schumpeterian forecast lightly; they concern themselves with the whole ballgame and not what happens in the early innings.

2.5.4. Flexibility and Television Broadcasting

In the television industry, the networks currently are only partially integrated in the production sphere and only supply a relatively small amount of their own needs. Because of this, there is no great advantage to take the monopoly profit at this level since it would only drive up input prices throughout the industry. Rather, the incentive lies in the opposite direction, that is, vertical integration into production may act as a threat to full foreclosure and a general depressant on input prices.[23] In short, since none of the networks is currently large enough to supply fare to the other competitor networks, there is no opportunity to drive others from the networking business through the use of a squeeze. However, if at some point in time the networks become large producers, they may decide to drive up input prices, increase the number of original episodes, or change the other rules of the game to further deter such potential entrants. Being integrated, some of the increased input prices would merely represent a transfer of income from one subsidiary to another; however, the new rival would have to pay the full measure of the increased costs. At present, such a scenario seems very remote.

On the other hand, the station ownership sphere provides a better opportunity for exercising power across the different strata of production. Suppose a new network wants to set up shop in

competition with the three established firms, but it decides to enter only at the networking level. The established networks may then try to squeeze this potential entrant by raising the clearance prices in, say, the top 15 markets which account for 42% of all television homes. New networks might then be forced to match these higher prices in order to obtain affiliates or lure away existing ones from the other networks. But notice that the existing networks need not suffer as great a financial drain as the new or potential entrant because they each own five of those stations covering 25% of the television homes. The existing networks would consequently have to pay higher prices to stations covering 17% of the television homes while the new or potential entrant must pay them to stations covering 42% of the national market. If the price increases are limited to the top ten markets which cover 34% of the national market, then the existing networks need pay increases to only 10% while the new entrant must pay the entire amount. The essence of this argument is that because the existing networks own stations covering such a large share of the total market, they have the power and opportunity whether exercised or not to squeeze those firms desiring to enter at only the networking level. While the price increases are real to the new entrant, to a great extent they are merely bookkeeping entries to the vertically integrated ones. Thus, the lesson can be taught or the potential firm might come to realize, that entry must occur at both stages of production, and this heightened barrier may be partly responsible for the absence of such entry since 1950. Unfortunately, there is no concrete

evidence on squeezes and thus the theory is simply given to demonstrate the power and opportunity available to the networks.

2.5.5. Foreclosure

Just as a squeeze is not an optical illusion, neither is the foreclosure of competitors from supplies or access to markets. Vertical integration when accompanied by exclusive dealing shrinks the open portion of the market and thereby raises the scale barriers to entry by the so-called "percentage effect."[24] If the foreclosure is large enough, it may force small nonintegrated firms from the market or relegate them to second class status by having their very existence dependent on the integrated firms. The frequent response of the nonintegrated firms to lack of adequate supplies or access at reasonable prices is for them to integrate as a defensive measure. Hence, *vertical integration may breed vertical integration apart from any gains in efficiency*. As more firms integrate, the open portion of the market becomes more constricted and small independents face an even more precarious existence. As Mueller notes, not all firms are equally capable of succeeding in the "contagious merger race." The larger firms will have easier access to capital and will find it easier to gain merger partners.[25] Finally, the net result of this merger race may be a totally integrated oligopolistically controlled industry in which small nonintegrated firms compete at only a subcontracting level.[26]

In the television broadcasting industry, the major complaint of the movie producers is that when the networks integrated into theatrical movies, this created the power for the networks to

foreclose them from access to the airwaves. As Chapter VIII more thoroughly explores, the networks had the ability to cream-skim the top "A" motion pictures from the major movie companies and provide their own needs in lesser quality fare. While normally the product of one's upstream producers is indistinguishable and interchangeable, and thus self-preference is irrelevant to consumers, in television broadcasting it has special importance. The decision to prefer one's own product is a decision to exclude other ideas and thoughts from the marketplace of ideas and to unnaturally influence the outcome of competition for access to this marketplace. Hence, vertical integration by those possessing significant monopsony power means that the networks have the power to exert even greater control over what the American viewer watches during the most important viewing hours. It therefore represents a special hazard--a constriction of the open market of ideas which is the foundation of our democracy.

2.5.6. Entry Barriers

The contagious drive to integrate teaches a lesson not only to those independents forced from the industry but also to those firms contemplating entry at some future date. The fact that it is becoming increasingly difficult or perhaps impossible to obtain supplies or access at regular intervals, at reasonable prices, and at acceptable quality levels, will generally *force a new entrant to come in at both levels*. This means more capital must be raised (perhaps at a higher price) and entry barriers are thereby heightened precisely because two stages of production have been joined together.

Vertical integration may also raise the barriers to entry to the extent it increases product differentiation through manufacturer-distributor chains (i.e., exclusive dealing arrangements like service stations or brand names).

> A firm so integrated can discipline its nonintegrated competitors through a foreclosure of access to markets, denial of supplies, or manipulation of relative prices so as to effect a simple or a double squeeze. Vertical integration, therefore, when it is combined with elements of horizontal power and dual distribution, can make a formidable barrier to entry. It becomes a structural obstacle to workable competition and tends to relegate competition to the interstices and fringes of an industry.[27]

To the extent that vertical integration does indeed heighten the barriers to entry, the firm will obtain a stream of revenues over time from the enhancement or maintenance of its monopolistic power. It will also spend a considerable amount of money on building the requisite capacity or acquiring firms in the next stage of production. Hence, the decision to vertically integrate is like any other investment decision--one must weigh both the stream of benefits and costs to determine if it is a profitable strategy.

In the television broadcast industry, the question of heightened barriers to entry arises in the context of the networks owning television stations and thereby gaining automatic access to valuable time. The position is advanced in Chapter V that such ownership becomes necessary and desirable for new firms seeking entrance at the network level. Perhaps more important in this context is the question of the vertical integration by contract present in the affiliation agreements (see Chapter IV). Such all or nothing contracts virtually tie up access to the most desirable station time

across the country, relegate independent UHF television to a marginal existence, and thereby indirectly prevent new entry of competitive networks.

2.5.7. The Search for Stability

As alluded to above, the prime goal of any powerful firm is to have the option of living the easy life free from the headaches of cut-throat competition, unreliable suppliers, and the vagaries of the economy. The "quiet life" hypothesis is best explained in the famous dictum of Judge Hand in the Aluminum Company case:

> Many people believe that possession of unchallenged economic power deadens initiative, discourages thrift and depresses energy; that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress; *that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough alone.*[28] [italics mine]

In order to live the secure and easy life, the firm must gain "control" of its operations and of its destiny; it must stabilize its position and that of the marketplace in which it operates. Vertical integration is one tool for controlling and stabilizing the situation. Kahn describes the motives of the major integrated oil companies as a search for stability and security: "The stability comes not from diversifying one's risks but from mutual reinforcement; not from scattering resources but from consolidating them."[29] The greater the control that oligopolists can gain over every phase of their industry, "the less overt a combination must be to insulate prices against competitive deterioration at the hands of independents" somewhere along the vertical chain. The greater the security and stability of oligopolists, the more power they can exert.[30] The more

power they have, the greater the probability that they will lead the "quiet life." With respect to the television networks, one must therefore not look at the short-run situation of maximizing profits but rather at the long-run cycle of obtaining total control of the industry from production through broadcasting as a method of maintaining high barriers to entry and significant influence with the Commission. This will be a subtheme which runs through this dissertation.

In summary, this chapter has presented a number of theories of vertical integration and has applied them to the structure of the television broadcast industry. This has led to a number of testable hypotheses concerning the effect of such integration on performance by the television networks in the production and broadcasting spheres. The remainder of this dissertation will more fully explore these hypotheses and try to reach some definitive conclusions about the effect of vertical integration in this key industry.

FOOTNOTES FOR CHAPTER II

1. Corwin, D. Edwards, "Vertical Integration and the Monopoly Problem," *Journal of Marketing*, vol. 17 (April, 1953), p. 404.

2. Willard E. Mueller, "Public Policy Toward Mergers," in Peltzman and Weston, eds., *Public Policy Toward Mergers* (Pacific Palisades: Goodyear, 1969), p. 151.

3. Oliver E. Williamson, "The Vertical Integration of Production: Market Failure Considerations," *American Economic Review*, vol. 61 (May, 1971), pp. 116-117.

4. George J. Stigler, "The Division of Labor is Limited by the Extent of the Market," *Journal of Political Economy*, vol. 59 (June, 1951), p. 193.

5. *Ibid.*, p. 190.

6. Alfred Kahn and M. G. deChazeau, *Integration and Competition in the Petroleum Industry* (New Haven: Yale University Press, 1959), p. 43.

7. Edwards, pp. 404-405.

8. Joseph J. Spengler, "Vertical Integration and Antitrust Policy," *Journal of Political Economy*, vol. 58 (August, 1950), pp. 348-352. Also see J. R. Gould, "The Firm's Demand for Intermediate Products," *Economica*, vol. 27 (February, 1960), pp. 32-41. Gould disproves the commonly held belief that it would not pay the firm to buy in whenever the market transaction price of the intermediate product exceeds both the average and marginal costs of producing that product within the firm. Gould shows that for a range of prices above the average and marginal costs of production, buying in is still the optimal policy.

9. The leading theory of bilateral monopolies is also consonant with the results of the Spengler-Bork theory on vertical integration--that is, that vertical integration of formerly fragmented monopolies will increase output and lower prices to consumers. For a detailed analysis of bilateral monopoly theory and vertical integration, see Fritz Machlup and M. Taber, "Bilateral Monopoly, Successive Monopoly, and Vertical Integration," *Economica*, vol. 27 (May, 1960), pp. 101-119.

10. *Ibid.*, p. 114.

11. Walter Adams and Joel Dirlam, "Steel Imports and Vertical Oligopoly Power," *American Economic Review*, vol. 14 (September, 1964), p. 653.

12. Robert Bork, "Vertical Integration and the Sherman Act: The Legal History of an Economic Misconception," *University of Chicago Law Review*, vol. 19 (1954), pp. 183-184.

13. Manley R. Irwin, *The Telecommunications Industry* (East Lansing: Michigan State University, 1971), p. 115.

14. Mueller, pp. 153-154.

15. *Ibid.*

16. Assume P_{12} is the final stage price after vertical integration as hypothesized by the Spengler model; P_{11} is the final stage price before vertical integration ($P_{11} > P_{12}$); and P_{21} is the price after entry has occurred in the industry ($P_{21} < P_{12}$ since it is assumed that vertical integration raises the barriers to entry). Over a period of time, there would be two streams of prices, stream A which assumes no vertical integration and early entry, and stream B which assumes vertical integration and heightened barriers. Will the present value of stream A be equal to, greater than, or less than stream B?

$$\text{A.} \quad \sum_{i=1}^{F} P_{11}(1+r)^{-i} + \sum_{i=F+1}^{N} P_{21}(i+r)^{-i}$$

$$\text{B.} \quad \sum_{j=1}^{N} P_{12}(1+r)^{-j}$$

1. This will depend upon the differential between P_{11} (the very high nonintegrated price) and P_{12} (the integrated price) as well as between P_{21} (the lower entry price) and P_{12}. The smaller the former differential and the larger the latter differential, the quicker will stream A converge with stream B.

2. The smaller is F relative to N--that is, the fewer the number of years at which P_{11} prevails relative to P_{21}, the quicker will stream A converge with stream B.

3. If the discount rate (r) is low, the future values (or price differentials) become worth relatively more in the stream. Hence, the lower is the discount rate, the faster will stream A converge with stream B.

In summary, the Spengler theory overstates the benefits to consumers which accrue from vertical integration because it neglects the aforementioned price differentials, increased height

of the barriers, and the rate of time discount. It is perfectly possible under this new analysis for the consumer to pay a higher long-run price because of the vertical integration. This would occur if the present value of stream A exceeded that of stream B.

17. Joel Dirlam and Alfred Kahn, *Fair Competition: The Law and Economics of Antitrust Policy* (Ithaca: Cornell University Press, 1954), p. 147.

18. Walter Adams, "Corporate Power and Economic Apologetics," in Peltzman and Weston, eds., *Public Policy Toward Mergers*, second edition (Pacific Palisades: Goodyear, 1975), p. 366.

19. An excellent example of how such a scenario works is portrayed by Manley Irwin in his analysis of the AT&T-Western Electric combination. When a regulated monopoly extends its operations by producing what it formerly purchased, it can easily broaden the range of its legal monopoly. It can internalize all transactions and force those who wish to cream skim to compete with a non-price. When challenged competitively in some marginal portion of its business, the "natural" monopolist will fight by tooth and nail to regain and maintain its markets from competitive encroachment. The fear of losing power casts all other thoughts to the wayside. See Manley Irwin, testimony in F.C.C. Docket No. 19129, January, 1975.

20. Alfred Marshall quoted in Machlup and Taber, p. 117.

21. The best example of such a strategic flexibility lies in the oil industry. Adams, Dirlam, Kahn and others have demonstrated how the major integrated oil companies have changed the level at which they use their power. At first, the powerful Standard Oil company built its monopoly at the refining level and extended back into distribution. With no control over crude production in the early days, John D. Rockefeller felt that the refining-transport layer formed the best bottleneck through which all must pass. Later, when the government instituted its prorationing control over supply and passed through Congress the depletion allowance, a radical change occurred in the industry as the majors integrated at a fast pace into production and decided to capture their profits at this stage. Even today, the incentive still remains to capture the profits at the crude oil stage by posting high prices.

22. Corwin D. Edwards, *Maintaining Fair Competition* (New York: McGraw-Hill, 1949), p. 98.

23. Sometimes, only the credible threat of vertical integration by buyers is enough to convince recalcitrant sellers to lower their prices near cost. Alternatively, partial integration may be used as both a means of maintaining a feel for costs and of forcing the independent suppliers to withstand the ups and downs of the economy. During booms, the partially integrated firm can meet the peak demands by contracting out for the extra requirements while during slumps, outside orders are cut back. Hence, the outside

suppliers must ride the roller coaster of the economy while the integrated firm produces near capacity at all times. In the Bell System, outside suppliers may even have to bear the risk of innovation without the reaping of long term profits. This can occur whenever Western Electric decides to make rather than buy in. See Irwin testimony, p. 52.

24. Mueller, p. 152.

25. *Ibid.*, p. 164.

26. Such is the case in the Bell System where subcontractors are hired by Western Electric to perform marginal tasks--not part of the main communications link. Foreclosure is obvious when operating companies refuse to purchase products from outside competitors in favor of future promised products from Western Electric at undetermined prices. (Irwin seminar at Michigan State University.)

27. Adams, p. 365.

28. *U.S. v. Aluminum Company of America* 148 F.2d 416, 427.

29. Kahn and deChazeau, p. 107.

30. *Ibid.*, pp. 432-446, 472.

CHAPTER III

THE INSTITUTIONS OF THE BROADCAST INDUSTRY

3.1. Introduction

To understand the structure of the television industry, it is paramount to understand the underlying economics behind such institutions as networks, stations, advertisers, and program suppliers, and how policies of the F.C.C. may directly or indirectly alter these relationships. In the course of such an exposition, it may also be instructive to detail the various paths which different fare may take to finally appear on the public's television sets and to identify the characters involved in this scenario, assessing their power or influence relative to each other and to the system as a whole.

3.2. The Regulatory Framework and the Allocations Problem

A natural scarcity of the electromagnetic spectrum meant that free competition in broadcasting would lead to inevitable and widespread interference as firms jockeyed for position and advantages. Because of the vitalness of the airwaves to the national defense and mass communications field, broadcasting very early became "clothed with a public interest." Government took an active role to insure good performance and to protect the consumer. Faced with the alternatives of total regulation from program production through

the actual broadcast or indirect control through a licensing of stations which would then operate at the pleasure of the government, the Congress finally chose the latter option in the Communications Act of 1934.[1] The former option suggested the potentiality of too much government interference with freedom of speech--a basic democratic principle which is the foundation of our democracy. In exchange for the grant of a license to broadcast, the government receives a quid pro quo promise from the station owner to program in the "public interest" in his local community. This less encumbersome regulatory path is founded on the concept of maximum competition among a limited number of local broadcasters--a system having the fullest measure of freedom of expression in the competition of ideas where broadcasters would operate as private entrepreneurs consistent with their responsibility to adequately serve the public.[2] This public responsibility is policed by a license renewal hearing every three years. While license renewal is usually an automatic procedure, five television and 82 radio licenses have either been revoked or denied renewal in the period since the inception of the Commission. Of course, lesser sanctions such as fines and short renewals are much more commonplace.[3]

To understand the current structure of the television broadcast industry, it may be worthwhile to briefly review some of the past F.C.C. decisions which were crucial turning points in the evolution of structure and power in this industry. The question of allocations has always been the paramount concern of the F.C.C., occupying the bulk of its time. This is the source of its legislative mandate, and hence the Commission has always been very

careful in how it doles out these government privileges. From the very beginning, the Commission has favored a policy of providing television for all the people in the United States. In its list of priorities, this ranks at the very top.[4] No one should be denied the experience of television--it is too crucial as a medium of communications and as an influencer of public opinion. Consequently, every local community should have control over what is broadcast over the air to its local citizens. Early in the history of television broadcasting, the question of how to implement such a worthy policy came up and the F.C.C. had a difficult decision over which band of the spectrum would be most technologically adaptable to television. While UHF (ultra high frequency) was much larger and could accommodate more frequencies, nevertheless, it had transmission problems which made its development less certain and lengthier. The Commission, desiring that television obtain a quick start from the blocks, chose the much narrower VHF band (very high frequency) as the prime instrument for implementing its policy of providing television for all the people with as much speed as possible. The UHF spectrum would be developed as quickly as possible and would help to satisfy the second priority of providing a television station to as many local communities as possible. This mixed bag of large powerful VHF stations intermixed with smaller, less developed UHF stations would continue until the time that UHF technology caught up with VHF; then all frequencies would be in the UHF band and compete on an equal footing. While the F.C.C. talked about the long run when all stations would be UHF, it nonetheless created a powerful lobbying concern which would not

want its power diminished at a later and more convenient hour. While it may be argued that in such a virgin field as broadcasting, the F.C.C. took the best road possible and could not be expected to perfectly foresee the future, it should be remembered that the Commission faced a very similar situation in the AM-FM radio allocations and either did not learn its lesson or did not want to learn it.

With these wheels set in progress, it soon became apparent that the UHF system was much weaker than VHF and only an affirmative action program in favor of UHF would lead to an eventual balance or equilibrium between similarly situated stations in the two systems. VHF had greater appeal because of greater network affiliation and thus higher quality programs. The VHF stations were generally bought up by businessmen who owned radio stations already affiliated with the two major radio networks--CBS and NBC. When these two networks moved into television, the VHF owners naturally followed the path of least resistance and business convenience and hence affiliated with them. In this way, CBS and NBC gained a powerful leverage into television through their existing power in radio. This points up another lack of foresight by the F.C.C. and the Congress. While the ideal of each local station being free to select the appropriate programming for its local public is indeed a worthy goal, the practical economics of broadcasting lends itself to the formation of networks with the consequent surrender of local autonomy over program selection to those not required by law to act in the public interest. The Commission knew that powerful networks were inevitable in television just as they had been in radio; yet, it chose policies creating a limited number of powerful

stations which would eventually mean a few very powerful networks. Hence, the Commission wanted both localism and diversity, but it failed to understand that these two goals were antagonistic rather than complementary and required a tradeoff of sorts.

VHF still had technical superiority--it could cover a wider area with a clearer signal as compared to a similar UHF station. But most importantly, the public had overwhelmingly purchased VHF only receivers which would get clearer signals and better programming rather than UHF only receivers or the more expensive all channel receivers.

> It was a vicious circle for the UHF independents. They cannot develop all channel set circulation because they are unable to present sufficiently attractive programs and cannot obtain first rate programs because they lack sufficient set circulation to attract high priced advertisers.[5]

In 1952, a "freeze" on further television station allocations was instituted by the Commission so it could consider some of its most pressing problems. This four-year period was a crucial turning point in the development of television. VHF stations were affiliated with networks and had a much higher survival rate while UHF stations were in a clear and present danger of foundering; yet, television was not so developed that a once and for all time change at this juncture would have markedly retarded its future development. Nevertheless, the Commission took the familiar regulatory protectionist policy of not wishing to upset the applecart, not wanting to change the status quo and disrupt the service to the public. Why move from a system of known good service to one of uncertainty and confusion? What the F.C.C. really meant was, why hurt your friends?[6]

As one famous lawyer and former chairman described it:

> Let's face it, this was the whorehouse era of the Commission. When matters were arranged and not adjudicated....This was the era when the Commission lost its virginity and liked it so much, it turned pro.[7]

The F.C.C. decided to continue its mixed allocation policy rather than move to an all UHF system. It rejected as out of hand a proposal by DuMont which would have created powerful regional stations to facilitate the formation of more competitive networks and hence more quality viewing options for the public. Finally, it postponed the requests of some small communities to "deintermix" their markets--to convert their markets to all UHF rather than retain the mixed bag which so favored the local VHF stations. While failing to act affirmatively on these pressing allocation questions, it enhanced the competitive advantage of VHF by authorizing increases in the permissible antenna heights and maximal power which only VHF was in a technical position to achieve.[8] Even the "freeze" itself, which dragged on for four years rather than the planned three to six months, is seen by Stewart Long as entrenching a proven VHF technology at the expense of a much younger UHF technology at a critical point in the latter's evolution. It allowed a coalescing of power for the VHF system while UHF was halted in the midstream of its development.[9] It assured CBS and NBC of an almost impregnable position in television much like they had achieved in radio.

In summary, the F.C.C. laid down a clear perspective for a nation-wide and competitive service which would utilize the vast UHF portion of the spectrum. It allowed the quick exploitation of the VHF band only as an expedient fast interim mechanism to achieve

nation-wide coverage. Yet, when the opportune time arrived to switch to its long-run game plan, it balked at the thought of disrupting the nation-wide service that had been achieved and dreaded the confusion and financial losses that would result when VHF licenses were switched or not renewed. It chose a non-neutral policy of promoting the status quo and hence its friends. The net result of its policy was to cement a two tiered structure in the broadcasting industry consisting of the haves (the networks and the VHF affiliates) and the have-nots (the independent VHF's and most of the UHF stations). The former would thrive while the latter would live a marginal existence--never able to fully compete and often dependent on the networks for their livelihood.

3.3. Networking

A television network consists of a number of geographically distinct television stations which are generally separately owned and operated and are interconnected by telephone coaxial cables or microwave relays so as to be capable of the simultaneous broadcast of the same television programs. A network can be as few as two stations or as many as 200 domestic and many foreign outlets; it can be a temporary one-shot special association (i.e., to cover a regional sporting event) or a permanent one consisting of long-term affiliation contracts (i.e., the ABC, CBS, NBC systems). Networking becomes profitable for two major reasons. First, the public goods nature of television programs means that one person's consumption during a time period does not lessen the consumption of another person during the same time period. Hence, a program's

quality does not diminish as more and more people view it. Secondly, when two or more stations form a network, they need produce only one program and can share the cost. Thus, aside from a slight increase in the interconnection costs between the stations, the average costs decline for both stations and the profits (from networking) for the stations will increase (or the losses will diminish). The most important relationship is between the dollars spent on programming and the resultant ratings that occur. While a local advertiser or a station may be very willing to spend $50,000 to reach a million people, what happens if it takes $250,000 to provide attractive enough programming to induce that many viewers to substitute television for other leisure time activities? Only by sharing the costs of programming through simultaneous networking can a station afford to produce the programs that generate the audience while not at the same time pricing television out of the advertising market. Therefore, economies of scale occur in programming-broadcasting and foretell the inevitable evolution of networking as a prime vehicle for the broadcasting industry.[10]

Whether the network arises from a mutual joining together of stations seeking to cut costs or from the emergence of middlemen who assemble national and regional linkups to take advantage of the economies of scale, the analysis is essentially identical. Because the concept of an independent network as the broker of local stations' time is the practice of the industry, this will be the sole focus of this analysis. As a broker of local stations' time, the network acts as a middleman between the suppliers of programs, the stations, and the national advertisers. It secures contracts

with a number of geographically dispersed stations for access to their frequencies and in turn sells to advertisers time in which it supplies programs and attached commercial messages over the entire network.

> The network need not own stations, provide cable or microwave interconnection or produce programs. It merely must maintain a brokerage office to bring national advertisers (the buyers) into contact with the sellers, the television stations who have time.[11]

Time is sold either on a per minute participation basis or to sponsor the entire show, and price is a function of the expected number of viewers (the expected ratings). Therefore, the emergence of networks should not be surprising. Their economic origin arises from their ability to reduce costs to broadcasters (by simultaneous broadcasting), to national advertisers (by diminishing the number of transactions required), and to program suppliers (by central dealing and long-term commitments).

The present television networks do not conform to the pure model of a network as simply the broker of time. They are the crucial bottleneck of the industry engaged in production of programs, ownership of stations, and various other related activities subsidiary to their major role in television. For a more detailed model of the economics of networking, see Appendix A.

3.4. The Network Monopoly

The network triopoly is the single most important force in television broadcasting today. As the brokers for between 177-217 local stations' time, the networks control the crucial bottleneck through which all national programs must pass. With their ownership

of some of the most lucrative television stations, they can exert significant influence and control over the syndication business. Because of the natural scarcity of television stations, widespread economies of scale, and past artificial restraints on competition, the networks have evolved into a very profitable operation. Looking at Table 3.1, one can see that network time sales for the years 1970-1974 averaged 46.5 percent of all time sales for the entire industry (including the 680 commercial stations). For the same time period, the networks (including their 15 owned and operated stations) have accounted for 40 percent of the total broadcast income of the industry. For the year 1974, the networks earned by themselves $225.1 million on a depreciated stock of tangible capital equipment of $101.1 million for a rate of return equaling 222.8 percent. The 15 owned and operated stations earned $105.7 million on a rate base of only $38.9 million of tangible equipment for a return of 271.7 percent. If we add the two terms, the combined rate of return to the networks is 236.4 percent. Table 3.2 also illustrates the general profitability involved in owning a television station with the possible exception of a UHF station in a small market.

The national television industry possesses all of the characteristics which allow monopsony power to also imply monopoly power.[12] The networks understood this logic. They discovered that widespread economies of scale existed in distribution and that the addition of all but the smallest markets was marginally profitable. Not satisfied with the short term position of affluence that accompanies most monopolies, the networks set upon an expansionist course of conduct which would enable them to lead the quiet life in perpetuity.

Table 3.1. Gross Advertising Revenues (in millions)

Year	Total	Network	% of Total	National Spot	% of Total	Local	% of Total
1974	$4353.8	$2005.3	46.1	$1336.1	30.7	$1012.4	23.2
1973	4002.1	1839.7	46.0	1230.2	30.7	932.2	23.3
1972	3675.0	1687.5	45.9	1177.4	32.0	810.1	22.0
1971	3178.8	1490.4	46.9	1022.8	32.2	665.6	20.9
1970	3242.8	1551.1	47.8	1102.6	34.0	589.1	18.2
1969	3235.5	1569.6	48.5	1119.1	34.6	546.8	16.9
1968	2916.1	1424.3	48.8	1009.8	34.6	482.0	16.5
1967	2634.4	1359.1	51.6	882.7	33.5	392.6	14.9
1966	2557.6	1302.4	50.9	882.2	34.5	373.0	14.6
1965	2265.9	1141.7	50.4	795.9	35.1	328.3	14.5
1964	2067.8	1044.8	50.5	721.2	34.9	301.8	14.6
1963	1836.4	944.7	51.4	626.0	34.1	265.7	14.5
1962	1704.7	886.6	52.0	564.4	33.1	253.7	14.9
1961	1514.3	801.9	53.0	489.5	32.0	222.9	15.0

SOURCE: F.C.C. Annual Report Fiscal 1973, 75.

Table 3.2. Rates of Return on Depreciated Rate Bases

	1974	1973	1972	1971
1. Networks:				
Income (millions) / Rate base (millions)	225.1 / 101.05 = 222.8%	184.8 / 101.085* = 182.8%	110.9 / 101.12 = 109.6%	53.7 / 107.96 = 49.7%
2. Owned and operated:				
Income / Rate base	105.7 / 38.90 = 271.7%	102.8 / 34.5* = 298.0%	102.5 / 30.10 = 340.6%	91.2 / 34.21 = 266.7%
3. Total (1 and 2)				
Income / Rate base	330.8 / 139.95 = 236.4%	287.6 / 135.585* = 212.1%	213.4 / 131.21 = 162.6%	144.9 / 142.17 = 101.9%
4. Other VHF				
Income / Rate base	411.1 / 523.40 = 84.9%	373.1 / 496.59* = 75.1%	354.7 / 469.78 = 75.5%	277.0 / 465.72 = 59.5%
5. UHF				
Income / Rate base	(4.9) / 114.29 = (4.3%)	(7.7) / 117.885* = (6.5%)	(15.9) / 121.48 = (13.1%)	(32.7) / 121.833 = (26.8%)

Table 3.2 (continued)

	1974	1973	1972	1971
6. All stations except 0 and 0's				
Income / Rate base	$\frac{406.3}{637.69}$ = 63.7%	$\frac{365.4}{614.475*}$ = 59.5%	$\frac{338.8}{591.26}$ = 57.3%	$\frac{244.3}{587.552}$ = 41.6%
7. All of broadcasting (1, 2, 4, 5)				
Income / Rate base	$\frac{737.1}{777.63}$ = 94.8%	$\frac{653.1}{750.060*}$ = 87.1%	$\frac{552.2}{722.47}$ = 76.4%	$\frac{389.2}{729.72}$ = 53.3%

SOURCE: F.C.C. Annual Reports 1969-1974.

The networks built their power structure from a base of flagship stations in the best markets. These markets would cross subsidize the networking business until television was widely accepted by the American people. It should also be remembered that RCA (the parent company of NBC) and CBS both produced television sets and thus had a secondary interest in the promotion and success of television. Promising quality programming plus a share of the national advertising revenues, the networks were able to sign affiliation agreements with the major stations in the country and thus solidify their control over the exhibition of television programs. Using such practices as "option time" and "must-buy," they insured clearance of an overwhelming majority of their best programs in the most lucrative markets. The networks even sought control over the production of network fare, the syndication of local programs, the creative inputs and even the copyrighted music used in their shows.[13]

When their power was endangered by proposed restrictive rules, the networks fought by tooth and nail to soften the impact of the rules, always forecasting the end of national broadcasting if the status quo was altered. The networks have been able to exert great influence in these regulatory proceedings, and compromises are the usual result.[14] When threatened by a changing technology, the networks have either stifled the wide development of the new systems (i.e., favoring cable restrictions) or else sought control over its development (i.e., satellites).[15] Ideally, the networks would like to be totally integrated and self-sufficient in production of network fare, control over creative inputs, station ownership and syndication. In this way, they could control every important facet

of their industry and lead the quiet life. Whether the networks ever had the wherewithal and capital funds to become totally self-sufficient or even if this was their secret desire will never be known because F.C.C. rules generally prevent any such undertaking. Of more importance is whether the current structure of the industry nevertheless allows them to control nearly every phase of the business. While they may not have achieved their goal of self-sufficiency, is *what they have so enormous that it may be thought of as the equivalent of a totally integrated vertical structure?*

3.5. The Stations

There are 900 television stations in the United States today, 680 commercial and 220 educational. Each station has a free government license to operate in a certain portion of the electromagnetic spectrum. Those stations located in the largest markets are more valuable because each dollar spent on programming attracts a greater number of viewers and hence lowers the advertiser's cost per thousand. Because of the UHF handicap in reception, possessing a VHF station (*ceteris paribus*) will generally mean larger profits. And because VHF stations are more profitable, they generally attract the second most coveted prize (the first being the license itself) of network affiliation. In all but the largest markets where independent stations are generally successful or the very smallest markets where even if affiliated the stations will seldom be "ordered" by advertisers, having a network affiliation means the difference between profits and losses, life and death.

3.5.1. The Profitability of Stations

For the fiscal year 1974, the F.C.C. reports that total income for all broadcasting stations was $511.87 million. The VHF stations as a group accounted for $516.75 million or 101.0 percent of the total earnings with 85.1 percent of them reporting profits. On the other hand, the UHF stations as a group lost $4.89 million with only 47.9 percent of them reporting profits. In terms of affiliation, the VHF affiliates earned $508.41 million (98.4 percent of the total income) with 87.3 percent of these stations having profits, and the UHF affiliates earned an additional $6.037 million with 57.1 percent of them reporting profits. As for the independents, the VHF's which are only located in the top markets earned $8.34 million with 54.8 percent of their number reporting profits while the UHF independents lost $10.93 million and only 29.1 percent of them earned profits.[16] The conclusion is inescapable. Being an affiliate significantly increases a station's income.

Besen confirms this casual empiricism with his regression analysis on the determinants of the value of a station's time. This value, as reflected by the station's published advertising rate, depends significantly on the size of the market, the number of competing television stations (and other mass media to some extent), whether the station is affiliated with a national network, and whether it is UHF or VHF.[17] Further evidence that such a quasi rent does in fact exist has been provided by Levin in his regressions on station sales prices. He finds that the sales price of a station depends on various indicia of market size, age of the station, and network affiliation.[18] The best stations will be VHF,

located in large cities, and affiliated with a national network, preferably CBS or NBC. While an affiliation agreement is not an ironclad guarantee of success, it is nevertheless highly desired and very valuable.

3.5.2. The Affiliation Agreement

The way the affiliation relationship works is as follows: A network will contractually affiliate or franchise with a local station for a period of two years agreeing to provide the local station with a schedule of television programs. The network will demand (but cannot compel) that the stations carry or "clear" each show in the lineup. Of course, since the station owner (and not the network) has the statutory responsibility for what is broadcast over his frequency, he has the last word on whether a program conforms to the local corollary of the "public interest" and whether it should be cleared. Formerly, each of the networks had a contractual option whereby with 56 days' notice it could preempt specified hours of a local station's time with a network show, and the station was required to carry the show unless it could "prove" it was not in the public interest or it had a substitute program of substantial local or national interest.[19] In return for granting this option over its time to a network (or as the practice now exists of voluntarily agreeing to clear the show), the station receives compensation amounting to 30 percent of its standard station rate--the value of its time, that is, the net contribution of the station to the total advertising package. These station rates and the percentages remitted to the stations are often

bargaining issues in the affiliation renewal process but for the most part reflect the size of the market and other important demographic facts.[20] Out of its 70% share of the time sales from each station, the network pays for the interconnection costs with AT&T, the advertising agency commissions, and all of its various functions including the provision of sustaining programs.[21]

Why should a local station accept only 30 percent of its advertising rate for televising a network program when it can get a much larger amount of money from national spot or local advertisers if it takes over the programming responsibility? The answer is first that the national spot and local rates are lower than the network rate because of the larger transaction costs that advertisers must experience and because of the supposed quality differential between a network and a local show. Second, a local station incurs very little expense in accepting a network program. It simply flicks on the switch and everything is provided. On the other hand, to substitute a non-network show is a risky business with no certainty of success. If the local show flops, the station could be out in the cold and undergo substantial economic setbacks. Why not just accept the network fare and lead the easy life? Third, since the Chain Broadcasting Rules, a network may offer the uncleared show to a competitor in the market, probably an independent station. Fourth, the whole point of affiliation is that the quality of the network lineup is a continuous and superior product. When network shows are adjacent to one another, this drives up the value of the local commercial break in between the network shows. This so-called "adjacency effect" drives up the prices of local and

national spot advertising time and increases the profitablity of the station. Finally, if the station fails to clear enough programs, it may face the prospect of disaffiliation which means a loss of the quasi rent associated with belonging to a network.

Besen and Soligo provide a simple calculus for a station which is considering whether to clear a network show or use a non-network program during the i^{th} hour of the day. The station compares the return from each alternative:[22]

$$V_i^{\ell} = A_i^{\ell} + S_i^{\ell} - C_i$$

V_i^{ℓ} is the return from a non-network program.

A_i^{ℓ} is the value of advertising time for the i^{th} hour.

S_i^{ℓ} is the value of advertising time during the adjacencies.

C_i is the cost of the program.

$$V_i^{n} = \rho A_i^{n} + S_i^{n}$$

V_i^{n} is the return from a network program.

ρ is the percentage of national advertising revenue accruing to the station.

If $V_i^{\ell} > V_i^{n}$, then the station will not clear the network program. The decision to clear obviously depends on the value of ρ negotiated with the network. They then construct a graph indicating for each level of ρ the value of hours the affiliate will clear. As ρ increases, the stations clear more of the network programs. An interesting result of their analysis is the fact that some stations will clear network programs even if ρ is less than 0. In other words, they would be willing to pay for affiliation because of the

contribution to profits of the adjacency effect. There is corroborating evidence that some smaller markets do pay the interconnection charges just to be affiliated with the network. Besen and Soligo also introduce the concept of free hours into their analysis. Each network requires that its affiliate accept so many hours (usually 5-25) without compensation in order to help the network out with its overhead and interconnection costs.

> By setting a high ρ, the networks can induce clearance while setting a large X_i (free hours), they can in effect price discriminate. The uncompensated time constraint thus appears as a relatively simple yet sophisticated device for practicing price discrimination among hours to eliminate almost all the profits from affiliation.[23]

Consequently, this important bargaining agreement between the network and the affiliate involves three dimensions: number of free hours, station rate, and the percentage of the station rate accruing to the affiliate. The power usually resides in the network since affiliation means the difference between an easy life and a marginal existence for a station. This is especially true if there are more stations in a market than networks so the threat of disaffiliation is very real. However, when a local market contains fewer stations than networks (and the market is of some importance) the station may itself threaten to affiliate with another network and exact valuable concessions in its agreement. Evidence that this latter situation occurs is provided in the Second Interim Report which mentions disparate rates for stations similarly situated but with different numbers of local competitors.[24] It has also been alleged that multiple station owners can use their

important markets as a bargaining tool for obtaining concessions in less important marginal markets.

3.6. The Advertisers

National advertisers commit over a billion dollars a year to finance the programs which appear freely over the public's television sets. The advertisers do not do this gratuitously or with a grandiose altruism toward supporting the arts or providing leisure time entertainment; they hope that by constant repetition and lively information, they can retain their old customers and induce new ones to purchase their products. Advertisers thus weigh the benefits of sponsoring programs (increased familiarity causing sales to increase) against the direct dollar outlays and the indirect costs (the loss of sales if their competitors advertise and they do not). It is of little concern here whether such persuasive advertising wastes society's resources as some economists claim. The important point is that advertisers see in television a relatively low cost way of reaching viewers, and eventually consumers pay for "free" television through surcharges attached to the advertised product.

The success of television depends critically on the advertising budgets of the largest companies in the United States, and these budgets reflect the condition of the economy at every turning point. When the economy is in a recession, the networks must still incur the costs of production even if the shows are not fully sponsored. Formerly, only very large giants like U.S. Steel, Alcoa, Armstrong Rubber, Texaco, DuPont, and Westinghouse could afford to sponsor programs because a huge financial commitment to produce and/or

sponsor the entire show for 26 or 52 weeks was required. During the late 50's and early 60's, the networks and advertisers changed the structure of this market with the networks assuming the financial risks involved in programming and selling 30 or 60 second advertising "spots" in each show. This move allowed advertisers to spread their risks and hedge their bets on a number of shows rather than chance everything on a particular program. The networks claim (in the Second Interim Report) that with the rising costs of programming due to color filming, on location shooting, hour length programs, and general inflation, few advertisers could commit for a full show for 26 or 52 weeks. Hence, the "magazine" approach of spot participations became the only possible means of continuing commercial television at the quality level the public was accustomed to.[25] While this plan also permitted networks to diversify their clients and thus hedge against slowdowns in certain sectors of the economy, the major result of this change in policy was to allow the smaller advertisers to compete for national time alongside their larger and more entrenched competitors. There was a diminishing advertiser concentration in television as a result of this change. Nevertheless, the top 25 national advertisers still account for 49 percent of the network television billings and 31 percent of the national spot dollars.[26]

However, the spreading of advertiser risks also meant the diffusion of responsibility and control over the quality of the programs. Hence,the networks had to assume the responsibility for what was being broadcast. In the hearings, several advertisers complained that they liked the identity and prestige that accompanied

the sponsorship of a "U.S. Steel Hour" or an "Armstrong Circle Theatre." Rather than appeal to a large number of diverse viewership, these advertisers presented unique programs which supposedly would appeal to those consumers most likely to purchase their products.[27] With the networks assuming greater financial risks, they became more centrist and could take less programming risks and hence these advertisers felt that distinct quality programming had diminished into mediocre mass conformity.[28]

In the television business, ratings and the marketplace determine the price advertisers pay for the commercials within the programs. While the three television networks compete against each other for sales, approximately 400 sponsors bid against one another to purchase a virtually fixed supply of commercial minutes.[29] Advertisers bid for minutes on each television program. The price per minute will reflect the prevailing strength of advertising demand in general as well as the expected ratings of the program. So if in general advertisers are willing to pay $4 per thousand viewers, then a show which can be expected to deliver 12 million homes would sell for about $48,000 a minute. According to Pearce, once a program becomes a hit and achieves ratings superiority in its time spot, it can demand a premium. He says that in 1973, the show "All in the Family" was sold for an all-time record of $120,000 per minute.[30] With an average rating of 31 percent of all houses using television, this comes to about 20 million viewers. Consequently, "All in the Family" was selling at a CPM of $6--nearly $1 greater than the CPM of the average prime-time show.[31] If a

program's ratings start to fall and this causes a failure to clear by some major markets, then the network may be forced to cancel.

National advertisers decide which of the network's 200 affiliated markets they want to "order." Because of the nonuniform distribution of population in the United States, it turns out that the top 50 markets contain 70 percent of all households using televisions and the top 100 markets nearly 87 percent. Since the time or station rates in the largest markets is set at a less than proportionate rate to the increased population, the actual cost per thousand is less and advertisers will thus place a greater number of orders in the top 50 or 100 markets.[32] For example, the average VHF affiliate station rate in New York City is $9,000 for an hour's time and reaching 6 million television homes while the rate in Detroit is $3,300/hour and reaching 1.5 million homes. Consequently, the CPM for New York is $1.50 while for Detroit it is $2.20.[33]

Formerly, NBC and CBS insisted that an advertiser place a "minimum" order on its so-called "must-buy" list in order to keep the network functioning as a national advertising medium. This must-buy list was supposedly just adequate to defray the fixed costs which the network had to incur in its brokerage function. CBS and NBC required national advertisers seeking access to network time to order a specified group of local market affiliates. For CBS the "must-buy" basic group included the five owned and operated stations plus 54 other designated stations; for NBC, the group included its seven owned and operated stations and 50 other designated stations. Since ABC was a much less powerful force in networking, it only required its five owned and operated stations and

such additional affiliates to yield no less than $50,000 for an evening hour.[34] The charge was leveled during the concentration hearings that "must-buy" was the equivalent of a tied good in the sense that advertisers were forced to order some markets which they did not desire in order to get the more valuable ones. The basic required stations were a package which represented an all or nothing decision. The networks countered such charges with the argument that must-buy represented only a minimum floor for doing business--a minimum order similar to that of many industries. Needless to say, those favored stations on the must-buy list became very profitable. Must-buy was modified by the F.C.C. so that regional sponsors can now order that part of the country in which they are most interested without having to purchase other less desirable regions. The advertiser's decision to add an additional region will of course depend on the marginal benefits and marginal costs of the additional markets.

3.7. The Supply of Programs

Taking an overall perspective, the suppliers of television fare operate in a monopolistically competitive field. This business is characterized by easy entry, well developed rental markets for the factors of production, wide ranges of firm size and types, and the fact that the networks handle the distribution of the fare.[35] There are four different types of fare that may appear on the television set: (1) Live fare which mainly consists of news, sports, and public information shows. (2) Film or taped original network programs produced by independents, the networks themselves, or

through a joint venture between the two. This is the most prevalent form of programming running the range from cartoons, to daytime serials and game shows, to prime-time adventure and variety shows. (3) The first-run television showing of a theatrical movie which is leased from the movie companies after the theatrical run is essentially completed. (4) The syndication market which includes some first run non-network programs but for the most part consists of old network reruns and old movies which have completed their network run.

3.7.1. The Syndication Market

The syndication business is a throwback to the old system (before networking took control) where a series is sold on a station by station basis, usually beginning at the top and moving down to the smaller markets.[36] It has evolved into something akin to the used car market where dealers polish up their specimen, predicting high ratings, making boastful claims as to the number of markets sold and the number of prime customers (women aged 18-49). After about four reruns in each market of such series as "The Beverly Hillbillies," "The Lucy Show," or "Gilligan's Island," the series have lost their value and are laid to rest. The important point to understand is that the success of an off-network (or rerun) depends on the success of the show in its original network run. Clearly a program which lasts only 13 weeks will have virtually no value in the syndication market while one that lasts five to ten years such as "Mission Impossible" or "Ironside" could become a virtual goldmine. Unless the original network run is at least

three years, the prospects for syndication success can best be termed bleak. Local stations like to "strip" shows (show them every day of the week) to habitualize the viewer into watching on a daily basis. With only 22-24 new episodes produced per year for the network, it is paramount for the show to enjoy a long network run to produce enough episodes for stripping on the local stations.

The syndication market has become the prime source of programming for the local broadcast industry, exclusively for independent stations and as a filler between network programs for affiliated stations. The syndication business is somewhat concentrated with 15 firms accounting for approximately 85 percent of the market for series syndication, the largest firm accounting for less than 10 percent.[37] According to many sources, the price for a given exclusive episode of a syndicated show depends upon the time period it will be shown, the size of the market, and the expected rating (which usually depends upon the popularity and duration of the network run). Pearce reports that syndicated companies try to get a thousand dollars for each percentage point of the national television households in an area. Since New York has 10 percent of the national households, a station would have to pay $10,000 per episode for two plays.[38] In the foreign markets, there is relatively little value to most half-hour situation comedies since the peculiarities of American culture are not present abroad. The greatest interest is in long form action drama shows where total revenue may be $40,000/episode in foreign syndication.[39]

The overwhelming majority of syndicated shows are off-network reruns because the costs of production are sunk, and the syndicator

need only cover the expenses of market by market distribution, the payment of residuals to the creative talents which produced the programs, and maintenance and positive film printing costs. Hence, off-network syndicated programs are generally cheaper and therefore more profitable than either locally produced or first-run syndicated fare and, of course, their quality is known *a priori*. The only exception to this rule concerns those foreign series being shown for the first time on American television and those game and variety shows which formerly had a run on network television or are seen during the day on the networks. Shows like "Lawrence Welk," "Hee Haw," "Wild Kingdom," "Let's Make a Deal," and "Truth or Consequences" easily illustrate this point. Looking at Table 3.3, one sees the preponderance of game shows (over 50 percent), music variety and nature wildlife programs during the prime-time access hours. This table also illustrates and corroborates the charge that television tends to program according to the mass-appeal choices of the public and emphasizes uniformity rather than diversity.

3.7.2. The Network Suppliers

In many cases, those companies which have a dominant position in the production of motion pictures are also large in supplying network television programs. According to the tables below, the eight major movie houses account for nearly half of the prime-time series. Many commentators (Pearce, Owen, and others) have noted that television, once the biggest threat to the motion picture business, is now a crucial link in its future. The long run decline in the movie business was hastened by the advent of television,

Table 3.3. Prime-Time Access First-Run Shows Ranked by National Ratings

Program		Program Type	National Nielsen Rating (weekday)	Number of Markets
1.	Hee Haw	Variety	23	192
2.	Lawrence Welk	Variety	22	195
3.	Price is Right	Game	17	123
4.	Truth or Consequences	Game	17	84
5.	Hollywood Squares (2)	Game	16	115
6.	To Tell the Truth	Game	16	87
7.	Wild Kingdom	Nature	15	192
8.	Candid Camera	Comedy	14	120
9.	Let's Make A Deal (2)	Game	14	90
10.	Name That Tune	Game	14	85
11.	$25,000 Pyramid	Game	14	73
12.	World At War	Documentary	14	21
13.	Don Adams' Screen Test	Game	13	80
14.	Bobby Vinton	Variety	13	66
15.	Animal World	Nature	13	55
16.	Match Game	Game	12	73
17.	Treasure Hunt	Game	12	64
18.	Last of the Wild	Nature	12	48
19.	Concentration	Game	12	42
20.	National Geographic	Documentary	12	17
21.	Space 1999	Action-Adventure	9	124
22.	High Rollers	Game	6	14

SOURCE: *Variety*, February 18, 1976.

Table 3.4. Suppliers of Made-For-TV Movies (9/10/73-9/8/74)

	ABC		CBS		NBC		Total	
	New	Rep	New	Rep	New	Rep	New	Rep
MCA	22	22	3	3	11	5	36	30
Spelling-Goldberg	7	9	-	-	-	-	7	9
Columbia	6	3	-	-	1	4	7	7
Fox	2	2	3	2	1	1	6	5
Warner	3	2	1	2	2	3	6	7
MGM	2	2	1	2	1	1	4	5
Lorimar	3	2	1	2	-	-	4	4
GE Tomorrow	2	3	2	2	-	-	4	5
Wolper	4	3	-	-	-	-	4	3
Metromedia	2	1	-	-	1	1	3	2
D. Thomas	2	2	-	-	1	1	3	3
Dan Curtis	2	2	1	0	-	-	3	2
Paramount	0	2	-	-	2	1	2	3
QM	1	1	1	1	-	-	2	2
Network	9	8	3	3	-	-	12	11
Other	10	8	6	4	5	3	21	15
	77	72	22	21	25	20	124	113

SOURCE: Tucker-Anthony Report, p. 16.

Table 3.5. Market Shares of Prime-Time Series Sales

Packager/Year	1964-1965	1965-1966	1966-1967	1967-1968	1970-1971	1971-1972	1972-1973	1973-1974
Universal (incl. Revue, MCA)	14	11	11	5	13	22	19	22
Warner Bros.	1	3	1	1	0	3	7	6
Paramount (incl. Plautus)	3	0	2	0	10	12	9	10
Screen Gems	3	6	7	5	7	4	5	5
MGM	6	5	7	7	2	3	3	5
United Artists	2	3	2	0	0	0	0	0
20th Century Fox	4	9	12	8	4	4	3	4
Others	66	62	56	74	64	53	54	49
Totals[a]	100	100	100	100	100	100	100	100

[a]Individual shares may not add up to 100 percent, due to rounding.

SOURCE: Appendix, Table 2-16. Owen, Television Economics, p. 22.

and naturally the movie companies moved into the new opportunities which television opened up. While the production techniques differ between the two media (i.e., time schedules are shorter and budgets are lower in television), most producers eventually made the transition. In recent years, the prominence of the made-for-television movie with its promise of greater creative freedom and larger budgets has even lured some of the stalwarts who had categorically refused to stifle their creative talents in the medium of television. Today, the movie houses rely on television for half of their total revenues--not only the direct television fare but also the supplying of theatrical movies for network and syndication showings.[40] According to Pearce, investment decisions on movies are evaluated with respect to the profit potential in three markets: (1) U.S. theatres; (2) foreign theatres; (3) leasing to television, both home and abroad. "Some studios will approve production of a movie only if it is viable in all three markets."[41] Besides the major movie producers, some small independents such as Quinn Martin, Tandem, and Mary Tyler Moore at times supply a disproportionately large share of the prime-time fare. In the 1974-1975 season, these independents produced at least 11 programs in prime-time on the three networks.[42]

The most recent trend has been the expansion of the prime time made available for movies to 12 hours/week across all three networks combined. The licensing cost for each run of the movie approximately equals the production cost of two hours of series fare that it replaces but generally gets first-run ratings which are about five points higher than that of the average series.[43] The evidence for

made-for-television movies seems slightly less impressive (about two to four points higher), but this category now comprises about 60% of all the movies shown on network television.[44] The reason theatrical movies generally obtain higher ratings is explained by the much higher costs that went into the original production leading to higher quality spectacles than the average series. A contrary but popular view holds that since networks try to habitualize their viewers with the same characters week after week, one might expect these series to effectively compete against the more expensive movies.

3.7.3. The Creative Path to Television

There are probably as many ways in which an idea or property reaches television as there are shows. Some are original, others adapted from successful plays, movies, books, foreign television shows or are spinoffs of current television hits. A network does not simply choose its programs in isolation by estimating an expected audience ranking. Rather, it must consider a lineup of programs taking into account the peculiar audience characteristics of each night of the week as well as how each show affects others in the nightly schedule. Important considerations include whether a continuity of entertainment is achieved as opposed to abrupt transitions. A network will try to capture the "audience flow"--make one show blend into the next one so that the public refrains from switching channels. Hence, ABC might put together an all detective-action lineup while CBS might assemble a nightly schedule of situation comedies (e.g., "All in the Family," "The Jeffersons,"

"Mary Tyler Moore," "Bob Newhart," and "Carol Burnett"), or the appeal might be towards a country theme featuring the "Beverly Hillbillies," "Green Acres," and "Hee Haw." A network such as ABC with poor ratings may try to "counterprogram" against the other two networks with blockbuster movies, football games, or totally different types of programming in order to lure away the audiences for at least part of the time and thereby break the audience flow pattern of the more successful network.[45] Each network thus has its own identity and many failures occur when the networks attempt to step out of character. According to Brown, the viewer intuitively knows that NBC comes more naturally to anthology melodrama dealing with contemporary themes and to sophisticated comedy; that CBS excels in situation comedy, rustic entertainment and star hosted variety shows; that ABC is best at action adventure, family cultures, and exploiting new vogues in popular culture.[46]

The basic starting point is then an idea which is derived from one of the above mentioned sources. Since each network has its own style and personality, an exceptional idea will appeal to one while the other two networks have no use for it. Either the network-advertiser thinks up the idea and approaches writers and producers to mold it into a workable property or a movie production company or an independent packager approaches the network with his own ideas. An independent packager is usually either a talent agency or representative of some big star and offers the star, writers, and directors as a preassembled package. If the network desires this package, the agency collects 10 percent of the production costs for its services. Once the idea has been accepted, the next step is the financing of

a script which usually runs $10-15,000. If this is approved, a pilot is filmed for $300-500,000/hour. The final step is the network order (really an option) for 13 or 26 shows. The attrition rate in the selection process is extremely high. For the 1974-1975 prime-time season, 24 new shows were accepted. These shows were culled from over 90 pilots. Hence the fallout rate is about 70 percent. While no statistics are available on the number of story ideas and script developments, it is generally accepted that 2/3 of the story ideas are eliminated before script development and 2/3 of those scripts are rejected before pilot commitment. Thus, for every 100 story ideas, only two shows are finally accepted as series.[47] Once the network commits for the show, the die is cast and the property is locked up for five years (unless it is cancelled during that time). If the network supplies some of the venture capital for the script or pilot, it formerly asked for profit participations in the first run and syndication rights. This practice has recently come under harsh censure by the F.C.C. in the Prime-Time-Access Rules. The networks claim that such profit sharing was their reward for the risk of securing advertisers and in case the show flopped. Some independents claim that if they failed to surrender such rights, they were excluded from access to network television.[48]

FOOTNOTES FOR CHAPTER III

1. The Communications Act of 1934 lists three major objectives: (1) to preserve and encourage competition; (2) to provide meaningful service to the entire country; (3) to have as many local stations as possible.

2. See F.C.C. v. Sanders Brothers (309 U.S. 470 [1940]).

3. For more detail on the incidence of these sanctions, see Lawrence Lichty and Malachi Topping, *American Broadcasting: A Source Book on the History of Radio and Television* (New York: Hastings House, 1975), pp. 642-643.

4. U.S. House of Representatives, Report of the Antitrust Subcommittee on the Judiciary, *The Television Broadcast Industry*, Eighty-fifth Congress, 1st Session, 1957 (Hereafter referred to as the *Celler Report*), p. 6.

5. *Ibid.*, p. 9.

6. *Ibid.*, p. 14.

7. Sterling Quinlan, *The Hundred Million Dollar Lunch* (Chicago: J. P. O'Hara, 1974), p. 4.

8. *Celler Report*, p. 16.

9. Stewart L. Long, *The Development of the Television Network Oligopoly* (unpublished doctoral dissertation, University of Illinois at Urbana-Champaign, 1974).

10. *Ibid.*, 7-8.

11. Robert Crandall, "The Economic Effect of Television-Network Program Ownership," *Journal of Law and Economics*, October, 1971, p. 386.

12. (a) No imports or exports during prime-time; (b) national markets for programs and other creative inputs; (c) a final product requiring a specially designed input that cannot be used in other products--a completed television program.

13. *Celler Report*, Chapter 7.

14. Examples are found in the Chain Broadcasting, Option-Time and Prime-Time Access decisions.

15. See Alfred Kahn, *The Economics of Regulation*, Volume 2 (New York: Wiley, 1971), pp. 32-46.

16. See Federal Communication Commission, *Annual Report*, 1974.

17. Stanley M. Besen, *The Value of Television Time and the Prospects for New Stations* (Santa Monica: The Rand Corporation, October, 1973), Chapter 2.

18. Harvey Levin, *The Invisible Resource: Use and Regulation of the Radio Spectrum* (Baltimore: Johns Hopkins Press, 1971), pp. 369-374.

19. See Pike and Fisher, *Radio Regulation*, Section 3.658 (d) and (e) of the Communications Act of 1934 as amended.

20. U.S. House of Representatives, Report of the Committee on Interstate and Foreign Commerce, *Network Broadcasting*, Eighty-fifth Congress, 2nd Session, 1958 (Hereafter referred to as the *Barrow Report*), Chapter 7.

21. *Ibid.*

22. Stanley Besen and Ronald Soligo, "The Economics of the Network-Affiliate Relationship in Television Broadcasting", *The American Economic Review*, vol. 63, (June 1973), pp. 261-264.

23. *Ibid.*, p. 265.

24. Federal Communications Commission, *Second Interim Report by the Office of Network Study*, Television Network Program Procurement, Part II, 1965 (Hereafter referred to as *The Second Interim Report*).

25. *Ibid.*, Chapter 8.

26. See *Advertising Age*, August 26, 1974.

27. *Second Interim Report*, p. 398.

28. According to Brown, a vice president of one of the networks, said, "We don't pick the shows we think have the best chance of becoming popular. To be honest, we're attracted to those that seem to have the least chance of failing." Brown, p. 25.

29. Alan Pearce, *The Economic Consequences of the Federal Communication's Prime-Time Access Rule on the Broadcasting and Program Production Industries*, September 1973 (Hereafter referred to as the *Pearce Report*), p. 41.

30. *Ibid.*, p. 41.

31. For ratings data see various issues of *Variety*.

32. For further proof on this point, see "Comments of Economic Consultants Dr. Peter O. Steiner and Dr. Harold J. Barnett on the MPATI Petition," F.C.C. Docket no. 14229, April 3, 1964, Appendix B, p. 16-20.

33. *Television Factbook*, 1974 Edition.

34. *Celler Report*, p. 85.

35. Bruce Owen, Jack Beebe, and Willard Manning, *Television Economics* (Lexington, Massachusetts: D. C. Heath and Company, 1975), Chapter 2.

36. *Pearce Report*, p. 126.

37. *Ibid.*

38. *Ibid.*, p. 127.

39. Dennis B. McAlpine, "The Television Programming Industry," Tucker Anthony and R. L. Day Company, New York, January, 1975, p. 11. For the prices in various countries, see *Variety*, September 3, 1975, p. 36.

40. *Ibid.*, p. 24.

41. Pearce, p. 93.

42. (a) Mary Tyler Moore Productions produced "The Mary Tyler Moore Show," "The Bob Newhart Show," and "Rhoda."
(b) Quinn Martin produced "The F.B.I.," "The Streets of San Francisco," "Cannon," and "Barnaby Jones."
(c) Tandem produced "All in the Family," "Good Times," "Maude," and "Hot'l Baltimore."

43. Roger G. Noll, Merton J. Peck and John J. McGowan, *Economic Aspects of Television Regulation* (Washington: The Brookings Institution, 1973), p. 40.

44. McAlpine, pp. 15-18.

45. ABC is sometimes accused of causing the sudden decline of serious drama on television when it counter-programmed Westerns against these shows and lured away a substantial amount of viewers.

46. Brown, p. 347.

47. McAlpine, p. 8.

48. *Second Interim Report,* Chapter 8.

CHAPTER IV

THE VERTICAL STRUCTURE OF BROADCASTING AND THE COALESCENCE OF POWER

4.1. Introduction

The affiliation agreement has been the mechanism through which the networks have solidified their power and erected barriers to entry for new competitors. This chapter will explore this basic vertical relationship from its early origins in radio to its most recent modification in the Prime-Time Access Rules. It will be shown that although the Commission has gradually weakened this vertical tie, a more radical revision is necessary to more equally distribute the power among stations, increase the quality of programming, and induce new firms to enter the networking business.

4.2. The Radio Origins

A fundamental point to understand is that the structure of the television industry can be traced back to the roots of the radio industry. Both developed along identical lines, and those persons who were strong in radio transferred their experience and power to television. The radio networks emerged from power bases of local station ownership. These stations were located in the most lucrative markets and were enormously profitable by themselves. At the zenith of their power, the radio networks owned ten of the 25 I-A clear

channel stations (the most powerful stations in the country) and NBC had two affiliated networks in many important cities.

4.2.1. Affiliation Agreements

The radio affiliation agreements were initially five years in length and provided a guarantee of exclusivity for both sides--the station agreed to carry only the programs of the exclusive network, and the network agreed to supply programs only to its station in the market even if the station failed to clear some of them. This exclusivity clause foreclosed potential national networks from access to the affiliated station's time and also denied stations their statutory obligation of choosing the best programs from all sources.[1] The five-year contract prevented any affiliate from quickly turning to another network if it thought its programs were of a higher quality while networks needed to give only a year's notice for terminating the contract. (Note: the station license only runs three years.)

Secondly, since the networks were limited in the number of radio stations they could own, another method had to be devised to assure preferential clearance of a large majority of a network's shows. Assurances of such clearances were necessary to induce advertisers into the radio market and allow radio to become competitive with the other mass media. The radio networks instituted "option time" into their contracts whereby they retained an option on the entire broadcast day. With only 28 days' notice, the network could preempt any local program with a network show, and the station was required to make the substitution. Without actually owning the

station, the network nevertheless controlled the station's time. The station was only too eager to make such a concession if it meant obtaining the valuable affiliation. The networks rationalized such a policy of vertical integration by contract as the only logical method of doing business in this industry--of having the power to guarantee clearances to national advertisers.[2]

"Option time" also gave the networks a flexibility to swoop in and destroy other competitors and keep local and national spot advertisers at a month's cancellation notice. With this threat of cancellation hanging over a station, these advertisers were understandably cautious in developing local shows.[3] While an affiliated station was given the right to reject network programs, *the burden of proof* was on the station--it had to "prove" that its program was more in the public interest than the network one rejected.[4] Under such bothersome circumstances, most station owners would choose the path of least resistance and lead the quiet life, free from the responsibility of programming. Finally, the radio networks tried to control through their affiliation contracts the stations' non-network advertising rates. Under such a price-fixing agreement, the station was prohibited from undercutting the network rate when it sold its local time. Hence, an advertiser would have to pay the same rate whenever he ordered a certain affiliate regardless of the type of advertising he purchased. The net effect would be to place national spot and local advertising at a competitive disadvantage and strengthen the networks' position.[5]

4.2.2. The Chain Broadcasting Rules

Against a rising tide of network control over the entire radio industry and complaints from independent program producers, the F.C.C. launched an investigation from 1938-1941 and in 1941 issued a *Report on Chain Broadcasting* which modified the anticompetitive practices highlighted above. In part, the report noted:

> The radio spectrum is essentially public domain. In delegating to this Commission the power to license, Congress was moved by a fear that otherwise, control would gravitate into few hands....In short, the joint effect of the various practices mentioned is to place the licensee to a considerable degree at the mercy of the network with which he is affiliated, but to leave the network free to pursue interest which may be very different from those of the licensees affiliated with it....At every turn, restrictive clauses taken cumulatively operate with even greater force than their effect considered in isolation would suggest. *Thus the doorway into the network field is both locked and bolted.*[6] [italics mine]

The new rules prohibited any station from signing an affiliation agreement (1) containing an exclusivity clause (now free to accept programs from all networks) or an option-time clause, (2) for a period longer than one year, (3) or with a network organization which maintains more than one network or which tries to fix advertising rates other than its own rates. The station also retained broad rights to reject any network program already contracted for which it considers contrary to the public interest.[7] The Commission also stressed the role of competition in the broadcasting industry:

> The benefits of competition are equally clear in the field of network broadcasting. If national networks compete for station outlets on the basis of performance, there will be an incentive to improve and expand the programs...which they offer to the public. Likewise, if stations are not tied exclusively to a single network over a long period of time and they compete for

> access to one or another network, each will be stimulated to improve the quality of the programs which it offers and hence its value as an outlet of a national network. This two-way competition will insure the listening public a well diversified high quality program service.[8]

The networks protested that these rules would take radio from the known good service to an unknown anarchy; that it was the end of competitive broadcasting--the destruction of the American system of broadcasting. They persuaded the Commission to reconsider its ruling and three important modifications were approved: (1) Stations were allowed the right of first call in their territory. (2) The affiliation agreement was extended from one to two years. (3) Option time was allowed for three hours in each quarter separation of the broadcast day.[9] Because the networks appealed the rulings to the Supreme Court (NBC vs. U.S. 319 U.S. 190 [1943]) and lost their case, the modified Chain Broadcasting Rules did not take effect until 1945. One significant result of the Chain Broadcasting Rules was that the proscription against stations affiliating with any corporation owning two radio networks caused NBC to divest its blue network in 1943. This blue network eventually became the American Broadcasting Company.

4.2.3. The Evolution of Television

The television broadcasting industry had a period of dynamic growth during the mid-forties and fifties. The owners of radio stations were granted licenses to build television stations, and the two most powerful radio networks obtained some of the best stations in the most lucrative markets. When the interconnection problems had been solved, CBS, NBC and, to a minor extent, ABC and DuMont

entered the television network business and soon had a position of power paralleling that in radio. According to Long,

> Almost every indicator of network concentration examined for the [pre-freeze period] of 1949- 52 shows an already large and in some cases increasing share of the market in the hands of the network oligopoly.[10]

Because the Commission failed to take any substantive reform policy on the various allocations problems during the "freeze" most observers felt that the fate of the two smaller networks, ABC and DuMont, was sealed. In order to save at least one of these networks and to provide an additional source of capital funding, the F.C.C. with the tacit approval of the Justice Department allowed ABC to merge with Paramount Pictures in 1953. With the ascendency of ABC, DuMont folded up operations in 1955 and the present three network structure was established.

4.3. Past Abuses in Television

Three separate investigations were launched in the mid-fifties to study economic concentration in the television industry, one by the F.C.C., Senate Commerce Committee, and the House Committee on Interstate and Foreign Commerce. While voluminous testimony was taken and many critical reports were written, no new legislation concerning television was passed. During the proceedings, Senator Bricker commented,

> The networks...have an unprecedented economic strangle hold on the Nation's television industry. Effective competition is stifled under this yoke of economic dominance. The result is private monopoly.[11]

Using their experience and business relationships in radio, the television networks lined up the best VHF stations to be their affiliates

often dealing with the same owners in television as in radio. The much stronger CBS and NBC networks thus entered television networking first and with a big splash and gained effective control of the industry. Not until the early 1970's has ABC been able to compete effectively against the other two giants.

While the Chain Broadcasting Rules had been passed to restrict some of the abuses of the radio networks, they also applied to television broadcasting. Despite the loud protestations of the radio networks, these rules proved to be only minor inconveniences in both radio and the expanding television industry. In television, the networks combined a modified option-time policy with a must-buy advertiser purchase plan to enhance their position and forestall and foreclose effective competition.

4.3.1. Option-Time Controversy

As in the radio industry, the networks used option-time clauses in their affiliation agreement as a means of quickly assembling a national network in times of emergency and of assuring advertisers contemplating the sponsorship of a network show that a sufficient number of affiliates would automatically clear the program. The networks again claimed that without option time, they would be emasculated through a checkerboarding of non-clearances throughout the system for the entire broadcast day. The uncertainty thus created would cause hesitancy on the part of both networks and advertisers to commit huge sums of money to create new types of programming.

The Celler and Barrow reports described the abuses of option time in the same terms that the Report on Chain Broadcasting had outlined 15 years earlier: option time permitted a network to substitute its own decisions on programming for the licensee's duty to select programs in the best public interest of his community. By simply "patching" into the network and leading the easy life, he has abrogated his responsibility to the public. Secondly, option time allowed networks the power to prevent competing networks and especially syndicated shows from obtaining access to the affiliates during the prime evening hours. While the producer of syndicated programs obviously has access to the fourth station in many markets, some of which are very attractive, nevertheless he is foreclosed from the three affiliated station markets without which the former markets are not sufficient to cover costs.[12] Hence, program quality will suffer from a lack of competition since the networks are essentially saying, either sell your program through us or forget about access to national time. As with must-buy, option time was seen as a form of a tied good. The network wanted to protect its inferior programs from competition so naturally it tied them to the better programs and offered only the entire service.[13] Under such a practice, many fine non-network syndicated programs would never become available or would be restricted to a certain region because weaker shows were required by the networks. Not only was this practice alleged to be the equivalent of block-booking but also of blind selling since stations were committed to accept a program without having seen it and at times without it being completed. Finally, option time was alleged to injure non-network advertisers by denying

them access to prime-time television and/or forcing them to operate with the threat of network preemption of the time period.[14]

In terms of the vertical integration issue, option-time clauses when fully exercised and enforced were the equivalent of a fully integrated network system. Since the Commission had earlier limited network ownership of stations to five VHF and two UHF,[15] option time was a clever mechanism for circumventing the intent of such a rule and concentrating among the networks control of what is viewed during a large portion of the day. The Celler Report concluded that option time was anticompetitive and inimical to the concept of freedom of choice by each station to choose the best programs available for each time period and let each program be judged by its own merits and not through an artificial tying restraint.

> True a network might encounter some difficulty in obtaining clearance, however that is a natural consequence of the market struggle which is based on the *concept that the stimulus of competition will bring to the American consumer the best goods at the lowest price*. That is the concept on which television should be based....More important, if network survival depends upon curtailment of competition--if networks must be insulated from normal market rivalry--that is a clear admission that competition in television broadcasting cannot be an adequate regulator...[creating the need] for public utility type regulation.[16]

With all the controversy surrounding the option-time clauses, the F.C.C. decided to take another look but, after noting the restraining effect of this practice on the station licensee's freedom to select programs and its adverse effect on other segments of the industry, the Commission concluded that "the optioning of time by affiliated stations to their networks is *reasonably necessary for successful network operations and is in the public*

interest."[17] A hearing on option time followed this finding and slight alterations were instituted to calm the critics of the F.C.C.'s policy. The option-time hours were cut from three to two-and-a-half during each quarter of the broadcast day and the length of advance notice was increased to 13 weeks. Straddle provisions were adopted for those programs which occupied only part of an option hour and the station's right to reject a network program was extended to cover those already contracted for (instead of merely those offered). More importantly, the Commission reaffirmed its finding that option time was a reasonable restraint and necessary to the public interest.[18]

Thoroughly disgusted with the F.C.C. ruling, the independent licensee of KTTV in Los Angeles, Mr. Moore, appealed the decision to the U.S. Court of Appeals citing the antitrust abuses of option time. Fearing that its decision would be overturned, the Commission petitioned the Court for a chance to reconsider its decision. This time it concluded:

> Upon review of the record herein, and in light of the data and arguments, *we are not convinced that option time is essential to successful network operations but rather are of the view that it is not.*[19]

It dismissed the network argument that option time was essential to planning by citing the success of some of the best network programs during station time. The simultaneity argument was not convincing since most programs were not live but actually were shown from videotape. The Commission also noted that the limited assurance which option time provided would easily be replaced by the automatic clearance of the network owned and operated stations (covering nearly

25 percent of all television households). On the other hand, the F.C.C. cited the competitive abuses outlined in the Barrow Report, the Celler Report, and its original Report on Chain Broadcasting. Particularly obnoxious was the limitation on the licensee's freedom to choose programs in the public interest. The final text of the Commission's ruling is as follows:

> No license shall be granted to a television broadcast station having any contract, arrangement, or understanding, express or implied, with any network organization which provides for optioning of the station's time to the network organization, *or which has the same restraining effect as time optioning.*[20]
> [italics mine]

The same effect provision was challenged by CBS (as applied to its Incentive Compensation Plan) as being so vague as to imperil network-affiliate negotiations and amounting to rate regulation. The Commission responded that the language is at least as specific as that of the antitrust laws and that without the same effect provision, another anticompetitive practice would merely be substituted for the outlawed practice.[21]

In summary, while the option time clauses were clearly anti-competitive and did result in a somewhat higher rate of clearance during option hours than during station time, the networks never really pressed this issue upon the stations. Perhaps fearing the interference of the Justice Department or simply wanting its affiliates to also carry network programs during station time, there were never any lawsuits instigated against recalcitrant stations. While option time was clearly a factor in inducing clearances, the networks had at their disposal the full range of financial penalties such as the amount of free time the affiliate must carry, the remittance

percentage, and of course the threat of disaffiliation if the station failed to clear a large percentage of programs. The most important question left unanswered by the networks is why they needed option time if their programming was so superior.

4.3.2. The Prime-Time Access Rules

The F.C.C. also noticed an unhealthy condition in the syndication market. It had hoped that the abolishment of option time would give first-run syndication program producers the shot in the arm they desired, and they could then effectively compete against networks in prime time. But the evidence indicated a decline in first-run syndicated fare and an upsurge in network reruns. To restore the health of independent producers, an affirmative action program *guaranteeing* their access to the top 50 markets during prime time had to be instituted. The adopted rule limited network service to an affiliate to three hours during the 7 p.m.-11 p.m. prime time period in the top 50 markets in the country, and these affiliates were not allowed to substitute network reruns for the lost network service.[22]

With the networks demanding subsidiary rights and increasing their share of the syndication market, the Commission became concerned with the potential leverage that this created. Being in a position to sell programs to independent stations which are in competition with their own affiliates and especially their owned and operated stations creates the possibility for conflicts of interest, squeezes, and denial of supplies.[23] In short, power in the syndication market not only coalesces the networks' control over what

the American public can view on television, but allows them to fix the price of a major substitute to their network fare. While only limited evidence of this theory was presented in the hearings, the potentiality for abuse was recognized, and the F.C.C. forced the networks out of the syndication business (with the only exception being that they could distribute programs, of which they are the sole producer, in foreign markets).[24]

Therefore, the removal of the option-time clauses and the opening up of the prime-time access hours were supposed to restore the balance of power in the industry, allow the stations more discretion in their programming selections, and encourage the entry of new networks and truly independent sources of programming. That these policies have failed is of extreme importance since it suggests that marginal structural solutions will not bring about the desired results in the television broadcast industry. The following sections look at the affiliation agreement as the underlying root of the problem and suggest a radical restructuring of these contracts as a means of inducing greater competition among stations, encouraging entry of new programming, and increasing the quality of such programming.

4.4. The Affiliation Agreement: The Heart of the Problem

While the removal of the option-time clauses supposedly weakened the power of the networks since they no longer had automatic access to the time of their affiliates, two results of extreme importance have surfaced since that ruling, and the net result is an industry structure virtually unaltered. The first result was the recognition

by the networks that their owned stations still provided automatic access (the equivalent of option time) for nearly a quarter of the viewing audience, and this was a sufficient foundation from which to build a nationwide network of clearances. Secondly, the new-found freedom of affiliates to reject network programs did not materialize because the network programs were to a great extent superior to local originations or syndicated fare and also because the network affiliation was like money in the bank and rejecting a large number of network programs meant the possibility of dis-affiliation. Hence, the networks hold a club over the heads of their affiliates (especially in the larger markets with more than three VHF stations) and several times have either exercised this power or threatened to use it.[25] Therefore, while the networks were supposedly divorced from automatic access to local stations' time, the affiliates still clear over 90 percent of their respective network's programs.

What can be done to remedy this imbalance of power and the clog on competition inherent in vertical integration by contract? What can be done to take advantage of the economies of scale of networking without the accompanying erection of barriers to effective competition? The essential problem with an affiliation contract both from the station owner's viewpoint and from the competitive viewpoint is that in the largest markets, it is an all or nothing choice--either a station is affiliated or it is not; there is no middle ground. Because of this, the affiliation contract is very valuable, and its value gives the networks the power they have in terms of high clearance rates. From the competitive standpoint, it

helps to create a class of powerful affiliates (usually VHF's) and a class of marginal independents (usually UHF's). Thus, UHF stations are condemned not only for technical reasons but also due to lack of affiliation contracts. The act of exclusive affiliation thus becomes a method for harnessing network monopoly power and extending it into the broadcasting sphere. The result is very similar to the vertical power that the auto companies achieve through their franchising agreements.

One wonders whether the affiliation contract need be such an all or nothing choice. What benefits does the viewer receive from knowing that a local station is a CBS or an ABC affiliate? The only possible benefit would be that viewers who like the style of one network as opposed to another need only turn on the local affiliate. But do viewers have undying loyalty to any one network? One doubts this, and suggests that TV guides are printed because they are needed and used. Viewers are not like cattle, something to be herded into one corral for an entire evening; they pick those programs which are most appealing regardless of network affiliation or the supposed inconvenience of changing channels. If stations did not carry the CBS, NBC, or ABC label, then perhaps viewers would come to recognize the stations as important entities rather than as mere conduits of network programs. This is the role that the F.C.C. has intended, but it has largely fallen by the wayside due to the strength of the three networks.

4.5. A Suggested Remedy

One plan which will be suggested here is that affiliation agreements be abolished, and each local station be permitted to bid for the network programs on a show-by-show basis. This might work in the following three ways. One way would be for the networks to announce their lineups in the spring as they presently do. For example, CBS would announce its Saturday lineup of "The Jeffersons," "Doc," "Mary Tyler Moore," "Bob Newhart," and "Carol Burnett." Now all the stations in a market, say Detroit, would have a right to bid for those programs in their original time slots. The "highest" bidder for each program would be that station willing to accept the lowest compensation payment for its local time. Under such a plan, the networks will still be competing against each other at any point in time but the audience flow concept would be lost since it cannot be assured in the local markets.

The second method would feature the networks simply announcing their entire lineup of programs with no reference to time slot or day. In short, they simply put their programs naked on the auction blocks. The local stations now have a tougher job because they must fashion their nightly schedules taking into account not only audience flow but also the selections of their competitors. The bidding will now take on the added dimensions of day and time slot. Since the best time slot and day will yield the highest revenues to the networks, they will prefer, *ceteris paribus*, to have a program on at 9 p.m. Sunday as opposed to 8 p.m. Tuesday. Thus, the station offering the most favorable combination of time slot, day, and compensation arrangement will win the bid for the respective program.

A third possibility which is less drastic would be to sell an entire evening's schedule as a block rather than show by show. This is less radical since the networks could now take advantage of audience flow and also reduce the number of negotiations. While it may be less cumbersome, one suspects that the results will not be as beneficial as the other two plans.

Are such plans technically possible? Under the current system, the networks feed their programs along the AT&T lines to a common point in each city. From this point, each of the affiliated stations has a local line. But since independent stations sometimes get rejected network programs, they also have local feeds. Consequently, the transmission mechanism is already in place and AT&T can easily switch the CBS feed from channel X to Y to Z during the course of an evening. The technology is there for the first and third alternatives. As one industry spokesman noted about the ease of setting up a network:

> There's no secret about being in the network business. ...What you do is get a program and then you call the telephone company and then you order lines. It's that simple.[26]

The second alternative is more complex since the networks would not be feeding the program at one common time. However, this is really no problem since private showings and tape delays are already part of the television business. All CBS need do would be to announce that it will be broadcasting "Mary Tyler Moore" to its successful bidders at some off-peak broadcast time, say 4 p.m. on Monday. The stations would tape the program and rebroadcast it at the negotiated hour. There is no technical problem in this plan although it may

be more inconvenient and cost slightly more than the other two suggestions.

4.6. Results of the Plans

What would be the results of these plans? Would the independent stations obtain any of the network programs or would they again be limited to syndicated fare? It seems clear that once the idea that affiliation per se is eliminated, then the independent VHF stations stand on as solid a ground as the former affiliates since there is no technical superiority of one VHF station over another. In terms of VHF competition, one would expect little difference among them in the bidding process. The only exception might be that former VHF affiliates may have extra reserves from the preceding years of high profitability and thus may have deeper pockets than the former VHF independents. While this may be true in the short run, one must remember that large city independents usually are multiply owned and may also have deep pockets. Hence, there is no reason to expect differences among the VHF stations in the long run. On the other hand, the VHF stations should have some advantage over UHF independents in the bidding since the latter suffer from the "UHF handicap" and are not generally as well endowed as the VHF stations. While an advantage accrues to the VHF's, it will be shown that such an advantage is not absolute and impenetrable. The UHF's and formerly independent VHF's will not be shut out of the network program market for the same reasons that baseball teams in small market areas need not be driven out of baseball when the reserve rule is relaxed.

Rottenberg explains why these conclusions are true:

> At first sight, it may appear that the high revenue teams will contract all the stars leaving the others only the dregs of the supply; that the distribution of players among the teams will become very unequal; that the contests will become less uncertain and that consumer interest will flag and attendance fall off. *On closer examination, however, it can be seen that this process will be checked by the law of diminishing returns* operating concurrently with each team's strategic avoidance of diseconomies of scale.[27] [italics mine]

The identical result holds true for television. If programs are bid for on a show-by-show basis, the first hit show on any night gives a higher marginal revenue product than the second or third hit shows. Television stations will pay a higher price (accept lower revenues) in order to obtain the first few hours of hit programs for any night. Having purchased these shows, the next hour or two is worth progressively less to them and thus their bids will be lower than those of other VHF stations which have fewer hits purchased. As the process works itself out, one would expect the hit shows to become fairly equally distributed among the VHF stations, especially if time slots are part of the negotiated price. What about UHF stations? Assuming they have only minor technical inferiority, the same analysis should theoretically apply to them. The first shows they obtain will be worth a great deal to them because of both a high marginal revenue product and because they may wish to habituate the viewer to the UHF dial. In fact, at first, they may be willing to accept hit shows as loss leaders in order to achieve this latter effect. It is thus possible that the UHF's may be able to effectively compete with the VHF's for some of the hit programs. More realistically, they might be willing to accept as

top choices the medium or even lower rated network programs in order to improve their present situation in a gradual manner. It seems clear that their chances of obtaining some of these lesser rated network programs are very good since these shows will have higher marginal revenue products for them than if purchased by the VHF stations.

If the number of network shows stays the same, then this plan of eliminating affiliation contracts will open up the market and destroy the artificial advantages that present affiliates possess. It may also decrease the "UHF handicap" as these stations obtain part of the network offerings (even if only five shows per week). This process will allow a much wider choice for stations even if they have to accept some lower rated programs at the margin. One might expect somewhat higher prices for network fare as opposed to syndicated programs. However, it is also reasonable to assume that the existing networks will expand their offerings because they now have access to the prime hours on other VHF and UHF stations. Perhaps more importantly, one can expect new firms to enter the networking business once they realize that they can compete on an equal footing and need not worry about breaking the affiliation strangle hold of the networks. More immediately, one might expect a much stronger first-run syndication market with more "Space 1999's" on the rise. This result can be expected to differ from the experience of prime-time access hour because it is an entire overhaul and not just a marginal one during the fringe hours. In fact, in the long run, one might reasonably expect networks as we now know them to no longer exist since program producers can just

as easily arrange for the telephone lines and advertisers as can networks. The only drawback to this plan would be that national advertisers may have less certainty about clearing specific times. They could still clear specific programs but, if option 2 is in force, they would have to buy specific time slots in the national spot markets. This would tend to strengthen the national spot and local advertising markets at the expense of the network ones.

4.7. Real World Evidence

Finally, is there any evidence that the above theory will in fact work in the real world? Will the independents gain at the expense of the affiliates and lead to a more equal competitive situation and a greater diversity for viewers? The answer is that after a short period of transition, one might expect the theory to work because of the present experience in the syndication industry. In the syndication industry, there is no advantage to being an affiliate as opposed to being an independent. Everyone competes on an equal footing and the highest bidder for syndicated fare prevails in any market. In fact, independents may have a slight advantage since they are more regular and larger purchasers. Have the rich affiliates been able to obtain the cream of the syndication fare? If this is true, then the affiliates' ratings should be higher than the independents' during non-network time. Looking at the following ratings data for several large markets, one sees that there is a significant advantage to being an affiliate during network prime-time hours but that the independents (especially the VHF's) are clearly able to compete in the prime-time access period

Table 4.1. Ratings Data for Several Markets, February 1975

Market	Station (Affiliation)	Prime-Time Ratings Share (%)	Prime-Time Access Share (%)
New York	WCBS (CBS)	27	24
	WNBC (NBC)	28	16
	WABC (ABC)	23	15
	WNEW (VHF-ind.)	11	18
	WOR (VHF-ind.)	5	14
	WPIX (VHF-ind.)	3	12
	WXTV (UHF-ind.)	<1	<1
	WNJU (UHF-ind.)	1	1
	WSNL (UHF-ind.)	<1	<1
	WNET (VHF-Ed.)	3	1
Los Angeles	KNXT (CBS)	27	12
	KNBC (NBC)	34	16
	KABC (ABC)	28	9
	KTLA (VHF-ind.)	3	16
	KHJ (VHF-ind.)	1	14
	KTTV (VHF-ind.)	7	19
	KCOP (VHF-ind.)	<1	9
	KWHY (UHF-ind.)	<1	<1
	KMEX (UHF-ind.)	1	3
	KBSC (UHF-ind.)	1	4
	KCET (UHF-Ed.)	<1	<1
San Francisco	KRON (NBC)	29	15
	KPIX (CBS)	29	24
	KGO (ABC)	26	18
	KTVU (VHF-ind.)	7	19
	KQED (VHF-Ed.)	3	5
	KEMO (UHF-ind.)	<1	<1
	KGSC (UHF-ind.)	<1	1
	KBHK (UHF-ind.)	2	11
	KNTV (ABC-San Jose)	2	3
Cleveland	WKYC (NBC)	33	27
	WEWS (ABC)	30	25
	WJW (CBS)	27	22
	WJAN (UHF-ind.)	<1	<1
	WAKR (UHF-ind.)	1	<1
	WVIZ (UHF-Ed.)	1	1
	WUAB (UHF-ind.)	4	13
	WKBF (UHF-ind.)	3	8

Table 4.1 (continued)

Market	Station (Affiliation)	Prime-Time Ratings Share (%)	Prime-Time Access Share (%)
Philadelphia	KYW (NBC)	27	26
	WPVI (ABC)	31	32
	WCAU (CBS)	32	19
	WHYY (VHF-Ed.)	2	1
	WPHL (UHF-ind.)	3	5
	WTAF (UHF-ind.)	2	6
	WKBS (UHF-ind.)	1	6

SOURCE: *Arbitron Ratings Book*, February 1975.

(7 p.m.-8 p.m.). In fact, in some cases the VHF independents obtain the highest ratings. This suggests that once the affiliation advantage is removed, more competition, higher quality, and more diversity will occur, and stations will once again assume the lion's share of responsibility for choosing the best programs for their local constituency.

Therefore, this chapter has shown that the affiliation agreement which is the vertical tie between the networks and their broadcasters has been used by the networks to fortify their own positions and prevent new firms from entering the industry. While the elimination of option time somewhat diminished the vertical power of the networks, the threat of disaffiliation still keeps station owners in line and subjects the American viewing public to the bad network programs along with the good ones. In the latter part of this chapter, several alternatives to the current all or nothing affiliation contract have been proposed. If enacted, the resulting competition will help to equalize the power among stations and bring higher quality programming to the American viewing public. Network programs will stand on their own merits rather than be artificially tied to one another.

FOOTNOTES FOR CHAPTER IV

1. Federal Communications Commission, *Report on Chain Broadcasting*, Commission Order no. 37, Docket 5060 (May, 1941), pp. 51-59.

2. *Ibid.*, pp. 62-65.

3. *Ibid.*

4. *Ibid.*, pp. 65-66.

5. *Ibid.*, pp. 73-75.

6. *Ibid.*, pp. 72, 76-77.

7. *Ibid.*, p. 92. Note: The rule proscribing radio networks from fixing non-network advertising rates was later applied and extended to forbid television networks from representing affiliates in non-network markets. Both practices caused inevitable conflicts of interest for the networks.

8. *Ibid.*, p. 47.

9. F.C.C. Supplemental Report, October 11, 1941.

10. Long dissertation, p. 91.

11. U.S. Senate Committee on Interstate and Foreign Commerce, Eighty-fourth Congress, 2nd Session, *The Network Monopoly--Report Prepared by Senator John W. Bricker*, p. 1.

12. *Celler Report*, p. 88; also *Barrow Report*, Chapters 7 and 8.

13. *Barrow Report*, Chapters 7 and 8.

14. *Ibid.*

15. Federal Communications Commission, "Multiple Ownership Report and Order," Docket 8967 adopted December 2, 1953, in *Federal Communications Commission Reports*, vol. 18, p. 288.

16. *Celler Report*, pp. 92-93. Also, the *Barrow Report* listed a series of policy options concerning option-time issues. (1) Eliminate it completely; (2) cut it down and increase the advance notice;

(3) confine it to shows requiring simultaneous live clearance such as news and sports; (4) limit each station's use of particular network to 75 percent of its prime-time hours.

17. Federal Communications Commission, "Option Time Report and Order," Docket 12859 adopted June 5, 1963, in Pike and Fisher, *Radio Regulation,* vol. 25, p. 1654.

18. *Ibid.*, p. 1655.

19. *Ibid.*, p. 1675. Note: The same data and arguments were presented in the original hearing.

20. See Amendment 3.658d to the Communications Act of 1935 in Pike and Fisher, *Radio Regulation,* current services.

21. F.C.C. *Option Time Report,* p. 1686 a-f.

22. *Prime-Time Access Report and Order,* p. 402. Since the networks were only programming from 7:30-11:00 p.m. E.S.T. at the issuance of the order, they "agreed" to program from 8-11 p.m. on Monday through Saturday and from 7:30-11:00 p.m. on Sundays. The residual prime-time hours became known as the prime-time access period.

23. For a more complete discussion of this issue, see the *Celler Report,* pp. 53-54.

24. *Prime-Time Access Report and Order,* p. 402.

25. See section 5.4.

26. *The Hollywood Reporter,* December 15, 1972, p. 4.

27. Simon Rottenberg, "The Baseball Players' Labor Market," *Journal of Political Economy,* June 1956, pp. 242-258; reprinted in *Readings in Labor Market Analysis,* ed. John F. Burton, Jr. *et al.* (New York: Holt, Rinehart and Winston, Inc., 1971), p. 152.

CHAPTER V

VERTICAL INTEGRATION INTO BROADCASTING

5.1. Introduction

This chapter examines the effect that network ownership of television stations has on the public interest criterion. It will be shown that (1) inevitable conflicts of interest arise whenever an entity wears both network and station owner hats, (2) that the networks have an unnecessarily large concentration of power as purchasers of syndicated programs, and (3) that public service can be improved if these two roles are separated. The first part of the chapter examines present and potential abuses arising from such vertical integration, and the second part measures the effect of divestiture upon public performance.

5.2. Conflicts of Interest

Networking is essentially the business of acting as an intermediary between the producers of television programs and the broadcasters of such fare. As the broker for local stations' valuable time, the network will achieve its largest profits when it clears the time of the most stations. The Commission holds the licensee of a local station legally responsible for all the material broadcast over his facilities and requires him to program in the public interest, which means choosing those programs which he perceives to

be of the highest quality and which best serve the needs and interest of the local community. When these two roles are joined irrespective of whether they are ostensibly separately managed, the chain of command will run from the network executives down to the station managers, and these owned and operated stations will clear virtually 100 percent of the parent network's programs. This policy of automatic clearance may be a written company policy or the network executives may actually have veto power over the actions of the local station managers; but even without such overt interference, local station managers will realize that progression up the corporate network ladder means responding in the proper fashion when the stimulus is presented to them. If a network station blindly accepts network programming without regard to quality or content, then that station has surrendered its responsibility as arbiter of what is best for its local community--the role which Congress attached to the granting of a scarce broadcasting license. In this section evidence will be presented to test the hypothesis that network owned stations clear a significantly greater amount of network programs than do similarly situated affiliates owned by other parties. The evidence consists of clearance records of both highly controversial special network programs as well as regularly scheduled prime-time and late night fare.

5.2.1. Evidence on Special Controversial Program Clearances

Sometimes the networks will abandon their conservative images and present highly controversial programming which either deals with sensitive moral or political issues, sexually explicit topics,

or unnatural acts of violence. When this occurs, many local affiliates decide, for one reason or another, that these programs do not serve the local public interest, and they reject them. Following an affiliate rejection, the network may or may not offer the program to an independent station in the market. Some might argue that they have a First Amendment right to watch such controversial programs and that the local stations are exercising prior restraint when they fail to clear such fare. Be that as it may, for the purposes of this analysis the important point is to distinguish between the behavior of regular affiliates and network owned ones when they are confronted with controversial questions. The first example of such a program is a CBS movie entitled *The Damned,* an x-rated picture which depicts the brutal life of a German industrialist family under Nazi control. When CBS scheduled this picture for the first week in March of 1972, some 30 CBS affiliated stations failed to clear the program. The stations were in such major markets as Boston, Providence, Baltimore, Dallas, Washington, Houston, and Cincinnati as well as in smaller markets. All of the CBS owned and operated stations routinely cleared the movie at the regularly scheduled time.[1]

In early March of 1973, CBS again presented its affiliates with a tough decision. The drama was entitled "Sticks and Bones" and dealt with the myriad of problems and hopeless resignation of a returning blind Vietnam veteran. The story ends with suicide as the only response to the oppressive atmosphere and vividly shows the body being carried from the house in a plastic bag. According to a *Variety* story,[2] only ten affiliates defected after the first

private showing more than a week before airtime. They cited as reasons, the degradation of big business as well as other American values and the showing of this drama at a time when the American prisoners of war had just come home from Southeast Asia. As word of the early defections spread, a number of station managers who evidently had not paid much attention to the first private showing asked for another one. Within a few days after the second showing, some 69 stations had dropped and "there was every reason to believe the number would grow before the Friday air date."[3] CBS decided to cancel rather than play the program on only half a network. None of the owned and operated stations were in the list of 69 stations failing to clear "Sticks and Bones." In mid-July of 1973, CBS announced that "Sticks and Bones" would be aired in early August and the same controversy surfaced again. After the dust had cleared, some 73 CBS affiliates had refused to clear and 28 others delayed the broadcast to a later hour. Surprisingly, the CBS St. Louis station, KMOX, bolted from the rest of the O and O group and decided to reject the program. *Variety* gave this singular defection a big headline, thus indicating the unusualness of such a move by a network owned station.[4] It should be noted that a previous *Variety* story indicated that CBS was accepting "without counterpressure" the decisions of its affiliates not to clear the controversial program.[5] Perhaps this explains why KMOX was allowed to reject the program.

The third example involves the series "Hot'l Baltimore," a second season entry on ABC which premiered on January 24, 1975, at 9:00 p.m. (E.S.T.). "Hot'l Baltimore," produced by Norman Lear,

who also controls "All in the Family," "Sanford and Son," "Maude," and "The Jeffersons," dealt with a hotel in a rundown section of Baltimore which was the central setting for a number of principal characters. In the normal Lear fashion, these characters were not the typical run of the mill stock found in most situation comedies. The premiere and second episodes dealt with material concerning two prostitutes and two homosexuals who lived in the hotel. Each carried a warning that "the following program deals with mature subject matter: parental judgment and discretion is advised."[6] A number of ABC affiliates failed to clear the program or else delayed it to a later hour. All of the ABC owned and operated stations cleared the first two very controversial episodes of "Hot'l Baltimore" in their original time period.[7]

The next example involves the recent CBS movie *Helter Skelter* which was scheduled to appear on the CBS Thursday and Friday night movies of April 1 and 2, 1976. *Helter Skelter* is the story of the investigation and prosecution of the so-called Manson Family for a grisly series of 1969 murders that included the highly publicized killing of actress Sharon Tate. As one critic noted of the program:

> Yet it was neither Manson nor the fleeting glimpses of the bloody crimes that I found revolting--it was the pretty girls who committed murder and told about it in such calm matter-of-fact tones that they could have been describing a Saturday night double date on "Happy Days."[8]

Needless to say some station managers decided that *Helter Skelter* was either too controversial or else unacceptable for their local communities. Don McGannon, head of the powerful Group W broadcasting

group, in rejecting the film for San Francisco and Pittsburgh, commented that "the Manson tragedy was one of the most publicized incidents of human depravity." While acknowledging that the "explicit presentation was minimized", he said he found "the conduct and attitude of the people extremely offensive."[9] Four of the five CBS owned and operated stations carried both nights of *Helter Skelter* in its original time period. The lone exception was the Los Angeles station KNXT, which did not carry either episode because of some very special local circumstances. Vincent Bugliosi, the prosecutor of the Manson trials and the author of the best selling book, is the hero of the movie. "He's as gallant and as forthright and as dedicated as any Gallahad in his dogged, determined crusade to bring these wayward killers to justice."[10] It just so happens that Bugliosi is running for district attorney in Los Angeles, and it was KNXT's feeling that showing the movie might be construed as influencing the election. There was also the question of the equal-time provision.[11] KNXT has decided to run the film after the June 8 primary. Hence, it was more an uncertainty with the law and a desire not to influence local politics rather than the intrinsic nature or subject matter which led to the delaying of the film.

The last example in the controversial category concerns Norman Lear's current adult soap opera satire, "Mary Hartman, Mary Hartman." This series deals with everyday life in a more explicit and comical manner than is the usual soap opera fare. All three networks originally rejected "Mary Hartman" and as a result Lear decided to go the syndication market by market route. This show usually plays in the late afternoon, prime-time access hours, or else in the late

nighttime slots in nearly 100 markets. While the show still elicits some protests over its subject matter, it is obtaining remarkably high ratings across the country and especially in New York, Los Angeles, and Chicago. *This non-prime-time program was not picked up by a single owned and operated station.* An article in *Variety* talks about Lear's attempt to sell "Mary Hartman" to an owned and operated station. Reportedly, he had KNBC lined up on the coast "but the deal was killed in New York by NBC O and O chieftain Ted Walworth."[12] Neither the ABC nor CBS O and O's have shown any interest in the series either. It should be noted that the program was piloted under financing by CBS and this lends credence to the claim made about the networks blackballing any property not picked up by the network originally financing it. Hence, this lack of O and O acceptance points out the fact that networks have a double powered sword--they can reject a series at both the network and station level and force it to take a very treacherous road to success.

5.2.2. Evidence on Non-Controversial Program Clearances

In a similar light is the story of "Space 1999," a current season science fiction series starring Martin Landau and Barbara Bain. "Space 1999" is produced in Britain at $200,000 an episode. After failing to achieve network prime time acceptance, the distributors went into the syndication market and sold the show to 146 stations (seven independents and 139 network affiliates). While this in itself is not an extraordinary event, the real surprise came when 70 of the affiliates preempted one of their respective network

prime-time programs to make room for "Space 1999."[13] The rejections looked like a checkerboard of holes in all three of the networks' lineups and immediately put four fall series into jeopardy since they had the largest number of preemptions. These series were ABC's "Barbary Coast," CBS's "The Montefusco's" and "Fay," and NBC's "Invisible Man."[14] However, the impact was felt by a dozen other shows including such surprises as "The Six-Million Dollar Man," "Happy Days," "Rhoda," "Phyllis," and "Cher" and in such important top 25 markets as Boston, Pittsburgh, Houston, Tampa, Cincinnati, and Hartford.[15] Of course, as with "Mary Hartman," not one of the network owned stations picked up "Space 1999" because to display it means that a network program must be rejected or else delayed--an action which has been shown to be alien to their character. Hence, whenever a syndicated show threatens the profits of the network, the owned stations can come to the rescue.

A question must be raised at this point. Why have the affiliates turned against the networks? Obviously, this action confirms a readiness on their part to do their own thing in programming at the margin when they believe they can obtain a better product and/or sell some blue chip local commercial spots. One curious and important fact in this situation is that the distributors of "Space 1999" have an "out" clause in their syndication contracts which permit the series to be sold to a network the following year.[16] This is important because it suggests that even if the concept of prime-time access somehow introduces new competing programming into the 7-8:00 p.m. time slot or a new syndicated program appears in prime time, the networks will have the incentive to pick up these series

and thereby eliminate the competition. *This is akin to a horizontal merger,* and with the high level of concentration in the network market, this would be very anticompetitive.

Another example of self-preference by the network owned stations occurred in 1974 and concerned the attempt by NBC news to reclaim the Saturday 7-8:00 p.m. time slot for an hourly news program. This time slot was made available by a recent modification in the Prime-Time Access Rules. *Variety* carried an account of the broadcasters convention when NBC first announced this change in its policy. Evidently, the affiliates strongly opposed surrendering so lucrative a time slot for an unprofitable news program, and some predicted that NBC would be lucky to get 80 clearances. In general, the affiliates "don't like the network 'grab' of the Saturday hour."[17] Robert Howard, president of NBC, explained the takeover of the Saturday slot by saying that "NBC news has got to have a home. I've told them that we want to be number one."[18] The real problem in this situation was that many of the affiliates were running "Hee Haw" and "Lawrence Welk" in this time period and obtaining solid ratings and high profits. They did not want to lose this sure money for the uncertainty and probable low ratings of another public affairs program and, of course, at the much lower network compensation rate. It is also reported that Howard noted "with confidence and a sneaky touch of humor that clearances for the news show already include New York, Los Angeles, Chicago, Cleveland, and Washington"[19]--the NBC owned and operated stations. This off-the-cuff comment should be given extreme importance because it suggests a mind set geared toward automatic acceptance of network

programs whether they be of the news or entertainment species with no consideration of content or quality.

The last special example involves the telecasting of major league baseball by local television stations. In all of the major markets with baseball teams, a local station carries about 40 games a season. During the spring and summer months, these live telecasts are a welcome relief from the network prime-time reruns and naturally bring in relatively high ratings for the station carrying them. Hence, there is usually a lot of competition by local stations to obtain these broadcast rights. There is at least one major league team in eight of the nine markets containing stations owned and operated by one or more of the networks (there are two in New York, San Francisco, and Chicago and thus 11 teams altogether). It has been stated many times that the network owned and operated stations are 15 of the most powerful and profitable stations in the country; *yet not a single owned and operated station has the local broadcast rights to a major league baseball team.* Is this just a strange occurrence, something which is just an oddity of our times, or is there some underlying reason for this lack of baseball rights?[20] The reason is obvious. Some of the local baseball games occur during prime time on the weekday schedule. If a network station carries local baseball, it will then preempt a network show, and the network must either lose this market or seek some independent for this one time preemption. Since no independent will interrupt its own schedule to broadcast a rerun of "Maude" or "Rhoda" on a temporary basis, the market will probably be lost and the ratings will therefore plummet and affect total network

advertising not only for that week but for all of the surrounding weeks. Thus, the orders have gone out to the locally owned stations not to compete for local baseball rights.[21]

Therefore, baseball and other sports are good examples of programming in the public interest, and the networks wearing both their network and station owners' hats have arbitrarily and automatically foreclosed this programming from their stations. *This is clear proof that conflicts of interest can and do arise in this manner.* If further proof is required that this is indeed the true state of affairs, one can point to the fact that four of the owned stations have radio broadcast rights to the same major league teams. In terms of radio, no conflicts between network programs occur and hence the O and O's actively compete for these broadcast rights.[22]

5.2.3. Evidence of Clearances of Regularly Scheduled Programs

Finally, an investigation has been made into the clearances of prime-time and late night regularly scheduled programs to see whether the owned and operated stations behave any differently than normal affiliates. The test was conducted for a two-week period (April 4-17, 1976) in 15 top markets including all of the markets containing network owned stations. The results displayed in Table 5.1 show the hours *not cleared* by the stations in these local markets. This rather long list of rejections includes only four hours on owned and operated stations, namely preemption of the CBS late night movie in St. Louis. In short, 14 of the 15 stations cleared all 70 of the hours over the two-week period and only one,

Table 5.1. Sample of Rejected Programs by Affiliated Stations (April 4-17, 1976)

Market	Station (Affiliation)	Time Period	Dates	Network Show Preempted	Local Show
Washington	WTOP (CBS)	Sun. 10-11 p.m.	4/11,16	Bronk	Local public affairs
		Tues. 10-11	4/13	Switch	Local public affairs
		Fri. 11:30-1:30	4/9,16	CBS Late Movie	Local movie
		Sun. 8-9	4/4	Sonny & Cher	Documentary
		Sun. 9-10	4/4	Kojak	World movie premiere coverage
		Fri. 9-11	4/9	CBS Movie	Local movie
Baltimore	WMAR (CBS)	Tues. 8-8:30	4/6	Selfish Giant	Documentary
		Fri. 11:30-1:30	4/9,16	CBS Late Movie	Local movie
		Fri. 9-11	4/9,16	CBS Movie	Local movie
		Tues. 10-11	4/6,13	Switch	Local variety
	WBAL (NBC)	Mon. 8-9	4/5,12	Rich Little	Documentary
		Tues. 8-9	4/6,13	Movin' On	Concert
		Fri. 8-8:30	4/9	Easter Special	Repeat of Sanford & Son
		Sat. 11:30-1	4/10,17	Saturday Night	Local movie

Table 5.1 (continued)

Market	Station (Affiliation)	Time Period	Dates	Network Show Preempted	Local Show
Baltimore	WJZ (ABC)	Mon. 8-8:30	4/5	On the Rocks	Local public affairs
		Sat. 11:30-1	4/10,17	Saturday Night	Local movie
		Mon. 8-9	4/12	Noah, Good Heavens	Basketball
		Wed. 11:30-1:30	4/17	ABC Late Movie	Local movie
		Sat. 9-10	4/18	S.W.A.T.	Easter special
Cleveland	WJW (CBS)	Mon.-Fri. 11:30-1:30	4/5-9, 12-16	CBS Late Movie	Mary Hartman and local movie
		Fri. 8-9	4/9	Sara	Documentary
	WEWS (ABC)	Sun. 7-8	4/11	Swiss Family Robinson	Local movie
		Mon. 8-8:30	4/12	On the Rocks	Local variety
		Mon. 8:30-11	4/12	ABC Baseball	Local movie
		Tues. 9-11	4/13	Rookies	Musical variety
		Tues. 11:30-1:30	4/13	ABC Late Movie	Telethon
Detroit	WJBK (CBS)	Thurs. 10-11	4/8,15	Barnaby Jones	Ironside
		Thurs. 11:30-1:30	4/8,15	CBS Late Movie	Local movie
		Fri. 11:30-1:30	4/9,16	CBS Late Movie	Local movie

Table 5.1 (continued)

Market	Station (Affiliation)	Time Period	Dates	Network Show Preempted	Local Show
Detroit	WWJ (NBC)	Sat. 9-11	4/10	NBC Movie	Local movie
		Sat. 11:30-1	4/10,17	Saturday Night	Local movie
San Francisco	KPIX (CBS)	Tues. 8:30-9	4/6	Good Times	Baseball special
		Wed. 8-9	4/7	Tony Orlando	Disney special
		Fri. 8-11	4/9	Entire schedule	Baseball

in the smallest owned and operated market, failed to clear four hours. For all practical purposes, it can safely be assumed that the network owned stations cleared 70 hours of network programming. It is possible to statistically test whether the regular affiliates behaved differently than the network owned ones. Using a t-test and the data in Table 5.2, the null hypothesis is that the regular affiliates cleared 70 hours of network programs; the alternative hypothesis is that they cleared less than 70 hours. The calculated t statistic (-6.576) lies outside the region of acceptance at the 5 percent level (-1.699) and, therefore, the null hypothesis can be safely rejected. This provides further evidence of the theory outlined above and confirmed in the previous examples.

Variety conducted a similar survey of the top 25 markets during prime time for October and November of 1972 and came up with identical results, namely, not a single prime-time hour was preempted on a network owned and operated station.[23] Thus, there is virtually 100 percent clearance during the crucial public opinion formation hours by those stations owned by the networks and this behavior is in sharp contrast to that of similarly situated affiliates owned by separate entities. In such an important and crucial industry as television broadcasting, the appearance or even possibility of a conflict of interest should be scrupulously avoided.

5.3. The Advantages of Owning Television Stations

Since each network owns five stations in the most populated markets, it has a great deal of buying power by itself and when the networks concur on a decision, their power is exponentially higher.

Table 5.2. Hours of Cleared Network Programs by Affiliated Stations (April 4-17, 1976)

Market	Hours Cleared by Regular Affiliates	Hours Cleared by Network Owned Stations
Washington	WTOP (CBS) - 63 WMAL (ABC) - 70	WRC (NBC) - 70
Philadelphia	KYW (NBC) - 64 WPVI (ABC) - 68	WCAU (CBS) - 70
Cleveland	WJW (CBS) - 49 WEWS (ABC) - 64	WKYC (NBC) - 70
Detroit	WJBK (CBS) - 60 WWJ (NBC) - 64	WXYZ (ABC) - 70
St. Louis	KTVI (ABC) - 66 KSD (NBC) - 70	KMOX (CBS) - 66
San Francisco	KPIX (CBS) - 59-1/2 KRON (NBC) - 70	KGO (ABC) - 70
New York		WCBS (CBS) - 70 WNBC (NBC) - 70 WABC (ABC) - 70
Los Angeles		KNBC (NBC) - 70 KNXT (CBS) - 70 KABC (ABC) - 70
Chicago		WLS (ABC) - 70 WBBM (CBS) - 70 WMAQ (NBC) - 70
Baltimore	WMAR (CBS) - 59-1/2 WBAL (NBC) - 61-1/2 WJZ (ABC) - 65-1/2	
Atlanta	WAGA (CBS) - 58 WSB (NBC) - 63 WQXI (ABC) - 68	
Milwaukee	WISN (CBS) - 57-1/2 WTMJ (NBC) - 65-1/2 WITI (ABC) - 69	

Table 5.2 (continued)

Market	Hours Cleared by Regular Affiliates	Network Owned Stations
Miami	WTTV (CBS) - 65-1/2 WPLG (ABC) - 66 WCKT (NBC) - 69	
Denver	KMGH (CBS) - 57 KBTV (ABC) - 67 KOA (NBC) - 68	
Kansas City	KCMO (CBS) - 55 WDAF (NBC) - 68 KQTV (ABC) - 67-1/2	
	mean = 63.933	69.733

If a syndicator can land an O and O deal, he has already taken care of a quarter of all the homes in the country, and if he also lands some of the other major groups, his task is downhill after that. According to an important syndicator, there is an extra measure of prestige associated with an O and O deal which obviates having to audition the program to every single station in the country.

> Hal Hough (V.P. in charge of programming for O and O stations at CBS) is one of the most respected programming men in our business. That stamp of approval is a very big help....If CBS has put a show through its mill and approves it, it's good enough for other program directors from smaller stations around the nation.[24]

Hence, the O and O's are extremely important; they can make life easy or most difficult.

While all three networks vehemently deny that their respective stations act in concert, a quick perusal of their prime-time access lineups reveals that with few exceptions, they are basically the same across all stations in the group. For example, both editions of "Hollywood Squares," as well as "The Price is Right" and "Don Adams' Screen Test" play on all five NBC owned stations while "Match Game 1976" and the two editions of "Let's Make a Deal" play on four of five of the ABC owned stations, and "Bobby Vinton," "Treasure Hunt," and "Candid Camera" play on four of five of the CBS group. In fact, NBC's express policy has been that each individual station *would be allowed* one wild card program *of its own choice* for the prime-time access period.[25] But when questioned in the recent Senate Antitrust Hearing on Pay Cable Television about a local station's role in purchasing syndicated films, NBC responded:

> When any NBC owned station needs films, the local program manager of the station will make his own arrangement with film distributors. NBC's owned stations do not centralize their purchases of feature films. *On occasion, general marketing information about the availability of feature films and other assistance in evaluating films and prices may be provided to each station by a central staff.*[26] [italics mine]

Notwithstanding this public statement, all the surface evidence suggests that with few exceptions and to a differing degree, the networks run their stations, and this lack of independence gives them buying power as a group. Now, there may be some efficiency in negotiations when a syndicator can line up a quarter of all the television homes with one fell swoop, but this group buying power also means that local station owners are not given access to the competitive bidding for certain shows.

Thus, if the CBS stations want the reruns of "Gunsmoke," the real competition may be with the other two network station groups or other large groups such as Storer or Group W rather than with the other stations in any one local market. The main point is that the network station groups have individual and collective power and when competitive threats such as "Space 1999" and "Mary Hartman" emerge, this power can be used in an exclusionary fashion. One should ask the question, if these 15 stations were not owned by the networks, would each of them have made the obviously "incorrect" decision to not bid for these two highly successful shows? It seems clear that the network owned stations have been used in the past to protect the long range interests of their parent networks, and such a spirit of cooperation and collusion is alien to a system

predicated on the greatest amount of competition from as many different sources and with as many different colors as is possible.

Another problem in the syndication market arises out of the attempt of the CBS stations to enter the syndication industry as producers. On two separate occasions in recent years, CBS has tried out in-house pilots for possible series during afternoon or prime-time access periods. Notwithstanding the automatic clearances that such programs would have in the owned and operated markets, this is a direct evasion of the prime-time access rules which were designed to prevent networks from obtaining any power in this industry. As a *Variety* story put it so well:

> If and when the CBS owned stations come up with the 4:30-6:00 p.m. strip they want, it will undoubtedly force the flagship WCBS-TV to give up the "Mike Douglas Show" which has been doing well in that period. *A New York outlet would be vital to amortizing the costs of a house strip* and would be an important showcase for further syndication of it.[27]

In a similar light, the idea of automatic clearance of network programs by network stations becomes even more ominous when one remembers the increasing trend of the networks into the production of their own fare. This vertical integration from production of TV programs to their actual broadcast may place in a few hands the *absolute power* to decide what a quarter of the entire nation views across their television screens. The entire idea of competition and checks and balances then becomes a true mockery.

Consequently, once more one witnesses this idea of self-preference and the need for automatic clearance and one starts to believe that the success of any network organization depends upon

laying the proper foundation of owned and operated stations. Hence, the terms of entrance into networking become even greater because not only must one purchase all of the capital stock and the personnel necessary to run a full-fledged network, one must also own stations to guarantee access to a significant portion of the viewing audience.[28]

5.4. Competition for Affiliation

The public service criterion under which television stations operate requires not only that the licensees program in the public interest but also that there be free and open competition for affiliation licenses. Suppose there are four VHF stations in the market and only three networks for possible affiliation, then at any point in time, the unaffiliated station should be continuously seeking to impress the network organizations that it deserves to be affiliated more than the current affiliated stations. It will try to assemble the best management team and the most aggressive sales personnel in the market. It will attempt to achieve parity or superiority in non-network time periods through vigorous programming, and in general it will seek to convince the networks that it is to their advantage to switch affiliations to this station. While the outcast station is improving its own quality, the existing affiliates will then be spurred on to meet the threat of the increasing level of competition with increased quality of their own. In this scenario, the public can only benefit from the continual necessity for stations to keep on their toes and take nothing for granted. However, when one of the three affiliated stations in the market is

owned by a network organization, it is ordained that this station will forever remain affiliated with the parent network, and thus independents are totally foreclosed from competing for its contract. When all three affiliates in a market are owned by networks as occurs in New York, Los Angeles, and Chicago, the opportunity for affiliation by an independent is totally blockaded. Nothing can be done to wrest this prize away from the owned and operated stations. Not only will the independent stations feel despair but the owned stations may lapse into lethargy in this aspect of competition.

Will this theory of affiliation competition work in practice according to the outlines of the proposed theory? In order to answer this question, one must distinguish several different types of market competition. Firstly, suppose there are fewer stations in the market than the number of networks. The stations then have the upper hand in bargaining and the stations can either have double affiliations or can play one network off against another. One would then expect these stations to obtain higher network compensation rates and/or become affiliated with the better networks. In such markets, ABC as the late comer has characteristically been shut out or else forced to settle for less appealing UHF stations. Over the past three years in its attempt to gain equal status, ABC has caused a number of small market affiliates to switch from NBC or CBS to its network. For example, in 1973, ABC lured away six such stations "with the promise of sweetened compensation arrangements."[29] These were in Twin Falls, Idaho; Tyler, Texas; Lufton, Texas; Panama City, Florida; El Dorado, Arkansas; and Gainesville,

Texas. In 1974, ABC lured away Bakersfield, California. In the case of Bakersfield, it was successful because it could deliver the young viewers by a 5-7 percent margin over CBS and NBC, and this city is one of growing families.[30] While the bids involve higher compensation, few stations would switch without confidence in the network's future. As an ABC executive noted,

> It's not like selling to advertisers who can get in and out again depending on how a network is going from season to season. We are asking for an owner to put his destiny with us and that makes it a tough sale. The family jewels are on the line.[31]

The other side of the coin comes up when the number of stations in a market exceeds the number of networks. Then each network has the upper hand and theoretically can wield a club over its affiliate if not enough network programs are cleared. This is the much more important case since it involves the bulk of large markets in the country and an overwhelming percentage of the television homes. In general, unless it is pushed, the network will not make an affiliation change in a major market. But it can happen. When ABC was confronted with this type of situation in Washington, D.C., *Variety* called such a switch "unbelievable."[32] The underlying facts in the case involved Metromedia's application of WTTG, a strong VHF independent, to replace WMAL, the ABC affiliate which supposedly had offended ABC during the second season of 1974 by refusing to clear "Chopper One," "Firehouse," and "The Cowboys." Because of these rejections, ABC went to WTTG to air the shows which later led WTTG to apply for affiliation. *Variety* noted and it was later proven by facts that:

> chances are ABC is using the potential shift to WTTG as a club over WMAL's head and a superb club it is....An actual shift would be a severe blow to affiliate morale across the country.[33]

While such competition for affiliation redounds to the network coffers in this case, even this limited form of competition is foreclosed by network ownership. This pecuniary competition is different from the competition for affiliation based upon the merits of the station, its management, its technical competency, and its public image. If these latter criteria become the reasons for changing affiliations, then the public would benefit from the increased quality competition. But if the form of competition is simply greater clearance of network programs or lower compensation rates, then the public gains nothing, and the networks simply obtain greater profits. Hopefully, the public service criteria form part of the network decision making calculus when it considers changing affiliations even if only at the margin. Nevertheless, the basic point still remains; when the network owns a station, all competition whether pecuniary or quality wise is totally foreclosed and, in this dimension, complacency and the easy life may prevail.

5.5. The Networks as Grantors of Affiliation Contracts

The networks may utilize their position as a network which is the grantor of the valuable affiliation contract to force multiple station owners to trade or sell stations to them under the threat of losing affiliation in markets not being considered. For example, if network A wants to move one of its owned and operated stations from the 10th market to the 5th market, it may either suggest a

trade or else a purchase of the station from a multiple owner which has stations in the 5th, 6th, and 7th markets. If the multiple owner refuses, he runs the risk of not obtaining reaffiliation in the 6th and 7th markets. Hence, the mere fact that networks are vertically integrated into owning stations gives them a special leverage which would be absent if such ownership were forbidden. It should be noted that such a situation actually took place in the early 1950's, when NBC traded its Cleveland station for Group W's Philadelphia station. The Celler Committee documents the fact that Westinghouse refused the trade until NBC made it known through a "veiled threat" that it would withdraw all its affiliations with Westinghouse.[34]

5.6. Deep Pocket Theory

Usually, the fiercest competition in any market occurs on the local newscast since this is virtually the only place where a station can display originality, individuality, and aggressiveness. Because of this, the ratings game for the local news takes on special importance in the managerial utility function, and most stations will purposely outspend their revenues in this form of programming. When the ratings slip, the entire news format is usually overhauled. This may mean expanding the news from a half-hour to an hour or longer, building a new set, switching to a "happy talk" format, highlighting local action stories, and usually importing new anchormen. While this is generally true for all large stations and especially cross-owned ones, one wonders whether the network owned stations are willing to devote extra financial

resources to win the numbers game, that is to say, have they deeper pockets than their competitors?

How does one test this proposition? Well, if it is true, then one can expect over time that the network owned stations will have higher ratings than regular affiliates but not necessarily higher profits if the marginal expenditures exceed the marginal revenues. Another manifestation of such a deep pocket policy would be a higher salary structure on the owned and operated stations. Unfortunately, the data on revenues and profits are not available on a per station basis and detailed ratings data are not easily obtainable. Nevertheless, one can glean some impressions by examining various trade stories about competition in the O and O markets. Needless to say, in the top three markets, the competition for ratings is the fiercest and small mistakes translate into large financial losses. Once more, the myth of local control should be dispelled. The networks have offices in these top markets and, according to one story, they are constantly breathing down the station managers' necks. In addition, top executives are constantly moving from one owned station to another and/or up to the network level.[35] This latter promotion provides one of the fringe benefits and incentives for any ambitious newscaster or salesman since a network position is the top of the profession and is very high paying. Hence, working for an owned station is generally thought to give someone an "inside" opportunity for network consideration.

According to a *Variety* story, the reason for ABC's dominance in four of its five O and O markets lies in its aggressive management style.

> The differences are subtle according to one veteran time salesman who works the secondary O and O markets, but the degree of day by day control is greatest with the CBS stations and least felt by the ABC stations with NBC about in the middle....The CBS stations always seem to be calling New York and they don't always get an answer.[36]

The same article notes that in terms of day long quarter hour totals, the O and O stations are in *first place* in five of the six "secondary markets"--the lone exception being a third place for WKYC in Cleveland.[37] With respect to the news hour ratings, these seem to ebb and flow since all of the large stations have deep pockets to one degree or another; but the general impression is that, in the long run, the network owned stations are either at the top or not far from it. As they seek to establish superiority, money seems to be no object in this plan.

These impressions come from scrutinizing the last four years of *Variety* and extracting various comments and incidents which perhaps in isolation seem innocent enough but when taken together, the weight seems heavy enough to carry the point. The first example concerns a story about WRC, the NBC station in Washington which is described as investing "heaps of coin" to plug its new format, the newscenter. WRC, the "long time ratings king and ruler of the roost," boosted its staff a "whopping 50%" to around 60, brought in the news director from KNBC (Los Angeles) and hired Fred Thomas, WMAL's (a local competitor) popular black anchorman.[38] Similarly, when WKYC (the Cleveland NBC owned station) started to

slip behind in the news ratings, it went to a new format emphasizing local involvement, lengthened into an hour time period, and hired Doug Adair away from its number one competitor, WJW, at a very high salary of $60,000 a year. When that did not do the trick, the newscast was lengthened to 90 minutes, the news bureau was expanded from 18 to 42 people, and in total, over a million dollars was spent.[39] Another example of this deep pocket theory occurred in the St. Louis market where KMOX, the CBS owned station, suspended Ernie Jarman, a black newsman, who had publicly charged the station with racial discrimination. He was replaced by another black newscaster, Julius Hunter, "who was enticed from KSD-TV"--a local competitor.[40]

Perhaps the best example of this hypothesis occurred in Detroit, where WXYZ is an ABC owned station and WJBK is part of the Storer group. As was reported:

> The nip and tuck battle for TV news primacy here between Storer CBS affiliate WJBK-TV and ABC O and O, WXYZ-TV has turned into a rout. In the February-March Arbitron Sweepsbook, WXYZ-TV has a 46 share of the late night audience vs. 26 for the Storer station. This margin is the largest news lead by an ABC owned station in any of the five ABC O and O markets.[41]

How did this rout occur? Well, after lagging behind for some time, WXYZ brought Jim Osborne from another network station, and he turned things around by luring away WJBK's top talent with record salaries. Three years ago, WJBK had the highest rated news team in Detroit, consisting of Jac LeGoff, a popular veteran anchorman, and John Kelly, a handsome, young anchorman. Together they had pioneered the "happy talk" format in Detroit some years before. In addition, there was Ray Lane, a well respected young sportscaster who had

broadcast both the Detroit Lions and Tigers games, and Marilyn Turner, a pretty weathergirl. WXYZ first lured away John Kelly, thereby splitting up the top rated news team. Then it obtained Marilyn Turner, who later wed John Kelly. Finally, it acquired Jac LeGoff at a reported annual salary of $100,000 a year and the former news team was reunited. The former anchorman at WXYZ was then promoted to the New York owned station. From this point on, the slow ascendancy of WXYZ turned into the aforementioned rout in ratings. It should be noted that WXYZ made no apologies for this wholesale raiding. They even ran commercials showing these popular newspeople being kidnapped away from their former jobs and saying, "We found out who you wanted and went out and got them." Large billboards showed the news teams with arms around each other under the heading, "We got who you wanted, Detroit."

If all of this was not enough, when WJBK began to pick up the pieces by turning a beautiful, young news reporter named Terry Murphy into an anchorwoman and started to make a dent in the ratings, she was lured to the "greener pastures of Chicago and the opportunity to work for a network owned station, ABC's WLS-TV."[42]

According to the *Detroit Free Press*:

> Part of Terry's deal with WLS and ABC includes joining the rotation of the weekend ABC network news. That was one of the carrots that lured Jac LeGoff and John Kelly to WXYZ-TV, ABC's Detroit station. There's always the possibility that the ABC network brass might be looking in and like what they see enough to offer a network news job.[43]

The *Detroit Free Press* also noted:

> *It looks as if ABC has executed another of its familiar, "if you can't beat 'em, buy 'em" numbers with Terry, the same ploy that took Kelly and LeGoff to channel 7.*[44]

This thought was reiterated in *Variety*, which commented, "In essence, WXYZ-TV's Jim Osborne has put together the best team money can buy."[45]

In summary, the evidence suggests that the network owned stations are willing and able to spend huge amounts of money on news and all of its related accouterments and, as a consequence, market quality is probably somewhat higher than would normally be the case. Nevertheless, the fundamental point remains that true competition is distorted when firms with giant parents compete against those with only large ones or none at all. This principle is noted in the Proctor and Gamble-Clorox Case (*F.T.C. v. Proctor and Gamble* 386 U.S. 568 [1967]) and is a fundamental tenet of conglomerate anti-trust theory. It is anticompetitive when a network owned station can lure away top newscasters of its rivals with exorbitant salaries and the possibility of network exposure and advancement. This behavior becomes even more intolerable when the network stations try to lure away other groups' in-house productions. The best example of this occurred in 1973 when both the CBS and NBC station groups tried to lure away the "Mike Douglas Show" from Group W. The show would have been produced at either the New York or Los Angeles outlets.[46] While this seems innocent enough, it should be viewed in the framework of the huge ratings success of the show in the O and O markets, especially in Los Angeles and Philadelphia where Group W has stations. Once one of the networks produces the show, it will of course switch over from the competing stations and

thereby remove the competitive threat that it poses. This is identical to the "Space 1999" story about the possibility of a network picking up the program for the following season if it is successful in syndication. While the end of this story is happy because Group W matched the network groups' offers of $2 million per year for Mike Douglas and he chose to remain with them, the potentiality and power remain for future elimination of competition and leverage.

5.7. The Effects of Divestiture

The first section of this chapter has outlined several compelling reasons for separating the business of networking from owning television stations. In this section, an attempt will be made to assess the effects a divestiture order would have on various public service criteria. Multiple regression analysis will be used to isolate the effect of network ownership on various dependent quality variables. The major hypothesis is that network owned stations perform no differently than similarly situated affiliated stations owned by other entities. Depending on the results of such an analysis, conclusions can be reached as to what quality and/or efficiency might be lost or gained if networks were severed from their role as station owners. The question of how disruptive such an order would be is also examined.

5.7.1. Measuring Quality in Television Programming

The Commission has since its inception favored a public service standard which places strong emphasis on keeping the local public informed. In 1966, it adopted the current license renewal form which

asks licensees to list the number of hours per week of news, public affairs and "other" non-entertainment programming. Although the Commission has never set minimum standards in its renewal procedure for weighing the news and public affairs and "other" informational data it receives, a 5 percent news, 1 percent public affairs, and 5 percent "other" standard is commonly thought of as "the minimum diet necessary to stave off complete information starvation."[47] Since these standards have been so minimal and easy to comply with, most broadcasters have readily met this informal level.

The data used for these classifications as well as the other dependent variables come from the F.C.C. renewal forms as published in the special edition of the *F.C.C. Reports* and in the *F.C.C. Television Broadcast Programming Data Report for 1973.*[48] The data are limited to the affiliates in the top 50 markets and represent a sample of 144 stations out of a population of over 600 commercial stations. Even though all the stations in the sample are affiliates, this does not qualitatively affect the results; it simply means that a binary variable denoting network affiliation is left out of the model. Also, it should be noted that 138 of the stations are VHF while six are UHF, and no correction is explicitly made for the so-called handicap associated with the UHF band. However, the market size variable, net weekly circulation, also measures the technical power of the individual station and thus can be expected to reflect the inferiority of these UHF stations.

While the number of hours of news, public affairs, and "other" programming and the sum of these categories represent the first four dependent variables, the quality of such programming is not

measured for the obvious reasons of subjectivity. Hence, quantity will be more important than quality and, although one station programs ten hours of very high quality news, it will be found to be inferior to another station broadcasting 15 hours of medium quality news. Another shortcoming of the data is that no adjustment is made for when the programming is shown during the broadcast day or week. Obviously, those programs broadcast during the peak viewing hours should receive higher marks than those shown at 9:00 a.m. on Sunday morning or 2:00 a.m. on Wednesday. While the absolute hours of such programming may be important, the percentage of the total hours of the three classifications has also been presented since this may conform more to the 5-1-5 standard mentioned earlier and represents a relative ranking of the importance of such fare to the station.

From the very beginning, the idea of broadcasting as a local service has been of paramount importance to those regulating the use of the airwaves. Such a view may have created a broadcasting network in which every local community has its own television station; but, as mentioned in Chapter III, it also severely restricts the diversity of programming and has hampered the emergence of new networks. The dependent variable, "hours of local programming," consists of any type of programming which is filmed in the locality of the station. This would include local news, politics, sports, religious and entertainment programs. While the Commission still strongly adheres to this standard,[49] Nicholas Johnson points out that this local concept has largely been a failure.

> The networks simply dominate "local" television. Most viewers know their local television stations by channel number, but few identify these channels with local stations. The identification tends to be with the network. Without the occasional station I.D. required by the F.C.C., the local stations could very well slip into total anonymity.[50]

Nevertheless, since the F.C.C. still considers local service and local programming to be of such fundamental importance, they have been included as dependent variables in both absolute and percentage terms.

In addition to requiring information in terms of news, public affairs, and "other" programming, the Commission requires that stations make public service announcements about local community events. The number of such p.s.a.'s is reported on the license renewal form along with the aforementioned data. The Commission has never attempted to set the minimum number of p.s.a.'s which is necessary to retain the license, but because it considers these as important, they will be used as a dependent variable in this study. Once again, quantity and quality or duration may diverge and, as a consequence, the number of p.s.a.'s may not be indicative of how a station meets its public service responsibility. Also, the data do not disclose when the p.s.a.'s were aired. Clearly, an announcement broadcast during prime time will be more beneficial than one aired near sign-off and will obviously have a higher opportunity cost. Thus, timing, length, or quality are not represented in the data.

Another dependent variable has been labeled excess commercials. In 1960, the F.C.C. said that broadcast licensees have an obligation:

> to avoid abuses with respect to the total amount of time devoted to advertising continuity as well as the frequency with which regular programs are interrupted for advertising messages.[51]

The Commission has never enacted any regulations concerning the number and frequency of commercials but has indirectly endorsed the limits agreed to by the National Association of Broadcasters. Their code sets a limit of 16 commercial minutes an hour during the non-prime hours of the day. The basic assumption Johnson used and which will be followed here is that the greater the emphasis on commercials, the worse the station is performing. A station performing in the public interest will be willing to sacrifice possible revenues for better programming--programming less cluttered by interruptions. The data come from the license renewal forms which ask stations to submit the number of 60 minute segments falling into four categories: A--up to and including eight minutes of commercials; B--over eight and up to and including 12; C--over 12 and up to and including 16; and D--over 16.[52] Although the N.A.B. allowable limit is 16, 12 minutes of advertising per hour amounts to 20 percent of the broadcasting hour and would seem a more reasonable limit for these interruptions. Hence, categories C and D have been added together to form the dependent variable. Now, it should be noted that good performance (lack of excess commercialization) may occur because of failure to sell the spots rather than a conscious policy to serve the public. According to Johnson, the 20 highest ranked stations in his index are in markets 26-50 where the difficulty of selling local time increases as compared to the top 25 markets.[53] Nevertheless, using regression analysis, this market size effect can be

controlled for, and then the comparisons and judgments as to relative station performance need not worry about this problem.

Since it is commonly assumed that quality in programming is a function of dollars spent, a variable has been included to measure the amount of programming expenditures relative to total sales. This "percentage of sales spent on programming" should give some indication of a station's dedication to public service rather than the dollar. Since large stations have larger revenues, one would think that this would automatically force their percentages to significantly lower figures. However, it must be remembered that (1) costs are generally higher in the large city in terms of news distance coverage and also the overall standard of living, (2) the larger the city, the larger the number of competitors and hence the lower will be revenue per station, and more money must be spent to effectively compete, (3) prices for syndicated fare are adjusted to take account of increased market size. Hence, there are forces at work which would suggest a somewhat lower percentage of programming expenditure for the larger markets, but since a market size variable is used as an independent variable, this variation is controlled for in the regressions. Unfortunately, since individual station data on revenues, income, and expenditures is unavailable, one has to settle for Johnson's *relative ranking* of the 144 stations and that is the datum which is used in this study.

5.7.2. The Independent Variables

The basic functional relationship used is that the dependent performance variables will depend linearly upon those independent

variables which determine the profitability of a station. One expects that more profitable stations will be able to more easily divert resources into public service programming than will those stations whose primary concern is avoiding the red ink. It is also known that the F.C. C. expects a higher level of performance from the more profitable stations than it does from the less profitable ones.[54] Consequently, one expects station performance to depend upon the market size, the number of competing stations, whether the station is affiliated with CBS, NBC, or ABC, and who owns the station.

The first independent variable is net weekly circulation, which is a measure of the number of television homes "reached" during a sample week. This measure of potential television audience is used for two reasons. First, it conforms more to the idea of a market than do conventional measures such as "Area of Dominant Influence" (ADI) or "Designated Market Areas" (DMA's). To avoid double counting, these latter two measures assign each local county uniquely to any one television area according to the dominant (majority) viewing pattern of the television homes in the county. However, contrary to economic wisdom, double counting is important in this context and a measure of market size which neglects minority viewership is clearly inferior to one which emphasizes it.

Net weekly circulation measures the "reach" of television stations, that is to say, the number of households who watch the station at least once during the week for at least five minutes and thus includes majority as well as minority viewership. Net weekly

circulation also is a measure of technical broadcasting power or strength, and one would expect those stations which can physically reach more people to have the larger potential audience and the larger revenues and profits. In this sense, net weekly circulation allows for intra-market comparisons of stations while the other two measures assume equal market size for all stations in the market. Also, net weekly circulation will pick up the variation in the data caused by not including a binary variable for UHF and VHF stations. One expects net weekly circulation to be positively correlated with the dependent variables.

The second important variable which will affect the profitability of a station and hence its public service record is the number of stations in the market. Theoretically, the more stations in the market; the greater the competition for the advertising dollar; the less effective will be the enforcement of a buying or selling cartel, and therefore profits per station should decrease as the total pie is split among a larger number of participants. On the other hand, it is possible that this negative effect is blunted somewhat by the theory that increasing the number of stations will increase the viewing options thereby stimulating the consumption of television in general as people sacrifice other leisure time activities to watch a more varied television menu. One would expect this positive effect to be of the diminishing marginal nature (i.e., the second station will elicit more additional viewers than the third or fourth and so on). One note of caution: since the number of stations is correlated with the underlying market size, it is possible that at times it acts as a scale variable for market size

and thereby has a positive coefficient. To correct for this, an interaction term has been added, and in most of the equations it has the proper negative sign.

Thirdly, a binary variable has been added for network ownership of the station. The reason for including such a variable is to test the major hypothesis that network ownership has some effect whether positive or negative on economic performance. The networks argue that these stations are more attuned to local needs because of local management and the high quality standard of the networks. Critics would argue that outside ownership by a group must lead to less community awareness and involvement, and that the local managers are the puppets of the network organization. Thus, according to their view, one would expect worse performance from these network owned stations than similarly situated ones owned by other interests.

The fourth independent variable is a binary for whether or not the station is owned by a local newspaper interest. One might expect that cross ownership by such a major local entity as a newspaper should lead to greater awareness of local needs and better performance in the public interest. Hence, one should expect positive coefficients for this variable. A binary variable has also been included for station affiliation with CBS or NBC. Since during the time frame of these data these networks clearly enjoyed higher ratings, those stations so affiliated should have higher revenues, greater profits, and therefore a better public service record in the indicated categories. Consequently, one expects positive coefficients for these two binary variables, which means that CBS or NBC affiliates will have superior performance than the ABC

affiliates whose values will be contained in the constant term for purposes of comparison. All of the data for the independent variables come from either *The Television Factbook*, various years, or the F.C.C. Annual Reports. Finally, it should be noted that other variables which defy measurement and which may be important to the model are not included. These are variables dealing with the involvement and commitment of the station owners and managers in local affairs.

5.7.3. Interpretation of the Results

The main issue of contention is what the effect would be of divestiture of the owned and operated stations. If the performance results show that having taken into account all of the other variables, the network owned stations perform significantly better, then the effect of divestiture would be a decrease in performance. If this were true, it would show up in the regressions as significantly positive coefficients on the network ownership variable. Alternatively, if the network owned stations perform significantly worse, *ceteris paribus*, then the case could be made that even without specific cause, the divestiture of these stations would lead to increased station performance in the public interest. This evidence would turn up as negative coefficients on the network ownership variable. Finally, if network owned stations perform no better and no worse than similarly situated stations, then specific cause is needed before requiring divestiture. This cause has been presented earlier in this chapter in terms of the inevitable conflicts of interest which occur when an entity wears both a network and a station owner hat. Hence, while insignificant coefficients,

either positive or negative, imply no difference between the stations according to ownership, *they also imply that no significant deterioration of public service would result if divestiture is ordered.*

Looking at the evidence presented in Table 5.3, one sees that only four of the 11 categories have network ownership coefficients which are significant at the 5 percent level. These categories are number of public service announcements, number of excess ads, hours of local programming, and percentage of revenues devoted to programming. Three of the four significant categories have negative coefficients, which suggests that the network owned stations performed significantly worse than similarly situated non-network owned stations. The lone exception, number of excess ads, has a positive sign which also indicates poor performance by the network stations. Therefore, recognizing the limitation of the data, one perhaps should not claim that divestiture would lead to better station performance, *but one can be confident in predicting that performance certainly will not decline if divestiture is ordered.*

5.7.4. Other Effects of Divestiture

Several final questions remain as to the effect of a divestiture order: (1) Will the networks suffer large financial losses? (2) Will such an order be disruptive to the industry and the American people? (3) Will the Commission's goal of local ownership be mortally wounded? On the first question, one should always remember that the license to broadcast is only a *conditional and temporary monopoly grant* of three years subject to revocation and renewal.

Table 5.3. Regression Results on Station Performance

Independent Variables	Dependent Variables	(1) Hours of News	(2) Hours of Public Affairs	(3) Hours of "Other"	(4) Total Hours (1+2+3)	(5) Number of p.s.a.'s	(6) No. of Excess Ads	(7) Hours of Prime Time Local	(8) Hours of Local	(9) $ Programming Total Sales (Ranking)	(10) Total Hrs. (4) Total Hrs. on Air (%)	(11) Total Hrs. (11) Total Hrs. on Air (%)
Constant		β=3.140***	-.772	7.351***	9.730***	150.586***	24.808***	-.558	1.391	48.841***	.147***	.059
		S=1.235	.989	1.428	2.266	40.737	4.518	.920	1.907	18.798	.015	.023
		t=(2.542)	(-.781)	(5.147)	(4.293)	(3.697)	(5.491)	(-.607)	(.729)	(2.598)	9.684	(2.533)
Net weekly circulation (millions of TV homes)		β=2.820***	3.812***	1.286	7.909***	95.235***	2.710	2.376***	7.460***	13.015	.048***	.058***
		S=1.015	.813	1.174	1.863	33.486	3.714	.756	1.567	15.452	.012	.019
		t=(2.777)	(4.690)	(1.095)	4.245	(2.844)	(.730)	(3.142)	(4.760)	(.842)	(3.875)	(2.999)
Number of stations in the market		β=1.170***	.960***	.454	2.583***	3.778	1.625	.687***	1.911***	1.853	.011***	.011**
		S= .268	.214	.309	.491	8.825	.979	.199	.413	4.072	.003	.005
		t=(4.375)	(4.483)	(1.294)	(5.260)	(.428)	(1.660)*	(3.450)	(4.627)	(.455)	(3.425)	(2.192)
Owned and operated station		β=-1.076	-1.275	1.668	-.679	-84.934**	12.020***	-.606	-4.990***	-36.083**	.012	-.026
		S=1.115	.892	1.289	2.045	36.762	4.077	.830	1.721	16.963	.014	.021
		t=(-.9650)	(-1.429)	(1.294)	(-.332)	(-2.310)	(2.948)	(-.729)	(-2.901)	(-2.127)	(.881)	(-1.236)
Newspaper owned station		β=-.256	-.259	.012	-.499	-3.577	1.354	.481	.632	-5.334	.006	.015
		S= .576	.461	.666	1.057	18.997	2.107	.429	.889	8.766	.007	.011
1		t=(-.445)	(-.562)	(.019)	(-.472)	(-.188)	(.643)	(1.120)	(.711)	(-.609)	(.894)	(1.351)
0												
CBS affiliate		β=4.597***	-.300	3.025***	7.323***	2.632	5.749***	2.041***	.880	23.675***	.037***	-.001
		S= .549	.440	.635	1.008	18.125	2.010	.409	.848	8.363	.007	.010
1		t=(8.365)	(-.682)	(4.760)	(7.261)	(.145)	(2.860)	(4.985)	(1.038)	(2.831)	(5.448)	(0.124)
0												
NBC affiliate		β=5.531***	1.392***	.033	6.955***	-.123	4.263**	1.807***	2.129***	20.530***	.038***	.000
		S= .549	.440	.635	1.008	18.115	2.009	.409	.848	8.359	.007	.010
1		t=(10.071)	(3.165)	(.052)	(6.900)	(-.007)	(2.122)	(4.417)	(2.511)	(2.456)	(5.630)	(.028)
0												
Interaction of N.W.C. and number of stations		β=-.333***	-.399***	-.135	-.865***	-6.729**	-.565	-.266***	-.788***	-1.403	.006***	-.005**
		S= .107	.086	.124	.196	3.523	.391	.080	.165	1.626	.001	.002
		t=(-3.121)	-4.656	(-1.092)	(-4.415)	(-1.910)	(-1.447)	(-3.340)	(-4.720)	(-.863)	(-4.422)	(-2.328)
		R^2 = .524	.321	.270	.506	.085	.184	.301	.271	.121	.360	.173

*Significant at 10% level; **Significant at 5% level; ***Significant at 1% level.

The Congress in passing the Communications Act of 1934 never intended to grant a property right to any station owner. Hence, legally the Commission has the right to require divestiture without batting an eye and remember divestiture is not an extreme prophylactic since the licensees are obtaining the current worth and the present value of a stream of future earnings. The problem, of course, comes over the fact that some of these network stations have been owned for 25-30 years, and the Commission has routinely renewed them over the course of these years, thereby giving indirect sanction to network ownership. To suddenly reverse such a long-standing period of acquiescence might seem like a stab in the back, especially since the tendency of the F.C.C. is to protect the existing licensees and maintain the status quo in the industry. This argument, of course, assumes that prices will be depressed in the marketplace and the networks will suffer lower profits than they should receive for their stations. Without harping on the argument that part of the sale price includes the value of the free government grant, one should recall that all of these stations are located in the largest markets and are extremely profitable. Why should there be a dearth of viable applicants for which local financing can be arranged for so profitable and safe a venture as television? There is no reason to expect the properties to be sold to outside interests and, even if only one of the 15 stations was sold to a local group, that would be an improvement over the outside control now exerted by the network management. There can be no loss in local control because there is none to begin with in these cases.

Finally, the argument that divestiture causes disruption which may cause lower performance than is presently being provided is easily put to rest when one recalls that there is usually a continuity of management whenever a station changes hands. In fact, the guarantee of such continuity is often a large determinant in consummating the sale. Furthermore, divestiture is no different than the normal transfer procedure which occurs all the time.[55] If changes in ownership are so disruptive, why is this seldom brought up in transfer hearings?

In summary, this chapter has clearly demonstrated that when a single entity is allowed to operate in both the networking and station broadcasting spheres, conflicts of interest surface which are inimical to the public interest criterion. Specifically, the network owned stations abrogate their fiduciary responsibility to choose the best quality programs for their local area by clearing virtually 100 percent of their parent networks' programs regardless of quality or content. In addition, such vertical integration has allowed the networks to obtain a very powerful position as purchasers of syndicated programs, and they have used this power to stifle development of first-run programming which threatens their networking activities. Vertical integration perpetually forecloses independent stations from access to affiliation contracts in O and O markets as well as raising the terms of entry to those desiring to become networks. It has also been shown that the network owned stations do not perform any better (and in some cases perform significantly worse) than similarly situated stations owned by non-network entities.

One finds little evidence to support the disruption, depressed prices, or vesting arguments which normally act as a deterrent to divestiture in the television industry as well as most other industries. There would be no loss in efficiency since there is no need to separate the television and radio stations. The net result of divestiture would probably lead to more rather than less local control and would also open up these stations to the competition for affiliation contracts which is presently blunted by the perpetual contracts they now possess. In addition, divestiture may not hurt and probably will improve station performance in those criteria which the Commission itself holds dear and sacrosanct. Decentralization of power is always the best protection against its possible abuses.

FOOTNOTES FOR CHAPTER V

1. *Variety*, March 8, 1972, p. 1.

2. *Variety*, March 14, 1973, pp. 39, 51.

3. *Ibid.*

4. *Variety*, August 3, 1973, p. 31.

5. *Variety*, July 25, 1973, p. 23.

6. *Variety*, January 29, 1975, p. 46.

7. *Ibid.*

8. *The Los Angeles Times*, April 1, 1976, p. 18.

9. *Ibid.*

10. *Ibid.*

11. *Ibid.*

12. *Variety*, October 29, 1975, p. 47.

13. *Variety*, September 3, 1975, p. 1, 31. According to ITC executive Abe Mandell, the reason the networks did not accept "Space 1999" is that "they just don't like to accept any project they don't have complete control over."

14. *Ibid.* The predictions turned out to be true as all four series were cancelled and replaced with second season programs.

15. *Ibid.*

16. *Ibid.* The same behavior is reportedly occurring with "Mary Hartman." All three networks have sought the program for the 1976 season, but Norman Lear has decided to keep it in syndication. See *Variety*, June 9, 1976, pp. 49, 58.

17. *Variety*, February 29, 1974, p. 27; May 15, 1974, p. 75.

18. *Variety*, May 15, 1974, p. 75.

19. *Ibid.*

20. The coincidence seems to be even stronger because, looking up the old Washington Senators and Los Angeles Angels, one finds that neither of these teams was broadcast by an O and O station. When one considers the top three markets which contain nine network owned and six baseball teams, one realizes that something more must be involved than mere coincidence.

21. This information was told to me in confidence by several affiliates located in secondary O and O markets.

22. The four stations are KMOX--St. Louis Cardinals, WCAU--Philadelphia Phillies, WMAQ--Chicago White Sox, and KABC--Los Angeles Dodgers.

23. *Variety*, February 14, 1973, p. 38.

24. *The Hollywood Reporter*, October 19, 1972, p. 1.

25. *Variety*, April 3, 1975, p. 35.

26. U.S. Senate Antitrust Subcommittee, *Hearings on the Pay Cable Television Industry*, Ninety-Fourth Congress, 1st Session, p. 229. It was also brought up at the hearings that the network owned and operated stations may be able to get exclusivity against pay cable in their markets whereas other local stations are not so lucky, p. 194.

27. *Variety*, August 23, 1973, p. 33.

28. According to Hal W. Bochin, one of the reasons why the DuMont network failed in the early 1950's was its "inability to clear the full complement of 5 O and O stations." Even one of the stations in which DuMont owned a minority interest (KTLA in Los Angeles) failed to clear the network programs. Hal W. Bochin, "The Rise and Fall of the DuMont Network" in Lawrence W. Lichty and Malachi Topping, *American Broadcasting* (New York: Hastings House, 1975), p. 190-194. The plan for Kaiser entering the networking business also revolved around the solid foundation of the Kaiser owned VHF stations which cover 17.5 percent of the nation-wide audience. See C. A. Keller, "The Rise and Fall of the Overmyer Network," *Journal of Broadcasting*, vol. 13, Spring 1969, p. 129.

29. *Variety*, May 16, 1973, p. 38.

30. *Variety*, June 12, 1974, p. 31.

31. *Ibid.*

32. *Variety*, May 29, 1974, p. 29.

33. *Ibid.* CBS recently disaffiliated stations in Boston and Spokane for similar reasons.

34. *Celler Report*, pp. 98-99.

35. For example, see *Variety*, June 11, 1975, p. 39.

36. *Variety*

37. *Ibid.*

38. *Variety*, January 15, 1975.

39. *Variety*, July 10, 1974, p. 33; September 18, 1974, p. 50.

40. *Variety*, May 22, 1974, p. 46.

41. *Variety*, April 9, 1975, p. 39.

42. *The Detroit Free Press*, December 24, 1975, p. 4-B.

43. *Ibid.*

44. *Ibid.*

45. *Variety*, April 18, 1973, p. 47.

46. *Variety*, March 7, 1973, p. 37.

47. Nicholas Johnson, "Broadcasting in America," 42 *F.C.C. Reports*, Second Series, July 1973, p. 17.

48. *Ibid.*; Federal Communication Commission, *Television Broadcast Programming Data Report for 1973.* October 8, 1974.

49. In fact, in the recent cross ownership report and order, the primary reason the Commission failed to divest the existing newspaper-broadcasting combinations was fear of sales to outside owners. See 50 *F.C.C. Reports 2nd*, 1046.

50. Johnson, p. 31.

51. *Ibid.*, p. 25.

52. *Ibid.* Owen interprets the F.C.C.'s *Carrol* doctrine as being perfectly consistent with its policy requiring programming (of the public service variety) other than that which maximizes profits. In order to require the latter, the F.C.C. had to protect local broadcasters from new competition and thereby virtually guarantee excess profits. See Bruce Owen, *Economics and Freedom of Expression* (Cambridge, Massachusetts: Ballinger, 1975), p. 108.

53. Johnson, p. 25.

54. Confidential source.

55. For the period of 1970-1972, there were 83 television stations changing hands. See Owen, p. 110.

CHAPTER VI

THE EXERCISE OF MONOPSONY POWER

> "Who knows?" said Bob, "maybe they thought you could pull off a miracle in California and write a script everybody would love, but as I told you on the plane, even if you had, Merle, this has got nothing to do with a good script or a bad script. It never did have. It has to do with pleasing one man, Jim Aubrey." (V.P. in charge of programming at CBS)
>
> --Merle Miller, *Only You Dick Daring!*, p. 317

6.1. Introduction

In this chapter, an examination will be made of the networks' behavior in the input market (i.e., television programming), the basic premise being that a limited number of networks having the opportunity and power to collude in the setting of advertising prices will also extend their cartel to the buying side of the market. In the context of the television industry, it will be shown how the networks' parallel buying practices have depressed and also stabilized the prices of regular series programs. However, when the stabilization plan became threatened by bidding wars over the rights to theatrical movies, ABC and CBS integrated into this production sphere as well as into its next best substitute, namely, made-for-television movies. This vertical integration (1) creates the power and ability to prefer their own product in the marketplace of ideas (see Chapter VIII), (2) provides a credible threat to massive

foreclosure of outside product, (3) once again stabilizes their buying cartel and strengthens their collective power over input prices. Having perfected their buying cartel, the networks could then earn both monopoly and monopsony profits.

6.2. The Network Buying Market

The television networks operate very similarly to the major league baseball industry with its classic example of monopsony power--the reserve clause. A player is drafted by a single baseball club, which has obtained the rights to him through the position in which it finished the season or as compensation for a trade. This club becomes the exclusive buyer (monopsonist) of the players in which it has draft rights. No other team in the league may bid for his services. Once he has signed his first contract, the player remains bound to the club for life through a series of renewable options in his uniform league contract known as the reserve clause. The reserve clause allows the team to continually renew the player's option even if he fails to sign a new yearly contract. The club has unilateral power in determining a player's salary, working conditions, and other amenities, and he can only move to another team if he is sold, traded or unconditionally released. If the player does not abide by these rules of involuntary servitude at any step in the procedure, his only options are to play baseball in another country (i.e., Japan) or to seek his next best employment alternative.

In the baseball market, rational profit maximizing teams would be expected to behave like discriminating monopsonists. Each

player has his supply reservation price; if he is offered less than this, he will choose some other occupation outside of baseball. Hence, a team would be expected to pay different salaries to different players of equal quality because of different reservation prices; but generally the wages will be very similar because "while each player has a monopoly over his own services, he is not truly unique and there are more or less good substitutes for him." "His salary is therefore partially determined by the difference between the value productivities and costs of other players by whom he may be replaced."[2] The rational team will try to maximize the rent it derives from each player. The rent will be the difference between the marginal revenue product of the player and his salary. Consequently, the team would be indifferent between two shortstops one of whom is worth $30,000 and costs $20,000 and the other who is worth $20,000 and costs only $10,000. Both will give a rent of $10,000. It will prefer the first if it can have him for $19,000; but it will prefer the second if it must pay the first $21,000 to induce him to play.

> It will be prepared to pay a Babe Ruth a fabulous salary, simply because there are no very good substitutes for him, and he is worth so much more to the team than any other player. But if a Ruth insisted upon receiving his full worth, it would pay to employ in his stead some other person of less skill upon whom some positive rent would be earned.[3]

In the television industry, the networks deal individually with inputs which are very similar to the baseball industry. The programs are unique in their own right, yet most of them are good substitutes for one another (especially the new shows). The Babe

Ruths of the broadcasting industry are the "Gunsmokes" and "All in the Familys" which achieve huge ratings season after season and allow the network to extract high prices and prestige. Yet just like Babe Ruth or other superstars, they may be traded or cancelled if their monopoly position becomes too well entrenched and the network can derive larger rents from lesser quality programs.[4] The networks like the baseball owners fully understand this logic; they realize that their bargaining strength and advantage lie in the initial developmental stages of a television show when the quality of the scripts and pilot are of unknown and subjective value. Once a show becomes a hit, it takes on the nature of a monopoly in the sense that either network A cannot do without it or networks B or C might be persuaded and tempted to cheat on the cartel by bidding the hit series away from network A. Thus, the monopsonist's profits are threatened when the real worth of a program becomes known. To hedge against this occurrence, the networks have developed a series of parallel steps in the buying process which, if commonly followed, will enhance their power relative to their suppliers.

6.3. The Achievement of Monopsony Power

The first step in the process of obtaining monopsony control over production occurred in the late 1950's when the networks took over the responsibility for programming from the national advertisers. As noted earlier, the networks claimed that this shift of responsibility was done at the behest of the advertisers who could no longer afford the mounting costs entailed in sole or alternate sponsorship. The advertisers said that the networks instituted this

change, *sui generis*, and in isolation it seemed like an innocuous and innocent event designed to encourage smaller advertisers into the industry. However, the number of buyers of prime-time pilots fell precipitously from between 50 and 100 advertisers to the three networks. Having achieved a triopsony position in the input market, the networks then enhanced their power through a series of identical practices designed to diminish the bargaining power of program producers.

After having looked over the story idea, but before funding of the script, the network and program producer sign a "pilot and series" contract which stipulates not only what share of the costs the network will pay for the pilot but also gives the network the option at a set fee for each year of the series up through the fifth year or longer. In the past there was normally a price escalation of about 5 percent per year built into the options, but recently the more typical procedure is to set out the exact dollar prices for the entire length of the contract. Evidence of this is presented in the following two contracts for regular series.[5] Therefore, the networks have in essence locked the producers into a set price even before the pilot is shot or the series is accepted and normally 18 months before the season begins. While this is the normal procedure, frequently shows seek acceptance without pilots as takeoffs on highly successful shows such as "Rhoda" or "Phyllis" or on the basis of advertiser supported pilots. Nevertheless, the end result is identical; the producers must sign the same type of fixed length-fixed fee contracts before they receive serious consideration and acceptance.[6]

Table 6.1. MGM Contract with CBS for "Medical Center" for October 1968

	New Program	% Increase	Repeat Program	% Increase
1st year	$172,500	--	$15,000	--
2nd year	$179,475	4	$15,500	3.33
3rd year	$186,764	4	$16,000	3.22
4th year	$194,381	4	$16,500	3.13
5th year	$202,341	4	$17,000	3.03
6th year	$210,659	4	$17,500	2.94

SOURCE: *U.S. vs. CBS, ABC and NBC*, Exhibit 6.

Table 6.2. Universal-TV Contract with CBS for "Kojak," August 25, 1972

	New Program	% Increase	Repeat Program	% Increase
1st year	$200,000	--	$20,000	--
2nd year	$207,000	3.5	$20,500	2.50
3rd year	$213,500	2.14	$21,000	2.44
4th year	$220,000	3.04	$21,500	2.38
5th year	$226,500	2.95	$22,000	2.33
6th year	$233,000	2.87	$22,500	2.27

SOURCE: *U.S. vs. CBS, ABC and NBC*, Exhibit 7.

How much of an encumbrance is the five-seven year contract? Cannot the producer extract some of his monopoly rent in the network and syndication markets if his show still receives top ratings after the initial contract has run out? The answer is yes, but the chances of remaining on the network long enough for either of these markets to pay significant rewards are slim indeed. Of the 379 new shows that premiered in prime time in the last ten years, 60 percent were cancelled after only one season, 17 percent lasted two seasons, 14.5 percent remained on the air for three or four seasons, and only 9.5 percent still were on after five years.[7] It seems clear that the networks have chosen the length of their option contracts very carefully and have taken advantage of the fact that less than 10 percent of the programs will even last the life of the original contract. This will then reduce their risk of possible profit drains arising from hit shows much the same way that the reserve clause reinforces monopsony power in the baseball industry. Why do the program suppliers accept this type of deal when there are three buyers bidding for their product?

> While there are theoretically three buyers, in reality, there is often only one buyer. For example, the producer may be trying to sell a half-hour situation comedy which typically would go at the start of an evening. One or two of the networks might already have enough situation comedies and would not be in the market for a new one. Or, the format of the proposed series might be too similar to a show that is already running on that network which would reduce their interest in that product. Thus, the three buyers might easily be reduced to two or even one. In addition, since all three networks follow this "pilot and series" process, there is no alternative.[8]

The networks also have a common understanding that once any network becomes seriously involved in the consideration of an idea

as evidenced through the financing of a script or a pilot, it achieves a virtual lifetime monopoly of the rights to these series even if it never purchases the show for exhibition or cancels the show during the lifetime of the contract. Just in case the show lasts beyond the contract expiration date and the producers seek to exploit their advantage, the original network retains the right to first refusal which means it can match any offer and retain the series. In practice, there have been only a handful of pilots and fewer television shows which have been transferred to another network after being associated with a prior one.[9] Hence, in these regards there is great similarity between the baseball industry and the television networks. The biggest similarity is that both have earned significant profits once a general understanding of the advantages of cooperation was learned by the firms.

6.4. Program Costs

The evidence on input prices is consistent not only with the buying cartel hypothesis but also with the fixed fee escalation clauses. In the following table, one sees that there is nearly identical costs per episode for comparable categories and years on the network. The movie rights have identical costs/episode of $775,000, while the first year situation comedies average around $100,000, and the very successful, long running situation comedies average $130,000/half hour episode. The first year action adventure shows start at $240-250,000 and escalate to around $265-270,000 after three or more years on the network. While there are some obvious exceptions to this vertical and horizontal structure, this

Table 6.3. Estimated Production Fee per Episode of Prime-Time Series, 1975-1976

	ABC		CBS		NBC	
	Show (no. of previous seasons)	Fee	Show (no. of previous seasons)	Fee	Show (no. of previous seasons)	Fee
Movies	ABC Friday Movie	$775,000	CBS Thursday Movie	$775,000	NBC Monday Movie	$775,000
	ABC Sunday Movie	775,000			NBC Saturday Movie	775,000
Situation Comedies	Happy Days (1-1/2)	130,000	All in the Family (4-1/2)	130,000	Sanford & Son (3-1/2)	130,000
	Barney Miller (1)	125,000			Chico and the Man (1)	105,000
	That's My Momma (1)	110,000	Mary Tyler Moore (5)	130,000	Fay (0)	100,000
	On the Rocks (0)	100,000	Maude (3)	120,000	Montefuscos (0)	100,000
	Welcome Back Kotter (0)	95,000	Bob Newhart (3)	120,000		
			Phyllis (0)	110,000		
			Doc (0)	100,000		
			Big Eddie (0)	100,000		
Action Adventure	Marcus Welby (6)	285,000	*Hawaii Five-O (7)	270,000	Emergency (3)	270,000
	Rookies (3)	260,000	Medical Center (6)	265,000	Disney (14)	275,000
	*Streets of San Francisco (3)	285,000	Waltons (3)	250,000	The Rockford Files (1)	265,000
			Barnaby Jones (2-1/2)	240,000		
	Baretta (1)	260,000	Kojak (2)	270,000	Little House on the Prairie (1)	260,000
	S.W.A.T. (1)	260,000	Switch (0)	250,000		
	Barbary Coast (0)	250,000	Bronk (0)	240,000	Police Story (2)	260,000
	Starsky and Hutch (0)	245,000	Kate McShane (0)	235,000	Police Woman (1)	250,000
	Mobile One (0)	250,000			Ellery Queen (0)	250,000
					Medical Story (0)	250,000
					Joe Forrester (0)	250,000

Table 6.3 (continued)

	ABC		CBS		NBC	
	Show (no. of previous seasons)	Fee	Show (no. of previous seasons)	Fee	Show (no. of previous seasons)	Fee
Variety	Saturday Night Live With Howard Cosell (0)	$250,000	Carol Burnett (8) Cher (2) Tony Orlando (1)	$260,000 250,000 230,000		

*On the scene shooting.

SOURCE: *Variety*, September 3, 1975, pp.61-66.

must be expected due to the differences in on site versus studio shooting and in the rents of the leading stars. Nonetheless, the impression is very clear, the three networks have virtually the same initial and long term pricing policies.

6.5. Profit Shares and Syndication Rights

Prior to enactment of the Prime-Time Access Rules, the networks used their power over their suppliers to extract valuable subsidiary rights in the syndication markets. Those who refused to play the network game were allegedly systematically excluded from access to prime time. As the following table illustrates, the networks were able to obtain: (1) domestic distribution rights in about 25-30 percent of their prime-time series; (2) foreign distribution rights in a similar percentage of series; (3) average domestic profit shares of 25-30 percent in 55-65 percent of their series; and (4) foreign profit shares of 25-30 percent in 55-65 percent of their series.[10]

By 1965 and 1966 when it became clear that the F.C.C. would enact some sort of restrictive rule, the networks obtained neither distribution rights nor profit shares in only 25-30 percent of all series which they scheduled. While the networks claimed that such subsidiary rights were their reward for the risks of network programming, producer after producer testified in the hearings of the necessity of looking toward the syndication markets to recoup their investment and "make themselves whole."[11] Why should they voluntarily give up a significant source of revenues which might jeopardize their ability to remain financially solvent? The Commission found

Table 6.4. Network Subsidiary Rights in Regularly Scheduled Entertainment Series (1957-1968)

Year	% Hrs. Networks Had Shares		% Hrs. Networks Had Rights		% of Hours in Which Networks Had Rights or Profit Shares	Average Foreign Profit Share (%)	Average Domestic Profit Share (%)
	Foreign Profit Share	Domestic Profit Share	Foreign Distribu-tion Rights	Domestic Distribu-tion Rights			
1957	37.2	36.5	33.0	30.2	45.6	30.0	29.7
1958	45.5	43.3	30.3	28.2	49.8	32.2	31.1
1959	53.2	51.2	29.4	24.6	57.3	30.6	29.5
1960	64.2	65.6	33.3	32.6	71.2	32.9	33.1
1961	65.9	65.9	29.7	27.0	71.3	32.7	31.9
1962	58.6	60.0	27.0	23.5	64.2	28.5	28.6
1963	56.8	58.1	30.5	28.4	60.9	28.7	29.0
1964	63.6	63.6	35.7	35.0	66.4	27.8	27.4
1965	66.2	66.2	35.1	28.4	69.6	28.7	28.7
1966	67.8	67.8	29.5	25.3	71.4	27.1	27.1
1967	65.9	64.6	31.0	28.3	65.9	25.4	25.4
1968	59.5	58.1	25.9	25.9	60.8	24.2	24.2

SOURCE: *Little Report*, 1969, p. 46-51.

"no necessary relation between networks providing developmental financing and the acquisition of syndication and foreign sales distribution and/or profit sharing rights."[12]

A considerable body of evidence has emerged in recent years to confirm the plight of program producers. The evidence was obtained from very reliable trade sources and unambiguously notes that program producers are increasingly being forced into deficit financing for the network run with the scant hope that syndication profits will return their investment. According to an article in *Variety*, major production houses spend about $300,000 on an hour show yet get only $200-225,000 from the network.[13] Universal, the largest major programming house, is reported as coming up $12 million short on original television programming in its last annual report.[14] Grant Tinker, the head of the highly successful MTM Enterprises (producers of the "Mary Tyler Moore Show," "The Bob Newhart Show," "Rhoda," and "Phyllis"), said that MTM loses money on all of its shows; that the company overall is in the red and has been for several years and that "he is working for nothing and going into debt doing it."[15] Tinker also noted,

> We have cried wolf in the past, but this time the protests are warranted. We *can take it when we're penalized for failure, you expect a loss when it's 13weeks and off, but we don't think television can remain a viable industry if it penalizes successes.* We're all straining to achieve a sale with only three networks and we usually end up doing it for the price they offer.[16]

The natural question is, if television production is so unprofitable, why do these firms still remain in the industry? The answer is twofold. First of all, there has been significant exit

from the industry in the past several years. A Mr. Price notes that several years ago there were 27 principal TV program suppliers and now there are 19.[17] Also, Metromedia, a very large production house, recently announced a moratorium on new idea development due to the low prices of the networks and the high production costs.[18] Secondly,

> there may be some type of egotistical reward that accrues from being part of the Hollywood scene and having a show carried on network television.[19]

More practically speaking, these producers are driven by the hope of creating that uniquely successful network program which will later turn into a syndication bonanza. Hence, the parallel buying practices of the three networks seem sufficiently strong to force input prices down to and at times below the reservation prices of suppliers.

6.6. Use of Facilities

It has also been alleged that the three networks use their position as the bottleneck and as oligopsonists to force independent producers to utilize their production facilities (where possible) as a quid pro quo for obtaining access to the networks. Pierce presents a summary of where each network show was filmed during the 1972-1973 season as evidence of this power by the networks. His data show that of the 11 prime-time shows which were taped, all 11 utilized their respective network facilities. As for daytime programs, only one program out of about 30 was not taped on network facilities. CBS is the only network which owns film facilities, and five out of its 18 filmed prime-time series utilize these studies.[20]

Testimony in the recent Prime-Time Access Hearings provides corroborating evidence that the use of production facilities is incorporated as part of the contract between the network and producer.[21] This obviously allows another dimension for the networks to exert significant leverage and obtain competitive advantage over independent taping and film facilities. By forcing the independent producers to utilize their studios, whether overtly or through the power of suggestion, the networks could presumably obtain economies of scale through close to capacity use while the unit costs of the independents would be higher since they must operate at less than capacity. Hence, it is perfectly possible that the networks may charge lower prices for the use of their studios. Another less ominous explanation is that either the network facilities are qualitatively superior or more convenient. Consequently, other than prima-facie evidence which shows a close association between having access to the networks and utilizing their facilities, no definitive conclusion can be reached on this issue.

Therefore, it can be fairly confidently stated that the *networks have collectively the power over the price of inputs* which they require. This has been illustrated by identical policies towards the deficit financing of new programs, the prices paid for this programming, the extraction of subsidiary rights and profit shares, the fixed fees and favorable contract options, the exit of significant prime-time entertainment suppliers, the possible exercising of leverage with respect to the use of their production facilities, and their general life and death power over their suppliers. This life and death power over their suppliers manifests

itself in the power (which they have used in the past) to blackball certain performers and other creative people from network television as well as the excess productive capacity which acts as a credible threat to full integration and the resultant foreclosure of recalcitrant producers who seek higher prices in line with their marginal contribution to output. The three networks have thus organized a nonrivalrous coterie which has stabilized prices and allows them to earn both monopoly and monopsony profits.

6.7. Monopsony Power and Vertical Integration into Theatrical Movies

The main question to answer in this section is, what is the effect of vertical integration by the networks into theatrical features and made-for-television movies? The hypothesis will be advanced that such integration enabled the networks to eliminate the only form of price competition which remained, that it solidified their cartel and further stabilized the industry.

As noted in the previous section, the networks have worked out very elaborate cooperative devices to achieve a virtual monopsony in regular prime-time programming. The essence of their cartel lies in eliminating the monopoly power which redounds to successful television programs and causes a loss of their monopsony profits. But theatrical movies represented a different species of network programming. Their attractiveness derived from knowledge concerning their value in the theatrical pre-market. Hence the risk and uncertainty was significantly lowered for all parties concerned (networks, advertisers, and movie producers) since they were dealing with a known quantity. Because of this, unexpected price wars occurred as

each network sought to outbid its rivals for the best pictures. The networks were of course concerned with the collapse of their buying cartel in this increasingly important area because they understood that cracks in a collusive front in one area fortell its demise all the way down the line.

The movie producers seemed to have the upper hand because the supply of movies does not respond quickly to new demand. Long lead periods exist between the planning of a theatrical motion picture and its eventual television broadcast. For example, there is significant time spent in obtaining appropriate properties, signing talent and producers, filming the picture, waiting for the appropriate season to release it, allowing it to play for several years in different runs both here and abroad, negotiating the television license and finally its broadcast. According to the following table from the *Tucker Anthony Report*, the mean number of months elapsed between theatrical release and first telecast was nearly 62 between 1967-1974.[22] As a result of its successful ratings and the networks' desire to obtain a large inventory of pictures, the average price of a theatrical movie rose from $100,000 for two network runs in 1961 to around $800,000 by the end of 1967.[23] During this period all three networks acquired a three to four year inventory of feature films since the number of movie nights was increasing and did not reach a plateau until around 1968 or 1969. Evidence that this indeed occurred is found in the statement of Barry Diller, vice president in charge of programming at ABC, when he announced in

Table 6.5. Age of Network Movies by Season in Months Elapsed Between First Theatrical Release and First Telecast

Network Season	Number of Films	Average No. of Months Elapsed (Mean)	(Median)
1961-1962	45	96.29	103.0
1962-1963	72	77.24	66.5
1963-1964	60	92.78	96.5
1964-1965	85	87.66	82.0
1965-1966	119	84.71	71.0
1966-1967	127	73.70	62.0
1967-1968	132	59.92	51.0
1968-1969	128	54.66	42.5
1969-1970	117	66.15	45.0
1970-1971	98	59.21	50.0
1971-1972	133	62.74	51.0
1972-1973	107	69.83	53.0
1973-1974	118	61.90	54.0
Total			
1967-1974	833	61.91	51.0
Grand Total	1341	70.04	54.0

SOURCE: *Tucker Anthony Report*, p. 14.

late 1967, that each network had 150 features lined up during the next three years from major movie company stockpiles and films currently in production. He said in part:

> We at ABC do not believe there is a lack of features to supply our needs as we project them into the future. *There is no desperate need for features,* but we are willing anytime to buy features if they have high quality and the price is equitable in today's market.[24]

Diller also noted the spiralling cost of feature films (*Cleopatra* had recently sold for $5 million while *Bridge on the River Kwai, The Robe* and *The Longest Day* each brought in $2 million and the average price was in excess of $750,000), and he said he expected the networks "to drive down" the price to around $700,000.[25]

Since 1967, the average price for a theatrical feature film has stabilized between $750,00-$800,000.[26] While the initial years of stabilization may be partially explained by the three to four year network inventory, that backlog disappeared in the early 1970's. A better explanation for this period of remarkable price stability in the face of tremendous inflation[27] is that the networks' entrance into the production of both theatrical motion pictures and later into made-for-television movies acted as a depressant on price and a credible threat to exert their leverage and foreclose a significant share of the remaining open market. This threat was brought into reality by ABC and CBS with the production of some 80 theatrical movies and 40-50 percent of their yearly requirements of made-for-television movies in the 1972-1973 season. The effect of such a large foreclosure was devastating and sent a clear message to the movie producers that hereafter prices would be stabilized.

Therefore, vertical integration by the television networks into theatrical and made-for-television movies was a major catalyst to the spreading of the buyers' league into the last two remaining areas of competition. The cartel was now complete; all sectors of the supplying industry were controlled and, in addition, the networks had through their production arms a better feel for production costs in the industry. Having achieved their informal cartel across all stages of production from story line through exhibition, they could now sit back and lead the easy life that accrues to those possessing significant monopoly power. It was truly a game they could not lose. Hence, while admittedly the possibility exists that short-run profits were not maximized through the plan to self-deal, it seems reasonably clear that a longer term strategy was contemplated and executed whereby the networks would have power and leverage over the entire industry from top to bottom. Vertical integration allowed the networks to enhance their power and eliminate the uncertainty that competition usually creates.

FOOTNOTES FOR CHAPTER VI

1. In this chapter as well as Chapter VIII, the words "cartel" and "collusion" are used in a very broad sense to indicate a *conscious parallel behavior* among the networks in both the input and output markets. As Owen notes, this form of oligopoly "game" should be expected in an industry such as television broadcasting where entry is blockaded and competition from substitute goods is virtually nonexistent. Under such a small-group structure, "there is an ever present tension between the rewards to be gained from cooperation and the rewards to be gained from cheating." (See Bruce Owen, *Television Economics*, pp. 108-111.)

As the oligopoly matures and the firms come to know and trust each other, a "meeting of minds" occurs, and each competitor acquires the ability to predict with near certainty the behavior of his rivals. Certain common cooperative practices become established in the industry and *no open consultation* need occur between the oligopolists to communicate what is the beneficial policy for the entire industry.

In short, the words "collusion" and "cartel" do not mean the type of overt behavior necessary to prove a conspiracy charge in a court of law. Rather, they indicate the establishment of identical behavioral practices which emerge from the oligopoly "game" and become routinized and regularized in the industry.

2. Simon Rottenberg, "The Baseball Players' Labor Market," *Journal of Political Economy*, Vol. 64 (June 1956), pp. 242-258; reprinted in *Readings in Labor Market Analysis*, ed. John F. Burton, Jr. *et al*. (New York: Holt, Rinehart and Winston, Inc.), p. 150.

3. *Ibid*., p. 151.

4. "Gunsmoke" was cancelled even though it still was one of the top 20 shows. At the time of cancellation, Jim Arness, the major star, was known to be getting one-half of all the network profits on the show.

5. Government Brief in *U.S. v. CBS, ABC, and NBC*, Exhibit 6, p. 108; Exhibit 7, p. 116.

6. Les Brown talks about the circumstances surrounding the hiring of Walter Brennan to increase the ratings for "From Rome with Love." Brennan only wanted a one year contract.

> "'Don't let him do that to us,' Don Wood said. 'His agents will have us over a barrel the second year and they'll kill us, because if we've got a hit show he'll be one of the reasons why. Get the *standard deal or tell him to forget it.*'"

(Brown, p. 24).

7. Government Brief, *U.S. v. CBS, ABC, and NBC*, p. 45.

8. Dennis B. McAlpine, "The Television Programming Industry," Tucker Anthony and R. L.Day, January, 1975, p. 7.

9. According to reliable industry sources, the only example of a pilot successfully switching networks was "All in the Family" which moved from ABC to CBS. It should be remembered that "All in the Family" had a successful British prototype. As for programs switching networks, the only examples are "The Danny Thomas Show," "Get Smart," "My Three Sons," and "Father Knows Best."

10. *Little Report*, 1969, pp. 46-51.

11. *Second Interim Report*, Chapter 12. Also see *Celler Report*, Chapter 3.

12. Federal Communications Commission, "Prime-Time Access Report and Order," Docket 12782, May 1970, 23 *F.C.C. Reports 2nd*, 389. Robert Crandall in two related articles has claimed that the Commission's conclusion about the exercising of monopsony power by the networks rests on faulty economic analysis. First of all, he tested the hypothesis that networks consider and prefer those programs in which it has valuable subsidiary rights in renewal decisions for the following season. He concludes:

> "The discriminant analysis should be rather conclusive evidence that network ownership of profit shares or distribution rights did not increase the likelihood of annual renewal of a program series. This is not surprising if networks pay for these syndication interests through higher initial program prices."

(Robert Crandall, "The Economic Effect of Television-Network Program Ownership," *Journal of Law and Economics*, October, 1971, p. 406.)

While Crandall reached his desired conclusions in this first article, the results have little meaning because the hypothesis is wrong. *The alleged network misconduct deals with the networks' denial of access to program producers who fail to*

surrender these subsidiary rights and not with the renewal decision once the program has already gained access to network time. In testing the second hypothesis that networks actually pay for these subsidiary rights, Crandall sets up an elaborate econometric model and regresses the prices networks paid for prime-time series against variables representing the value of the time in which the program appeared, its quality, and the subsidiary interests involved. He discovers:

> "The ordinary least squares estimate for both samples is satisfactory with one *glaring exception.* The coefficient of the syndication profit share variable is *negative and significant,* suggesting that networks pay less for programs in which they obtain profit shares."

(Robert Crandall, "F.C.C. Regulation, Monopsony, and Network Television Program Costs," *The Bell Journal of Economics and Management Science,* Autumn, 1972, p. 497.) Hence the analysis fails to confirm his hypothesis. Upon closer examination of Crandall's underlying model and assumptions, one notices that he assumes a Cournot type conjectural variation in which a network always programs its weakest programs against the strongest ones of its competitors. Empirical evidence and expert testimony give the lie to these assumptions. For counter examples to the Cournot type assumption, see Appendix A.

13. *Variety,* October 3, 1974.

14. *Advertising Age,* November 11, 1974, p. 2.

15. *Ibid.*

16. *Ibid.* Also see Bankers Trust Investment Research Service, April, 1975, p. 6.

17. *Broadcasting,* September 23, 1974, pp. 15-16.

18. *Variety,* October 30, 1974, p. 1.

19. McAlpine, p. 7.

20. *The Pierce Report,* Appendix II.

21. Federal Communications Commission, "Prime Time Access Hearings," Docket 19622, Transcript of July 30, 1973, p. 36. Also see charges of Videotape Production Association in *Variety,* March 27, 1974, p. 60.

22. McAlpine, p. 14.

23. Confidential source.

24. *The Hollywood Reporter*, November 22, 1967, p. 1.

25. *Ibid.*, p. 4.

26. *Variety*, New Season Editions, various years.

27. The Consumer Price Index as a whole was about 165 in late 1975 using 1967 = 100 while the Consumer Price Index for indoor movie admissions had an annual average for 1975 of 170.8 (1967 = 100). Hence, there was a greater rate of inflation in the price of movie admissions than for the economy in general.

CHAPTER VII

CONFRONTATION OF THE THEORY OF VERTICAL INTEGRATION WITH THE BEHAVIOR OF THE TELEVISION NETWORKS

7.1. Introduction

In the last chapter, it was shown how vertical integration and the threat of foreclosure enabled the television networks to perfect their buying cartel and depress program prices. This raises several important questions. (1) Does the leading theory of vertical integration apply to this industry? In other words, will the networks pass along the cost savings from vertical integration in the form of lower prices and increased product? (2) What is so bad about monopsony power? Doesn't it just involve a transfer of income from one group to another?

This chapter will demonstrate that the uniqueness of the television broadcast industry negates the predictions of formal vertical integration theory. Rather than increase the number of advertising minutes and lower prices, the cost savings simply translate into increased rent for the networks, and these extra profits can then be used for downstream network and station operations. Secondly, monopsony power will lead to restrictions in the input market just as monopoly power causes less to be produced in the output market. In the context of the broadcasting industry, these restrictions will take the mixed blessing to consumers of less advertising minutes

being offered than would occur in a more competitive industry and less original as opposed to repeat programs.

7.2. Spengler's Model of Vertical Integration in the Context of the Television Industry

As mentioned earlier, Spengler's model of vertical integration predicts that the evasion of monopoly surcharges and the consequent cost reduction will be passed along to consumers in the form of increased output and lower prices. A simplistic response to this theory would note that obviously such a model cannot be applied to the television broadcast industry because: (1) Programs are already provided "free" of charge and thus the notion of price reductions would take on the highly unlikely scheme of negative prices. (2) Output cannot be increased because of the limitation of time in the broadcast day and the fact that all of the hours are currently being programmed.

Argument one obviously neglects the fact that consumers pay directly for the viewing instrument and electricity needed to watch television and indirectly through a surcharge on the prices of advertised products. In this latter regard, it may be possible for prices to fall. Argument two neglects the fact that the programming chores are split between the networks and the local stations and, while it is true that an increase in network offerings must displace an equal increment of station fare, this does not negate the idea that the output of networks may be increased. To really grasp a handle on this question, a more thorough elaboration of the model of networking needs to be presented.

Part of the confusion lies in trying to describe the product which the networks supply. The networks are involved in two separate markets; they are the suppliers of program fare to the American viewing public and thus the custodians of a vast news-entertainment marketplace of ideas and, secondly, the suppliers of advertising minutes to a multitude of national advertising firms. These two operations are interconnected since in essence it is the chance to expose their commercial messages to a vast audience of viewers (lured into watching by high quality programming) that the advertisers really purchase. Consequently, it is necessary to analyze the Spengler predictions of price and output adjustments in the advertising market as well as the programming sphere.

7.3. The Advertising Market

The number of advertising minutes does not have an upper limit in the United States because of several key factors, some of which reflect natural scarcity and others man-made scarcity. First of all, the electromagnetic spectrum is limited and this scarcity has required allocation to various uses. One of the largest allocations has been to commercial television with both the crowded VHF and the surplus UHF bands. As noted in Chapter 4, the F.C.C. decided to retain the present structure of commercial television (the so-called mixed bag) when it failed to live up to its original directive to switch to an all UHF system once that system proved technically viable. This failure to switch over has acted as a deterrent to the entry of new networks since they would largely be confined to the "handicapped" UHF spectrum and thus not fully able

to compete with their VHF based counterparts. The limited nature of the electromagnetic spectrum and the regulatory decision on how to allocate it has therefore placed an artificial upper bound of three to the number of networks able to offer commercial advertising minutes for sale at the present time.

Secondly, because of the 8-5 working syndrome and the 8-3 school syndrome, the amount of available potential viewers is unevenly distributed. One would expect this pool of viewers to reach its maximum when the entire family is freed from its other responsibilities and is available as a group for viewing. It turns out that this time period from 6-11 p.m. (E.S.T.) is called prime time for just this reason--there is the chance to reach the greatest potential viewing audience. Even within this prime-time classification, the hours between 8-10:30 p.m. attract the most viewers. The number of viewers will always vary inversely with the opportunity cost of leisure time and, as one would expect, this will vary according to the season of the year. Hence as the following table shows, the fall and winter months usually provide the greatest number of households using television while there is a drastic drop off in the warmer months.

Looking at Table 7.1, one should be struck by the almost constant percentage of households using television across such a long period of time. There have been vast changes in the nature of television programming over this time span[1], yet the percentage of households watching prime-time television remains virtually fixed. This is a crucial point because it suggests that television is the opiate of the masses and their habits do not change regardless of quality.

Table 7.1. Houses Using Television as a Percentage of Households with Television

Year	March	April	May	June
1953	61.8	59.8	54.6	45.9
1954	60.1	58.2	54.7	46.1
1955	61.5	58.5	52.2	49.1
1956	63.1	60.3	53.6	47.3
1957	63.3	62.0	53.1	47.5
1958	63.4	61.0	54.4	49.7
1959	62.3	59.7	51.9	46.1
1960	63.2	59.0	54.8	50.1
1961	60.7	59.9	55.0	49.8
1962	61.2	58.8	52.6	48.9
1963	60.8	57.3	53.5	48.5
1964	60.9	59.2	51.7	48.8
1965	63.2	60.1	53.4	49.9
1966	61.2	58.9	55.3	49.0
1967	61.8	59.2	56.2	49.3
1968	61.2	59.7	55.7	49.5
1969	61.3	59.7	53.7	49.2
1970	62.2	59.8	53.5	50.0
1971	62.8	59.0	54.7	49.3
1972	61.3	58.5	53.7	50.5

SOURCE: O.T.P. Study, Appendix, Table 29.

Keeping this in mind, the networks have little incentive to upgrade quality. In fact, the incentive lies in the other direction, to collude to downgrade quality. Therefore, the networks are constrained to operate at highest profits during only five hours of the day, and this places a second restriction on the number of advertising minutes available for sale.

At this point it may be worthwhile to explicitly try to specify what the demand for television programs might look like. On the vertical axis is the price which includes not only the cost of the viewing instrument, its annual maintenance costs, and the cost of electricity, but also the advertising surcharges, and the opportunity cost of time spent viewing. The rich have high opportunity costs and therefore they watch fewer hours of television. The poor, the unemployed, housewives and children, have smaller opportunity costs and hence demand more hours of television.[2] The demand for television programs or hours of viewing will also depend upon the number of commercial interruptions. Regardless of the quality of commercials, their quantity will suffer diminishing marginal utility until the point is reached when the viewer is no longer willing to tolerate the number of commercial interruptions, and he simply turns off the set and engages in another leisure time activity.[3] At the extreme limit, a half hour of test patterns would elicit no viewers (save the mentally ill). Consequently, increases in the number of advertising minutes will adversely affect the demand for television.

7.4. Network Restrictions on Advertising Minutes

7.4.1. Models of Network Behavior

Each individual television program is a unique entity and therefore has its own advertiser demand for commercial minutes. The hit shows such as "All in the Family" or "The Waltons" will have a more inelastic demand than a new show since the probability of success will be greater, there are fewer good substitutes, and audiences are believed to pay more attention to high rated shows than low rated ones. The network will maximize its profits through the sale of advertising minutes. Since the programs are readily separable into differing elasticities and there is no possibility for resale, the network will be able to practice third degree price discrimination and obtain greater profits than if it simply sold its product at a single price. Under such a pricing mechanism, the network would choose to vary the number of advertising minutes for each program until the marginal revenue from an additional minute on "All in the Family" just equaled the marginal revenue from an additional minute on a new show. This would cause a higher price per minute of advertising for the show which has the lower elasticity at the output in question and vice versa.[4]

Utilizing such a model, a decrease in the cost structure due to the savings associated with vertical integration would cause the price of advertising to decrease (Pa→Pa' and Pb→Pb') and the number of advertising minutes to increase (Qa→Qa' and Qb→Qb') for each of the above shows. This is perfectly consistent with the Spengler theory. However, two problems arise within the context of the

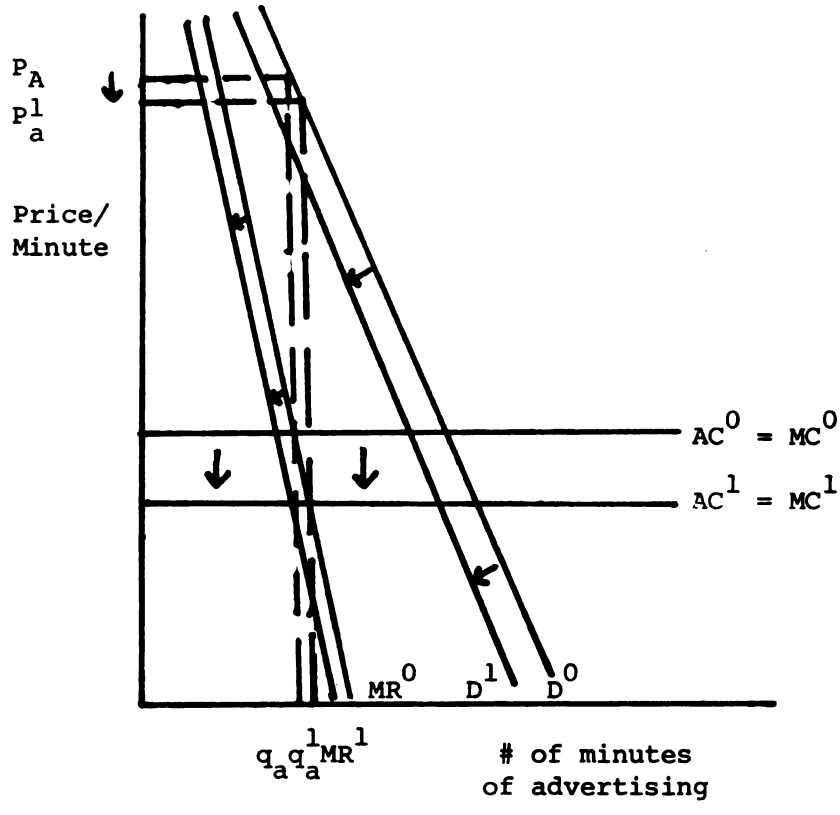

Figure 7.1.--Model #1 for "All in the Family."

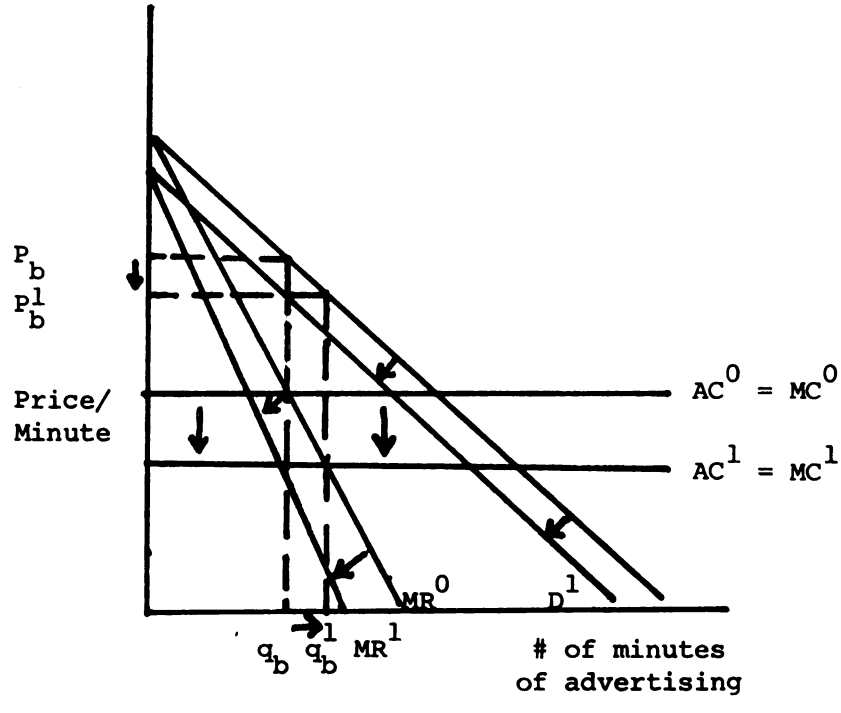

Figure 7.2.--Model #1 for a "New Show."

unique television industry which make this analysis less secure. First, as was noted before, the demand for television programming in general and the demand for each individual program by consumers will depend inversely upon the number of commercial minutes associated with the program. Hence, when the network increases the supply of advertiser minutes because of the supposed savings from vertical integration, the demand curves of advertisers for these two types of shows (which are derived from the consumer demand curves for television in general) may decrease and cause the profit maximizing price and output to move back toward their original levels (see Figures 7.1 and 7.2). Secondly, and more importantly, the networks do not follow this profit maximizing calculus. *They do not consider the number of commercial minutes to be a variable which should be adjusted on each show to maximize total profits.*

7.4.2. The Complication of Commercials

Network executives recognized the existence of the diminishing marginal utility of television commercials and have taken steps to control this problem. The National Association of Broadcasters, of which all television stations and networks are members, have set up guidelines for the maximum amount of advertising minutes in any given time period. For example, during the prime-time hours of 8-11 p.m., the code permits four minutes and 25 seconds of commercials, billboards, station breaks, and program promotions for each half-hour program and 9-1/2 minutes for each hour program.[5] The networks have all undercut these maximum limits and openly abide by the standard of three minutes of paid network advertising per prime-time half

hour.[6] Are the networks so public spirited that they have been willing to sacrifice profits for consumer welfare? The answer is that, while this number of advertising minutes does not maximize short-run profits, it may be thought of in terms of a long-run strategy designed to prevent competition and simultaneously keep the Congressional and regulatory dogs at bay. It is another instrument for cooperation that allows the networks to sit back and lead the quiet life.

This new wrinkle in the profit maximization calculus now will affect our previous results about the effect of a cost reduction upon advertising prices and minutes. The supply of minutes for each television program will now be fixed at three minutes[7] and the demand curves will be the same as drawn in Figures 7.1 and 7.2. The price that the networks would charge for their advertising minutes will be demand determined and the hit shows will earn higher profits than the new shows even though they have higher costs. In such a model, *when vertical integration drives down costs, prices and advertising minutes are unaffected. The cost savings simply become increased rent for the television networks*. There is no incentive for the networks to pass along the cost savings to either advertisers or final consumers. (See Figures 7.3 and 7.4.)

While this type of network behavior results in a nice profit, the networks practice first degree price discrimination in the sale of their advertising minutes to earn even larger rents. This works in the following way. The advertising minutes on each show for a 13-week period are put on the market in the early spring of the preceding season. Some sponsors are willing to pay higher prices

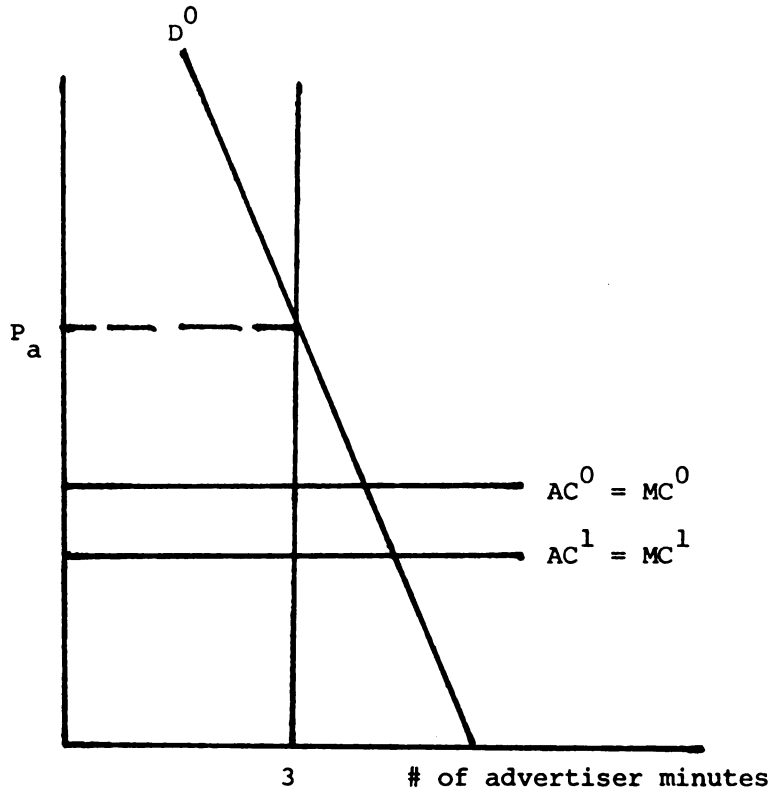

Figure 7.3.--Model #2 for "All in the Family."

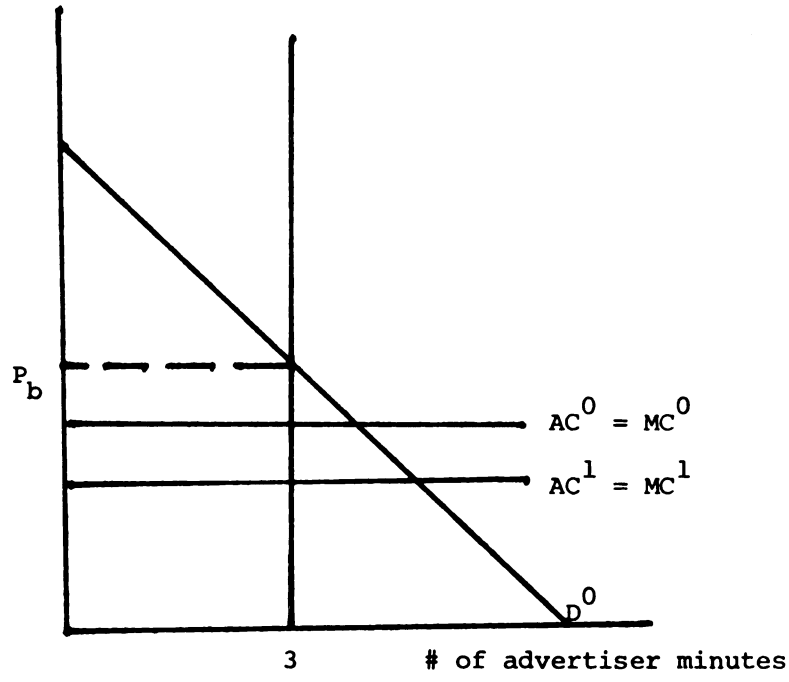

Figure 7.4.--Model #2 for a "New Show."

than would be established by the interaction of supply and demand. They pay the higher prices because of the certainty it affords them in terms of choicest time periods and shows and the long lead time it gives them to plan their commercials. As show time approaches, the networks are willing to shade their published prices in order to "sell out" their entire schedules. Hence, some advertisers pay a higher price than others for the commercial minutes on a television program.[8] This is the essence of first degree price discrimination by which the networks are able to extract the consumer surplus in the inframarginal units.

The advertiser contracts usually last a minimum of 13 weeks, after which time the prices are readjusted according to the ratings actually received and the strength of demand at that time. Thus, if a new show such as "Chico and the Man" or "Rhoda" becomes an instant hit, then its price/minute will rise and the price of relatively less successful shows will fall. In summary, there is no evidence that the networks consider adjusting the number of advertising minutes per hour of programming when they are setting their optimal prices. The custom of three minutes/half hour of programming has emerged as a collusive device to limit supply and as an answer to those critics both in and out of government who claim that the networks fail to act in the public interest.

7.4.3. Restrictions on Hours Programmed

While the number of advertising minutes remains fixed, the networks still have the option of increasing or decreasing the number of programs in any time period. Any such alteration in the

number of hours programmed will directly affect the number of advertising minutes available. In the prime-time period from 1960-1970,[9] both the O.T.P. and Little reports indicate little overall variance in the number of prime-time hours programmed by the networks. (Note: The start of the network season varies, and this may affect the number of hours in any one season.)

Since 8-11 p.m. is the cream of the prime-time hours, why would the networks program in anything outside of these hours? While these hours do give large profits, the other hours also make marginal contributions to profits and, furthermore, the networks will be willing to cross-subsidize the marginal hours in order to provide a continuous audience flow into the 8-11 p.m. slot. In the early years of television, the networks were much more heavily involved in providing their service than is true today. The gradual F.C.C. modifications and the eventual elimination of option-time clauses and the maturing and popularity of the medium meant that by 1970, the local stations would be able to carry any void created by the networks. Hence, the networks pulled out of the 7-7:30 p.m. time slot and only programmed 3-1/2 out of the 4 prime-time hours.

In 1970, the Prime-Time Access Rules forbade network programming from being carried more than three out of the four prime-time hours in the top 50 markets. The rules were passed to open up the airwaves to the emergence of new networks. The three networks, with the approval of the F.C.C., colluded on an 8 p.m. starting time for their portion of the prime-time schedule so that no network could get a jump on its competitors.[10] The net result of the F.C.C. policy has been to relieve the networks of the responsibility

Table 7.2. Number of Network Prime-Time Hours Programmed per Year (7:30-11 p.m.)

Year	ABC	CBS
1962	1199	1274
1963	1223	1268
1964	1218	1212.5
1965	1309	1289.5
1966	1276	1288.5
1967	1286	1366
1968	1213	1293.5
1969	1260	1296.5
1970	1178	1290

SOURCE: O.T.P. Report, Appendix, Table 7.

Table 7.3. Number of Network Prime-Time Hours Programmed per Week (all networks combined)

Year	7-11 p.m.
1960	74
1961	76
1962	74-1/2
1963	73-1/2
1964	73-1/2
1965	75-1/2
1966	75-1/2
1967	75
1968	74

SOURCE: *Little Report*, p. 154.

for programming in the marginal 7:30-8 p.m. time slot; their product has correspondingly become scarcer, and their profits have risen considerably to record levels (see Table 3.2). Even during the first year of operation (1971), with all of the confusion and the added loss of cigarette advertising (10 percent of their business) due to the government ban, the networks increased their profits over the previous year.

Therefore, it can be safely concluded that through their own actions in *cutting back* rather than increasing their prime-time schedule and with the help of the regulatory agency, the networks have further restricted the number of advertising minutes available for sale, and *thus the predictions of the Spengler theory of vertical integration seem invalid within the framework of this unique industry*. If there are any savings from vertical integration, the networks retain them in the form of increased rent rather than pass them along to the advertisers in the form of lower prices.

7.5. Evidence on Prime-Time Prices

It has already been mentioned that the prices of theatrical movies licensed to the networks stabilized at between $750,000-800,000 per picture after 1967. The question now is, what happened to the prices that advertisers paid for these movies and other television fare during this time span? Unfortunately, the prices per minute of each network program are not readily available for this period, but average prices are and will be utilized to construct the index. Also, there is no evidence to show that the prices of theatrical movie programs differ significantly from the prices of

other prime-time entertainment. If anything, these prices are generally higher than other network fare.

To calculate the average price/minute for a network prime-time television program requires the following steps: In column one of Table 7.4 is the average price/1000/minute of advertising as reported by the networks in various publications. This column is then multiplied by the total number of homes watching network television during March of each of the years (column two). The result of this multiplication (column three) is the total network television price for a minute of time on all three networks combined. This column is then divided by the number of networks (three) to give, in column four, the average price/minute/network show which is the desired result. The data in column two come from the following calculations which are not given: The number of television homes is multiplied by the average percentage of homes which viewed prime-time programs during March of the years in question. This gives the total number of homes viewing prime-time television. This figure is then multiplied by 92.5 percent, which is the share of prime-time homes which the combined networks have averaged for a long period of time. The net result is the total number of homes viewing network television during prime time.

How accurate are these data? Pierce notes that for the 1973 season the average price of a prime-time minute of advertising was $59,000.[11] In Table 7.4, the midpoint of the range for the year 1973 is $59,612. Thus, the figures are nearly identical. Similarly, in the Government brief, it is mentioned that the current price for a minute of a prime-time movie is $75,000,[12] which is nearly

Table 7.4. Average Network Prices for Prime-Time Minutes

Year	(1) Price/1000/ Minute	x	(2) Total Homes Watching Network Programs (millions)	=	(3) Total Network TV Price/ Minute	÷3 =	(4) Average Price/ Minute/ Network Show
1960	$3.25		26.43		$ 85,898		$28,633
1961							
1962							
1963	3.12		28.85		90,120		30,004
1964	3.50		29.63		102,225		34,075
1965							
1966	3.69		31.08		114,685		38,229
1967	3.88		32.01		124,199		41,400
1968	3.86		32.26		124,524		41,508
1969	4.20		33.17		139,314		46,438
1970	3.96		34.58		136,937		45,646
1971	4.18		36.08		150,814		50,271
1972	4.30		36.74		158,000		52,665
1973	4.50-5.00		37.65*		169,425-188,250		56,475-62,750
1974	5.00		38.90*		194,500		64,833
1975	5.00-5.60		40.15*		200,750-224,840		66,977-74,947

*Estimated

SOURCES: Pierce Report, p. 42-43; Senate Antitrust Subcommittee Hearings on Network TV Advertising--numerous pages; Office of Telecommunications Policy Report, Appendix--various tables.

identical to the high side of range for 1975. This also adds credence to the assumption that the prices of commercial minutes on movies and other prime-time fare are approximately the same or the former is a little higher. Looking at Table 7.4, one sees that since 1967 the average price/minute has risen nearly $30,000, or about 70 percent. Coupling this with the fact that the input price to the networks for theatrical movies has remained about the same provides clear evidence that the networks have followed the model outlined in the previous sections and retained the fruits of their monopsonistic power rather than passing them along to the advertiser to in turn pass along to the consuming public. This conclusion is reinforced by the rise in network profits over this same time span (see Table 3.2).

7.6. Quality Considerations

Finally, it is possible that vertical integration may increase quality rather than decrease price and an attempt (however cursory) should be made to assess any changes in quality during the period of 1967-1975 when the vertical integration question arose. Now, quality in any context is a very difficult and slippery concept to measure. In the television industry, the only accepted measure of quality is the number of people watching each show or television in general. As mentioned above, the mere act of viewing tells nothing about intensity of preferences which become critical in estimating the demand curve for each type of program and allocating resources efficiently within the industry. Nevertheless, the evidence presented earlier suggests that the percentage of households viewing

prime-time television has remained remarkably constant over time, as has the average number of prime-time hours watched. However, during the fall 1975-1976 season, the trade papers reported a significant loss of viewership of about three million people during the prime-time hours.[13]

> By mid-season, more than 15 shows had been axed and there would have been more if the networks had sufficient replacements. That's a dismal record even for TV, which is accustomed to the executions. Even more dismal, perhaps was the fact that the format series were being replaced by same-old-stuff types--cops, comedies, variety shows, and the like. *What the viewers seemed to be telling Hollywood and the networks was that they were weary of these formats after more than 25 years.*[14]

Rather than innovate in the face of declining demand, the networks resorted to the "same-old-stuff" of imitating those program types which had proven popular and would allow them to again gain rating respectability. Hence the networks inserted more movies and cops and robber series to plug up the gaps, the end result being that 25 of the current prime-time programs (over 33 percent) are of the action-adventure-cops and robbers variety. Another *Variety* article noted, "The fuzz tends to flourish in the 9 to 11 time periods at the expense of everything but sitcoms."[15] This trend toward endless imitation simply makes a mockery of the balanced programming concept which the networks so espouse and which is supposedly part of the F.C.C.'s requirement to program in the public interest. Why do the networks imitate one another? One must remember that they are in the business of delivering the widest viewership possible to their advertisers. Hence they appeal toward the center of the mass taste rather than to the special interest viewer. This

naturally creates the tendency to imitate the most popular programs in an attempt to siphon off some of the viewers from the original prototype.[16]

7.6.1. Testing the Imitation Hypothesis

It is possible to statistically test the hypothesis that the networks imitate each other. To test this hypothesis, each network program for the years 1970-1975 has been placed into one of ten categories.[17] The results are displayed in Table 7.5. From this table it is immediately apparent that the networks have concentrated their schedules with variety, situation comedy, feature films, and mystery and suspense programs--the so-called mass taste programs. A chi-square statistic has then been calculated for each year to test the hypothesis that the networks concentrate their hours in the same categories. As Table 7.6 shows, the chi-square statistics all fall within the region of acceptance and thus the null hypothesis cannot be rejected.[18] Hence, one can conclude that in terms of program categories the networks do imitate each other.

7.6.2. Measuring Horizontal Diversity

It is also possible to measure the horizontal diversity of network programs. Horizontal diversity refers to the number of program types available across the networks for each half hour in the week. This quality index can take on values from 1 (perfect imitation) to 3 (perfect diversity). As Levin notes, horizontal diversity comes closer than vertical diversity to diversity as seen by the viewer, whereas vertical diversity is more important to the Commission.[19] The procedure used to measure horizontal diversity is to

Table 7.5. Hours of Regularly Scheduled Prime-Time Programming by Categories (1970-1975)

	1970			1971		
	CBS	NBC	ABC	CBS	NBC	ABC
General Drama	3	3	3	1	1-1/2	3
Variety-Comedy	6	6-1/2	4-1/2	2	4	1-1/2
Western-Early American	1	3-1/2	0	1	2	1
Adventure	1	2-1/2	1-1/2	2-1/2	1-1/2	1
Situation Comedy	6-1/2	1-1/2	5	4	1/2	4
Quiz	0	0	1	0	0	0
Mystery and Suspense	2	1-1/2	4	5	4-1/2	3
Feature Films	4	6	3-1/2	5-1/2	6	5
Science Fiction	0	0	0	0	1	0
Other (Religious, Documentary, etc.)	1	0	2	0	0	2-1/2
Total number of hours of programming	24-1/2	24-1/2	24-1/2	21	21	21

	1972			1973		
	CBS	NBC	ABC	CBS	NBC	ABC
General Drama	1	2	3	2	2	2
Variety-Comedy	3	3	2	2	3	1
Western-Early American	2	1	1	2	0	1
Adventure	1	1	0	0	1	0
Situation Comedy	5-1/2	1	3	4-1/2	3	3-1/2
Quiz	0	0	0	0	0	0

Table 7.5 (continued)

	1972			1973		
	CBS	NBC	ABC	CBS	NBC	ABC
Mystery and Suspense	3	6-1/2	4	6-1/2	8	5
Feature Films	5-1/2	4	5	4	4	6-1/2
Science Fiction	0	2	1	0	0	0
Other (Religious, Documentary, etc.)	0	1	2	0	0	2
Total number of hours of programming	21	21	21	21	21	21

	1974			1975		
	CBS	NBC	ABC	CBS	NBC	ABC
General Drama	1	3	1	2	3	1
Variety-Comedy	2	0	1	3	0	1-1/2
Western-Early American	2	1	2	1	1	1
Adventure	1	3	2-1/2	1	4	3
Situation Comedy	5	1	2-1/2	6	2	2-1/2
Quiz	0	0	0	0	0	0
Mystery and Suspense	6	7-1/2	5	7	8	7
Feature Films	4	5-1/2	5	2	4	4
Science Fiction	0	0	0	0	0	0
Other (Religious, Documentary, etc.)	0	0	2	0	0	2
Total number of hours of programming	21	21	21	22	22	22

SOURCE: *TV Guide* (1970-1975).

Table 7.6. Chi-Square Results for Testing the Hypothesis of Imitation among Networks

Year	Calculated Chi-square Statistics
1970	14.99
1971	14.22
1972	11.64
1973	10.87
1974	12.62
1975	13.33
Table value for chi-square at $\alpha=.05$, $N=18$	= 28.9

SOURCE: Calculated from Table 7.5.

examine each prime-time half hour and count the number of different program types, sum up this number for all the half hours in the week and then divide by the number of prime-time half hours in the week. The resulting index of horizontal diversity is really the average number of program types per half hour. This index is calculated for the period of 1970-1975. The results are displayed in Table 7.7 and show a steady decline in diversity since 1970 (from a high point of 2.81 to a low point of 2.12).

Table 7.7. Average Half Hourly Diversity, 1970-1975

Year	Average number of viewer options per half hour
1970	2.81
1971	2.75
1972	2.83
1973	2.36
1974	2.53
1975	2.12

SOURCE: Calculated from Table 7.5.

7.6.3. Another Measure of Quality

In another light, one could look upon "quality" as the broadcasting of original programming in contrast to repeating previously seen fare. The consumer obtains more welfare from watching a program for the first time than watching a repeat. The O.T.P. study examined

the proportion of original programming versus repeat programming for the network schedules from the 1961-1972 seasons and found an unmistakable trend toward more repeat programming. In this regard, Table 7.8 demonstrates a clear downward trend since 1966 in the amount of network hours of original prime-time programming shown during the course of a year. This decrease in first-run programming resulted from a decrease in the average number of original series episodes. From a high of 32 original episodes per series, in 1961, Table 7.9 shows that the number of originals has fallen to 22-24. Table 7.10 demonstrates that original broadcasts of theatrical movies have decreased significantly since 1965 from about 60 percent to 47 percent. Theatrical movies are repeated once during the same or following season, and it is not uncommon if they are repeated twice.

Finally, the number of original episodes can be looked upon as a measure of the quantity of input purchased and output produced by the networks. The networks have very similar policies toward the number of original versus repeat episodes just like their gentleman's agreement as to when the original season will end and the repeats will begin. The input-output agreements tend to stabilize and narrow the inter-network rivalry and thereby effectuate greater profits than if more competition prevailed in the industry. Without such restrictions on inputs and outputs, one network might seek to place new episodes against the reruns of his competitors and, by doing so, touch off a new round of non-price rivalry. The above evidence showing a decline in original episodes is therefore

Table 7.8. Network Hours of Original Programming by Year (prime time only)

Season	ABC		CBS		NBC	
	Hours Orig. Prgmg.	% Orig.	Hours Orig. Prgmg.	% Orig.	Hours Orig. Prgmg.	% Orig.
1961-1962	-	-	-	-	885	71
1962-1963	829	69	892	71	-	-
1963-1964	885	72	921	73	-	-
1964-1965	853	70	876	72	-	-
1965-1966	915	70	909	71	-	-
1966-1967	906	71	889	69	-	-
1967-1968	838	65	855	63	-	-
1968-1969	847	70	799	62	-	-
1969-1970	798	63	784	61	-	-
1970-1971	761	65	721	56	-	-
1971-1972	709	65	609	56	644	59

SOURCE: O.T.P. Study, Appendix, Table 1.

Table 7.9. The Distribution of CBS Network New and Repeat Feature Films

Seasons	% of Original Feature Films	% of Repeats
1965-1966	59.6	40.4
1966-1967	52.0	48.0
1967-1968	51.4	48.6
1968-1969	51.0	46.4
1969-1970	46.4	53.6
1970-1971	50.9	49.1
1971-1972	46.7	53.3

SOURCE: O.T.P. Report, Appendix, Table 11.

Table 7.10. Average Number of Originals on NBC TV Network for Various Seasons

Season	Originals
1961-1962	32
1962-1963	32
1963-1964	30
1964-1965	30
1965-1966	30
1966-1967	30
1967-1968	26
1968-1969	26
1969-1970	26
1970-1971	26
1971-1972	24
1972-1973	24

SOURCE: NBC, O.T.P. Study, Appendix, Table 10.

consistent with the evidence in the previous chapter describing the maintenance of oligopoly-oligopsony power as well as the theory suggesting a perfection of such power as a result of vertical integration by the networks.[20] Similarly, it provides added proof that the Spengler theory of vertical integration is non-operational in the context of this industry. A corollary to Spengler's prescription of lowered output prices as a result of vertical integration would be increased quality. The above data in terms of the tendency to imitate and to repeat fail to confirm the theory and, in fact, point in the opposite direction.

In summary, this chapter has shown that the networks' plan to vertically integrate into theatrical and made-for-television movies in order to enhance their buying power and stabilize prices gave rise to little benefit for consumers. It failed to reverse the tendency toward imitation and repeat programming and, contrary to the predictions of the Spengler theory on vertical integration, it neither lowered prices nor increased output (whether measured in terms of minutes of advertising or additional network programs). The savings dividend was captured by the networks in the form of increased rent, thereby strengthening the most dominant force in broadcasting and exacerbating the degree of inequality of power in the industry.

FOOTNOTES FOR CHAPTER VII

1. For example, television has changed from being predominantly black and white to virtually all color, and the mix of programs has changed from emphasis on variety, original drama, and situation comedies in its early years to an emphasis today on action-adventure series and situation comedies featuring outspoken, stereotyped people.

2. It has been argued that television programming is aimed at the large lower middle class in American society. Hence the rich and better educated may see little value in watching commercial television since there is nothing there that interests them.

3. Some people find the commercials more entertaining than the regular programs and will have utility functions which will exhibit increasing marginal utility over a wide range of values.

4. The formal conditions for a discriminating monopolist are:

a. $MR_{\bar{x}1} = MR_{\bar{x}2} = MC_{(\bar{x}1+\bar{x}2)}$

b. $MC_{(\bar{x}1+\bar{x}2)}$ increasing faster than $MR_{\bar{x}1}$;

$MC_{(\bar{x}1+\bar{x}2)}$ increasing faster than $MR_{\bar{x}2}$

c. $$\frac{P_{\bar{x}1} \cdot \bar{x}^1 + P_{\bar{x}2} \cdot \bar{x}^2}{\bar{x}1 + \bar{x}2} \geq AVC_{(\bar{x}1+\bar{x}2)}$$

If (a) and (b) hold, but (c) does not, then $\bar{x}^1 = \bar{x}^2 = 0$. Note: It is possible that the output levels in each market are identical. It is also possible that, if the linear demand curves have different slopes but identical Y intercepts, then the monopolist in maximizing profits would charge identical prices in both markets and discrimination would not work. See Joseph Hadar, *Elementary Theory of Economic Behavior* (Reading, Massachusetts: Addison-Wesley, 1966), pp.103-105.

5. *Pierce Report*, pp.15-16.

6. Very recently, CBS quietly requested the National Association of Broadcasters to check out a possible violation by ABC of the allowable code on prime-time promotions. CBS believed that ABC was secretly cheating on the industry-wide gentleman's agreement and this was part of the reason for the latter's ratings surge during the second season of 1975-1976. See *Variety*, April 14, 1976, p. 43.

7. Using a slightly different model of networking, Bowman provides corroborating evidence on this point. He measures the elasticity of the supply of viewer-minutes and finds it to range from .04-.15 depending on the structural form of the supply equation. He notes that these results are not significantly different from an elasticity of 0 which is the definition of a perfectly inelastic supply curve. See Gary Bowman, "Demand and Supply of Network Television Programming," *The Bell Journal of Economics*, volume 7 (Spring 1976), pp. 258-267.

8. U.S. Senate Subcommittee on Antitrust and Monopoly, *Possible Anticompetitive Effects of the Sale of Network TV Advertising*, Hearings, Parts 1 and 2, Eighty-ninth Congress, 2nd Session, 1966, various pages. Also confidential sources.

9. This is the period of time after the initial modifications in the network-affiliate option-time clauses and before the implementation of the Prime-Time Access Rules.

10. For a more detailed history of this Commission approved collusion, see Les Brown, *Television: The Business Behind the Box* (New York: Harcourt-Brace-Jovanovich, 1971), pp. 354-356.

11. *Pierce Report*, p. 42.

12. Government Brief, *U.S. v. CBS, ABC, and NBC*, p. 17.

13. *Variety*, January 7, 1976, p. 103. A recent Harris poll also showed that viewers desire more live sports, new movies, plays and drama, and variety specials and less crime and spy shows, westerns, situation comedies, and soap operas. This confirms the economist's theory of diminishing marginal utility--the more you have of one good the less an additional unit of that good is worth and vice versa. "Do We Like What We Watch?," *Life*, September 10, 1971, p. 41.

14. *Ibid.*

15. Les Brown describes the 1970-1971 season as follows:

> "Everything was imitated....Each network had its own police: ABC, 'Mod Squad;' CBS, 'Hawaii Five-O;' NBC, 'Adam 12.' Each had its father centered situation comedy: CBS, Fred MacMurray's 'My Three Sons;' ABC, Henry Fonda's 'The Smith Family;' NBC, the

> 'James Stewart Show.' Each had its stylized western: ABC, 'Alias Smith and Jones;' CBS, 'Cade's County' and 'The Big Wheels;' NBC, 'Nichols.' And each had its ninety-minute ersatz movie begat of ABC's 'Movie of the Week.' As NBC had a successful series with a crippled police investigator in 'Ironside,' ABC would have a new one with a blind detective 'Longstreet.' As ABC had a hit with federal crime busters in 'The FBI,' CBS added 'O'Hara, U.S. Treasury.' As NBC had its winning barristers in the 'Bold Ones,' ABC added 'Owen Marshall: Counselor at Law' and NBC another to its roster, 'The D.A.'
>
> (Brown, pp. 362-363)

16. Steiner, Rottenberg and others have noted how television broadcasters trying to maximize audience (and hence revenues) will tend to duplicate or imitate the mass taste programs in order to split up the audience. Each network's share of audience must be greater than that available by programming to a specialized taste. For a more in-depth presentation of this model, see Bruce Owen *et al., Television Economics* (Lexington, Massachusetts: D. C. Heath, 1974), Chapter 3.

17. The ten categories are the same as those found in the *Broadcasting Yearbook,* various years. In placing programs within those categories, several general rules were followed:

1. Any program relying on a western or early American setting is placed in that category. Hence, "The Waltons" and "Little House on the Prairie" are westerns.

2. Any program featuring police, detectives, or other law enforcement personnel are classified as mystery and suspense programs. Hence, "Cannon," "Kojak," and "Adam-12" all belong in this category. Additionally, the NBC mystery movies are so classified.

3. Any other action series which does not fit into either the category of westerns or mystery and suspense is classified as an adventure series. Hence, "Walt Disney," "The Invisible Man," and "Movin' On" fit into this program type.

4. For a program to be considered a situation comedy it must have a regular cast of characters and revolve around some family or other setting. All other comedies are placed in the category of variety-comedy. Hence, "All in the Family," "Rhoda," and "Maude" are situation comedies but "Love American Style" is a variety-comedy program.

5. All programs featuring doctors and lawyers are categorized as general drama. Additionally, any other program stressing the development of characters or the tragic problems of

life (as opposed to action chases) are so classified. Hence, "Marcus Welby," "The Bold Ones," and "Bracken's World" are general drama shows.

6. Finally, any other program which is neither a movie, variety, quiz or science fiction show is classified as an "other" program. The best examples of other programs are "60 Minutes" and "ABC Monday Night Football."

18. The chi-square statistic for each year was calculated as follows:

Let i = the number of program categories and

$$e_i = \frac{CBS_i + NBC_i + ABC_i}{3}$$

$$\lambda^2 \text{ calculated} = \sum_{i=1}^{10} \frac{(CBS_i - e_i)^2 + (NBC_i - e_i)^2 + (ABC_i - e_i)^2}{e_i}$$

While some might argue that this statistical test only measures the tendency of the networks to program within the same general mass-taste categories and is not conclusive proof of the imitation hypothesis; nonetheless, it is the only practical test available which does not introduce an unacceptable level of subjectivity into the analysis. The test may best be considered a necessary but not sufficient proof of the imitation hypothesis.

19. Harvey J. Levin, "Supplementary Comments," Center for Policy Research, filed before the F.C.C., May 15, 1974, p. 3. Note: Table 7.5 gives the vertical diversity for each network, that is, the distribution of programs among the different program types.

20. In other words, the restriction in input and output is consistent with the theory of oligopoly-oligopsony power while the decrease in original programming and movies since 1967 is consistent with the theory of perfecting the covert cartl. The O.T.P. study also shows it is consistent with the rising level of regular series program costs during this time period.

CHAPTER VIII

SELF-PREFERENCE IN THE TELEVISION BROADCAST INDUSTRY

8.1. Introduction

The allegations that the networks prefer those programs and movies in which they have a financial interest are vehemently denied and dismissed by the networks. They claim that it would be economic suicide and contrary to the profit maximization incentive for any network to broadcast low quality programs because the other networks would lure away viewers in the fiercely competitive battle for ratings. The task of this chapter is to examine within an economic framework this idea of self-preference to determine if it is a legitimate concept.

Two theories to explain this type of behavior will be proposed. The first is that the networks produced their own programming to solidify their buying cartel and depress input prices (see Chapter VI). To make this threat of foreclosure credible, the networks must use these in-house programs and having sunk the costs in them, they therefore have an incentive to prefer this fare, *ceteris paribus*, over similar fare from outside suppliers. A second explanation for the tendency to prefer their own product may stem from the prestige and utility inherent in producing network programs. In particular, it is hypothesized that network managers sacrifice profits for the

utility obtained from presenting programs in which they have a creative and/or financial interest. Also, an evaluation will be made of the evidence supporting these hypotheses with respect to the networks' vertical integration into theatrical movies. Finally, the question of how such integration affects the marketplace of ideas will be examined.

8.2. Self-Preference under Profit Maximization

Chapter VI presented evidence confirming the networks' behavior in enhancing their power in the various input markets. It was shown that in seeking to perfect their spirit of cooperation,the networks try to eliminate or decrease the potential monopoly power which accrues to their suppliers. One of the strategies in this plan is partial integration into the production sphere which forecloses some of the open market for programming and at the same time sends the message that further integration will occur if prices are not kept in line. For such a threat to be credible, the network must effectuate this plan through the actual use of some of their own programming. Hence, while in the abstract the argument that it would be economic suicide for a network to prefer lower quality (its own product) may have some outward appeal, it may also be looked at in the context of the sacrificing of short-term for long-run profits and stability. Also, once the decision has been made to produce in-house product, it can be shown that a short-run profit incentive exists to prefer one's own product over a higher quality product produced by outside sources.

Assume the network is choosing between its pilot and one furnished by an independent advertising agency. Assume both pilots cost $400,000 and would be used as the first episode of the new series. Also assume that 24 more episodes will be purchased at $400,000 each. Hence the total season's cost for the series will be 25 x $400,000, or $10 million. *Assume that each of the pilots is judged to be of equal quality,* that is, each new series will have an estimated audience of 20 million viewers. If the network price/1000 = $5, then this will be $100,000 per minute of advertising times six minutes of advertising per hour, giving $600,000 per episode times 25 episodes, equaling total revenue of $15 million. If the network picks its own pilot and series option, its net revenues will be $5 million ($15 - $10 million). However, if it chooses the advertiser pilot and series, it still obtains the $5 million in net revenues but it loses the $400,000 it sunk in pilot costs.[1] Hence its overall profit would be only $4.6 million. The network thus has a short-run profit incentive to prefer its own show if its quality is identical to an independent program.

Suppose the in-house pilot and series has a lower expected rating (i.e., lower quality). How will the profit maximizing network now respond? Assume the expected rating is equal to 19.47 million viewers rather than 20 million viewers. This translates into a total revenue of $14.6 million for the season. If the costs are identical to the first example, then the network will realize net revenues of $4.6 million ($14.6 - 10.0) if it chooses its own

series and $4.6 million ($15.0 - 10.0 - .4) if it picks the independent pilot and series which has the higher rating. It is indifferent between choosing the two series even though its own is of lower quality. *Hence, within a range of estimated quality values, a network will be maximizing short-run profits by preferring lower quality in-house product.* The range will be widened if the network has subsidiary rights and profit shares in its own programs since long-run profit considerations must now be incorporated into the analysis.

In the theatrical film market, the networks purchase a mix of high, medium, and low quality pictures. There is widespread evidence to support this contention of a mix of feature films. For instance, inspection of the season's movie lineup for any network will show a mix of blockbuster, high and low quality features. Similarly, an examination of movie deals between the networks and independent movie companies reveals that the films in any package vary considerably in quality. Thirdly, an executive of ABC, Everett Erlick, admitted in the F.C.C. Pay Cable Hearings that ABC as a purchaser and user of theatrical feature movies wants a mix of product, high and low quality films, to average out costs.[2] Why do the networks want a mix of programs and movies? Well, a "B" quality movie may not do well rating-wise against a highly successful television program but, if it is placed against a rerun of that hit show or against another "B" movie, there may be an even split in the ratings. Also, it may in some circumstances be more profitable or equally profitable to show a low-quality, low-cost movie even if the advertising prices are significantly reduced due to lower

advertiser demand.[3] Finally, when one network is showing a block-buster movie such as "The Godfather" or a special sporting contest such as the "Super Bowl," the other networks might be willing to allow the one network free reign by counterprogramming with low quality feature films.[4]

Keeping in mind the facts that not every movie produced is licensed and that the networks purchase a mix of high, medium, and low quality films, the probability that all the medium and low quality ABC and CBS pictures would be licensed is not certainty in an open and free market. If the networks decide to substitute their own "B," "C," and "D" feature films for similar films of independents at similar prices, then this represents an absolute foreclosure of lower quality product, almost the erection of a barrier to entry or access. The movie companies in fact allege that the vertical integration game plan was designed to cream-skim their top features from the marketplace while the networks replaced the lower-medium quality product with in-house feature films. *Notice that this form of discrimination works without the need to accept lower quality product.* Also, this very subtle form of self-preference may cause a foreclosure of product which is different from similar industries. The hours which are foreclosed are gone forever; they cannot be recaptured and the message broadcast cannot be recalled.

Therefore, while quite clearly no network would be willing to fill up its entire schedule with medium quality programs or movies, there is an incentive to include them in the quality mix to take advantage of special opportunities and to perhaps make

significant marginal profits. The important point to remember is that it is idle to talk in isolation about the expected rating or share of a series or a movie; this obviously will depend upon what the other networks run opposite them.

A monopolist television network will thus have a freer rein and will be able to more easily substitute low-quality, low-cost programs for high-quality, high-cost programs. Nevertheless, when there are only three competitors, oligopoly theory suggests that the three firms have an incentive to collude and approximate the monopoly solution. This collusion need not be open; rules of the game will come to be known and the cartel can be run with no open discussions. Assuming arguendo, that self-preference is the equivalent of accepting lower quality movies, *this would not affect profits significantly if every rival understood that this was a new form of collusion to which he must accede.* In the case at hand, it was not purely coincidental that ABC and CBS entered virtually simultaneously into the production of theatrical and made-for-television movies; it may be thought of as part of the cooperative spirit by which the industry is governed. Furthermore, suppose the networks decided that they would remain in production but would not show their own product. What would be the effect on industry performance? A good case could be made that the performance would alter very little in terms of quality product since one could imagine the emergence of a Paramount type situation in which each network seeking access to the other two would show reciprocal preference to the programs of its rivals. Rather than opening up the market,

this might be expected to further restrict it and help perfect the covert cartel.

8.3. New Theories of the Firm

Up to this point, it has been assumed that networks follow the economists' game of short-run profit maximization to the exclusion of any other motives. This may work well on blackboards but not in practice; and hence new theories of the firm have been developed to explain how businesses really operate. In Baumol's theory,[5] the managerial class of the firm obtains utility from directing a large rather than a highly profitable enterprise. The managers will seek to maximize sales subject to the constraint of earning sufficient profits to remain in their power positions within the firm. In the Williamson model,[6] the managers have a utility function which depends on dollar expenditures for staff, management slack, and discretionary investment spending. The managers attempt to maximize the value of their utility function subject to the minimum profits constraint. The end result of this utility maximization calculus yields higher staff expenditures and more management slack than under a pure profit-maximizing objective.

It is possible to incorporate this idea of managerial utility into a model of network behavior. Assume that the network executives have a utility function which depends not only on staff expenditures, management slack, and other perquisites but also upon the mix of programs which the network presents. If the network executives obtain high critical acclaim and social standing from the inclusion of quality newscasts, documentaries, and original

drama in their program schedules, then subject to the minimum profits constraint and the F.C.C. constraint on balanced programming, more of these programs will be included than a simple profit-maximization model would predict. Various commentators have pointed out this prestige element which frequently creeps into the network programming decisions:

> Call it the *quest for prestige or image, or class.* By whatever name, it's an intangible value whose meaning...is as hard to pinpoint as it is to assess....It is measured more or less by feel. But experience has proven with certainty that it is far better all down the line to have the stature of a leader and the good reputation as an occasional (or frequent) presenter of quality than not to have it.[7] [italics mine]

Les Brown describes the present office of Oliver Treyz, a former network president, as containing such memorabilia as a letter from Winston Churchill thanking him for scheduling a Churchill series, a photograph of the third Kennedy-Nixon great debate which originated from ABC, and a photograph of himself and his former boss Leonard Goldensen with President John F. Kennedy. "No reminders, however, of the animated cartoons and potboiler adventure hours from Warner Brothers which had predominated on his network."[8] Finally, in describing the huge losses encountered from the program "CBS Playhouse," Brown notes:

> The value to CBS had been in the response from prestigious sectors of society and the fallout of praise, the mail, and critical applause that were rarely experienced from ordinary television efforts.[9]

In sum, the networks may only be under regulatory pressure to carry a minimum amount of these "sustaining" programs, not to insure that their quality is high. Since it is generally agreed that the quality of these network programs is exceedingly high and coupled

with the fact that the networks continually bewail the excessive costs and losses associated with these types of programs, it seems safe to conclude that the network managers obtain positive utility from these shows and are willing to sacrifice profits in order to gain this utility.

From this plausible model of network behavior it seems not too great an extension to claim that network managers may also obtain utility from viewing entertainment programs and movies in which they have both creative and financial control. In other words, will not the television programming executives (much like the movie producers) gain some kind of personal artistic satisfaction from including programs in which they themselves may have helped create on the drawing boards? And if the choice is between an "A" movie from MGM and a "B" movie from ABC or CBS pictures, is it impossible to believe that the ABC programming executives might be willing to sacrifice profits to show the outside world that ABC can make a network quality picture? Or suppose CBS was making a television movie and was approaching the maximum budget. Would not the network executives more willingly grant an extra budget to their own project rather than to a similarly situated independent movie?[10] In short, the temptation may be present whether consciously or unconsciously to make adjustments when dealing with one's own product. And these adjustments may result in less profits than if the networks followed the strategy that economists find most appealing, namely that of short-run profit maximization. In another light, Robert Montgomery claims that the networks' control over the entire production process can no longer be explained under the profit

motive; rather, one must think in terms of a power motive--the power to control every phase of the television industry by eliminating all uncertainties and vagaries.[11] Thus, he suggests that the correct model of network behavior is one emphasizing long-term rather than short-term profits, one in which the networks become the masters of their destiny and lead the quiet life.

8.4. The Economics of Discrimination

Are these ideas of discrimination and the sacrificing of short-run profits for increased utility new to economics? The answer is of course no; the economic theory of discrimination is replete with examples of just such practices. The most important point to remember is that when a firm discriminates against blacks, women, or the old, it will pay a higher wage to a less or equally skilled but nonetheless favored class of workers; hence it will not be minimizing costs and consequently not maximizing profits. For illustrative purposes, one can look at a simple example of how this works.[12] Suppose a firm has a production function in which output (houses) depends on two inputs, black bricklayers (B) and white carpenters (W). Assume further that the employer wishes to minimize the cost of producing a given number of houses (q_0). Then we see the familiar isoquant-isocost diagram pictured below. If no discrimination occurs, the firm produces q_0 and minimizes cost along C^0; it hires a_0 whites and b_0 blacks. If discrimination now occurs, the employer no longer observes the true market wage of P_b for blacks; he now observes $P_b + d$; $d > 0$, where d is a measure of the intensity of his discrimination. The total price of hiring blacks

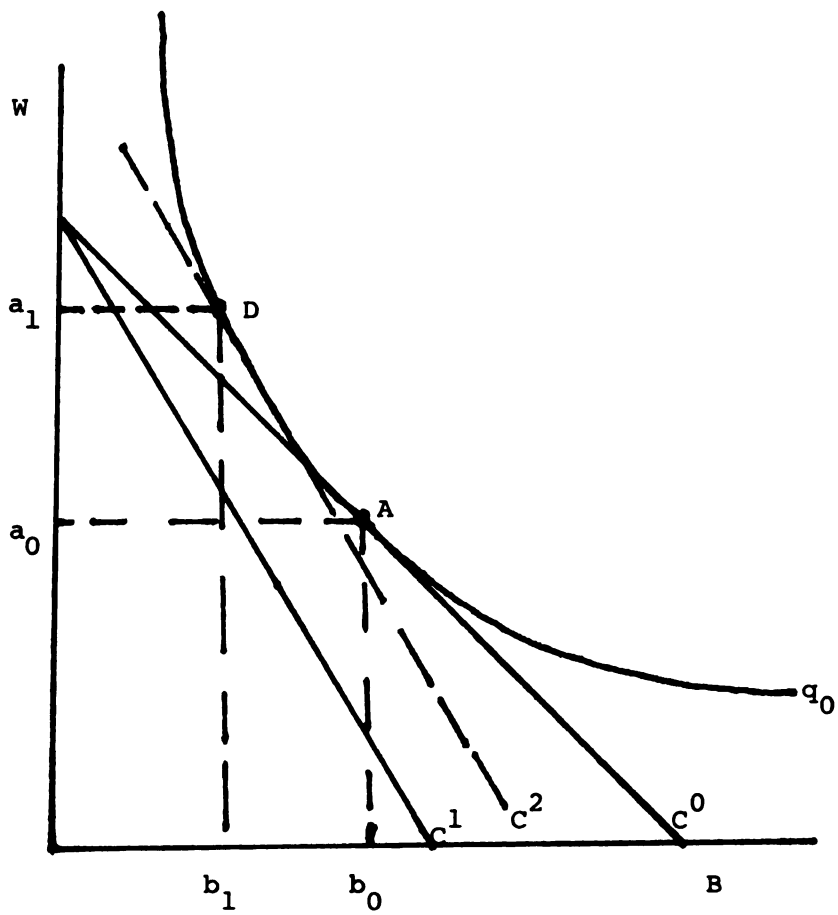

Figure 8.1.--A Model of Economic Discrimination.

has now risen thus causing the slope of the isocost line to become steeper (C^1). *To produce q_0, the firm now moves to a higher cost line C^2 and hires more white carpenters (a_1) and less black bricklayers (b_1).*

Therefore, the theory of self-preference has greater plausibility and applicability than causal theorizing would indicate.[13] It cannot be dismissed as purely irrational behavior or something which would never exist in the real world.[14] The real question is, how susceptible to measurement is it in the context of the television broadcast industry?

In summary, two models have been presented to explain the appearance of self-preference within the television broadcasting industry. The first suggests that it is a logical step towards creating a credible threat to further integration and solidifying a buying cartel. It is not at odds with the theory of long-run profit maximization. The second model explains self-preference within the context of a managerial utility function. The network executives may obtain utility from scheduling programs in which they have a creative or financial interest. The following sections test whether there is sufficient evidence to prove that self-preference actually occurred within this industry and, if so, how this affects consumer welfare.

8.5. Evidence Concerning Self-Dealing

As mentioned before, the F.C.C. Prime-Time Access Rules and Order of May, 1970, found an unhealthy situation in the television broadcast industry.

> Control over programming and over access to the licensed television stations is heavily concentrated in only three hands...the market is seriously unbalanced to the disadvantage of independent producers and a freer, more diversified television production and distribution process....In addition, *the three national television networks for all practical purposes control the entire network television program production process from idea through exhibition.*[15] [italics mine]

To document its allegations, evidence was presented showing that between 1957 and 1968, the share of network affiliated evening program hours either produced or directly controlled by networks rose from 67.2 percent to 96.7 percent.[16] The Commission investigation dealt solely with regular entertainment series; this dissertation extends their findings into the virgin area of theatrical and made-for-television movies.

8.5.1. Germination of the Plan

The networks began scheduling movies as a substitute for regular prime-time series during the early 1960's. As the following table shows, there was a steady increase in the number of prime-time hours/week devoted to theatrical movies until 1968 and 1969, after which there was a stabilization and then, very recently, an increasing trend again toward their use, especially as mid-season replacements.[17] These movies were warmly greeted by the television public, and advertisers were willing to pay higher prices for the certainty of being associated with a hit product. To illustrate their high public acceptance, reference is made to a headline in a trade paper in November of 1967, "Six Movie Nights in Nielson Top 20."[18]

Motion picture production was the only form of television programming that the networks did not already control. The opportunity

Table 8.1. Hours of Theatrical Feature Film Programming per Week

	ABC	CBS	NBC	Three Network Aggregate
1962	2	-	2	4
1963	-	-	4	4
1964	2	-	4	6
1965	2	2	4	8
1966	2	4	4	10
1967	4	4	4	12
1968	4	4	6	14
1969	4	4	6	14
1970	2*	4	6	12
1971	2*	4	6	12
1972	2*	4	6	12

SOURCE: O.T.P. Report, Appendix, Table 5.

to integrate into the production of theatrical movies looked very appealing to them. The appeal sprang from the reality that the networks controlled the important television market and thus had the advantage of an assured access for any theatrical movie they produced. Hence, they would not enter simply as minor producers; rather, they could exert their network leverage and thereby foreclose their rival-suppliers from this crucial secondary market. In 1965, recognizing this logic, an official of a major network proposed the following steps in such a game plan:

> (1) These features should be released theatrically first for a short run (12 months), both domestically and abroad as well.
>
> This release enables us to recoup part of our investment as fast as possible and enhance the movie as a TV feature.
>
> (2) After the picture has run its theatrical course, it is then sold to the network plays at a *pre-established price,* based on the picture and the TV feature marketplace. [italics mine]
>
> (3) After the picture has played its two runs on the network, it is then sold to:
>
> (a) The [network] O&O stations on a multiple run basis.
>
> (b) [The network] films to be sold in syndication to stations on a multiple run basis.
>
> (4) *If all of the aforementioned steps take place, I find it almost impossible to see how we can lose out on an arrangement like this.* [italics mine]
>
> I most certainly think that we can make back our negative cost. The only thing that can happen to us is that we get a network TV film at no cost...which in itself is a pretty good deal.[19]

Notice that mention is made in this document of how the organization's network and O and O stations will perfunctorily absorb its own

product. This is the heart of the charge of self-preference whether in the subtle or more blatant forms mentioned above.

In the autumn of 1966, a top network official and his associate traveled throughout Europe and engaged in exploratory talks with various producers on the possibility of 50-50 co-production movie deals. During these meetings the idea to prefer their own product and utilize their network leverage was further developed. For example, the official thought that the distribution fee that the network will be required to pay will be significantly less than under normal conditions because of the company's reciprocal power over the major film distributors.

> [The network] will be in a position to trade from strength and obtain terms which should enable each film to move into a profit position much sooner than is presently the case.[20]

More importantly, the official outlined the feature of the co-production deal concerning network television rights.

> In a co-production deal under which the distribution rights are split hemispherically between the partners, *a price will be negotiated and agreed in advance (and this figure will be written into the agreement) for the network TV rights* (but not syndication rights) in the U.S.A. If the film proves to be an outstanding success theatrically, and, thereby, can be presumed will be equally successful later on television, this arrangement may at first sight appear to be opposed to the partner's best interest. If the reverse applies, the arrangement would doubtless be in the partner's favour. However, whilst such arrangement involves an element of "gambling" by the partner, the attraction to him of such a scheme is that the opportunity of entering into a profit position in [the network's] hemisphere will be brought forward to the extent that the price agreed for the TV network rights in the U.S.A. will be credited to the production account immediately viz; if [the network's] investment in the production is, say, one million dollars, and the agreed figures for the network rights

> is $300,000, as soon as the net earnings from the film concerned exceeds $700,000 the partner will commence to receive his share of the profits.[21] [italics mine]

In another conversation, the official modified this position slightly by saying that the pre-sale price for network television rights

> would only be a minimum and would be linked with an agreed figure of minimum gross film rentals. As this minimum gross was exceeded, so the price of the television showing would escalate in accordance with a previously agreed scale.[22]

Once again, this network's plan involved the blind purchase of theatrical movies in which it had a significant financial interest. This self-dealing would enable the co-producers to obtain a significant advantage over similarly situated producers who not only must wait a considerable time before receiving their license fees but also face the prospect of never being licensed. The official also mentions his plan to use new acting talent in secondary roles on television dramas and "to promote them by means of television into star names prior to introducing them into starring roles in theatrical feature motion pictures."[23]

8.5.2. ABC and CBS Begin Movie Production

In 1967, both ABC and CBS became major producers of theatrical feature films. ABC began its productions through three subsidiary companies, Palomar Pictures International, Selmur Productions Company, and ABC Pictures. ABC also entered into a distribution contract with Cinerama, Inc., a large movie producer-distributor and owner of the exclusive rights to the Cinerama photographic process for theatrical films. The agreement allowed Cinerama to

distribute a large percentage of the films produced or financed by ABC and its subsidiaries, and each party had the right to purchase an interest in films produced by the other.[24] It should be noted that the principal stockholder and largest creditor of Cinerama, William Forman, also is president and principal stockholder of Pacific Theatres, which owns or operates 115 theatres in the United States (the largest circuit of drive-ins in the country).[25] In August 1970, Pacific Theatres acquired control of the RKO-Stanley Warner circuit of 133 theaters. Thus ABC, which itself took over the 400 Paramount theaters after the dissolution decree in the late 1940's, along with Pacific, own and operate more than 684 theaters--the largest theater consolidation in the country.[26] This alliance gives ABC the opportunity and the power not only to exact reciprocal price concessions from the major movie distributors but also to give preferred access and status to its own pictures and those of its partner. This is precisely the accumulation of power which the *Paramount* decree was fashioned to prevent.

In 1967, CBS entered theatrical feature film production and became a large producer of this product. Like ABC, it signed an exclusive long-term distribution agreement with an integrated distributor-theater operator, National General Corporation. National General owns and operates the second largest chain of motion picture theaters in the country (250 theaters); it is also involved in production of movies. CBS film production was carried on through CBS Theatrical Films, Inc., which later became CBS Films and then Cinema Center Films.[27] CBS therefore also possessed the power to exact reciprocal price concessions from distributors and favor its

movies in its theaters as well as on its network. ABC and CBS finally discontinued theatrical film production in 1972 when the major movie companies brought a lawsuit charging the networks with self-dealing and foreclosure of access to the television networks. During their production years, the networks produced approximately 80 theatrical feature films. In 1968 and 1970, respectively, CBS and ABC entered the business of producing their own made-for-television movies and continue to produce a significant portion (35-50 percent) of their requirements in this area.

8.5.3. "XYZ's" Self-Dealing in Theatrical Movies

In both 1967 and 1969, network "XYZ" borrowed money from two major banks to help finance its theatrical motion pictures. Part of the collateral for these production loans was the pre-production blind sale of the television rights in all of these pictures to network "XYZ-TV" for some $20 million. The language of the second agreement is very clear:

> ["XYZ"] *is to commit for the purchase of the television rights to each of the pictures.* The present commitments of $18,750,000 as shown by ["XYZ"] on the attached Summary of TV Commitments...are to remain unchanged. Commitments on new pictures are to average at least $750,000/picture.[28] [italics mine]

Hence, "XYZ-TV" did not consider the merit of these films (which of course was impossible since most of the films were incomplete or not yet started) as required by its fiduciary responsibility under the Communications Act of 1934; it simply acquired them as an accommodation to its production subsidiaries. Having acquired these films, it now had the incentive to use these films and thereby foreclose similar films of the independent movie companies. This is a

very important point. Even if these pictures had value to the other networks, they should have been allowed to bid for them because the public interest requires an open competitive market for a diverse source of programs. Even if some of the pictures would have been shown on other networks, a network can still prefer its in-house productions in very subtle ways. For example, a network can give preferred playing times to its own pictures. When ABC showed *Charly, They Shoot Horses, Don't They?,* and *Krakatoa, East of Java,* it placed all of these ABC films in the early weeks of the television season when they would elicit the highest possible ratings since viewership is at a peak. For the 1971 and 1972 seasons, one network intended to show eight of its own pictures. Seven of the eight pictures were to be shown on a movie night which elicits higher ratings than the other available movie nights.[29] If this network did not plan to play off its own product and give it preferred status, why were these films included in its preliminary movie night schedules?

In the summer of 1969, even before the second bank loan had been consummated, in a memorandum talking about the network "game plan" for acquiring theatrical movies, a high network official noted that part of the "game plan" includes the 15 "A" pictures (pictures earning a share of 33 percent or larger) available from the network production subsidiary starting in 1971.[30] Now by this time, only 19 pictures had been theatrically released, very few of them of actual "A" quality; hence, was he referring to 15 of these 19 pictures, the four additional films to be released during the next six months, or to those pictures yet to be made? This memo is of extreme

importance since it provides solid support for the contention that this network was prepared to accept blindly a significant percentage of its own pictures with the question of merit seemingly lost in the shuffle. Further confirmation of this plan emerged in early 1970, when another high official wrote a memorandum saying his network's inventory "indicates no present need to buy feature film rights *beyond the presently contemplated* [*network*] *package* and heavying up with World Premiers."[31] [italics mine]

Finally, a top official of one of the networks who has consistently lectured that it would be economic suicide for his network to accept lesser quality product whether through self-dealing or otherwise, made the following revealing and damaging statement in an inter-office memorandum:

> I firmly believe that those films programmed under a movie umbrella will do just fine for us. We will not be number one in the time period, but I think we will have good product at low cost, thereby making a great deal of profits. *I think it represents a far better business arrangement than 2 one-hour series that we have no real equity in.*[32] [italics mine]

In summary, evidence has been presented showing that several networks formulated and carried out a game plan concerning their theatrical movie product which included the intentions of self-dealing and preferring their own product. Even if the bank loans, scheduling decisions, and inter-office memos do not individually indicate such a plan, *collectively they provide solid evidence of the power, intention, opportunity, and mind set to commit these anticompetitive acts.*

8.6. Empirical Evidence of Self-Preference

In this section, an attempt will be made to quantify the allegation that the networks prefer their own product over similar fare from outside suppliers. In statistical language, the hypothesis to be tested is that the networks behave no differently when purchasing packages of films from outside sources as they do when purchasing from wholly owned subsidiaries. If the data show significant differences between the two groups of packages, then the hypothesis must be rejected and this would be additional proof of the theory of network self-preference. The contract data come from various trade articles[33] as well as information provided under strict confidence.

Theatrical film licenses invariably are conducted in terms of packages rather than picture by picture. The networks claim this is a carryover from the post-war block-booking practices of the major movie companies; however, the movie companies say that not only is this the most economical method of conducting negotiations (because of the savings in transaction costs) but, more importantly, this is the way the networks wish to deal. Some strong evidence of this latter contention is given in a statement by Barry Diller, vice president in charge of programming at ABC, when he said in a 1967 interview that ABC is always looking for a good *group* of pictures.[34] Also, it is known that the networks seek a wide mix of quality in the packages in order to "average out" prices.[35] Why would they do this? Probably to work within their given budget but also to hide the actual worth of the films so that they have

the upper hand in later negotiations with advertisers to whom they usually sell minutes in unnamed movie packages.

The Supreme Court has ruled that block-booking is illegal because the low quality films borrow quality from the high quality films and tend to equalize rather than differentiate the reward for individual copyrights. "Each film stands not on its own footing but in whole or in part on the appeal which another film may have."[36] To get around the letter of the law, individual prices are listed in some of the contracts or clauses are added under which each side agrees that no block-booking is involved in the agreement. Nevertheless, some of the films are of such low quality that they will never be shown on network television, will be shown during the "black weeks" when no ratings are taken, or else will be shown once rather than the two runs normally specified. Knowing this, *individual prices must be suspect*. Thus, the safer method is to look at the contracts as entire entities rather than as individual pictures. This will be the procedure followed in this section.

8.6.1. The Data

The data on film "quality" come from two basic sources. The first is a quality measure utilizing information about the previous theatrical run of the movie. The "film rentals accruing to the distributor" for each picture will therefore provide a handy index of the relative quality of each film as determined by actual marketplace data. These data come from *Variety*, which each year lists all films earning over $1 million in theatrical rentals. Unfortunately, there is no way to obtain rental information for those films earning

less than $1 million and hence these films will simply be grouped under the classification of "films earning less than $1 million" and assigned rentals according to two assumptions: (1) that the films earned rentals of $500,000 and (2) that the films earned rentals of $750,000. This will give a range to the estimates of average quality for various packages. Also, theatrical rentals attributed to the films will be either inflated or deflated by the consumer price index for indoor movie admissions (1967 = 100). Thus, a film earning a theatrical rental of $1 million in 1960 is not equivalent to one earning a comparable rental in 1967. In 1967 prices, the former would have a value of $1,538,462 while the latter's value would of course be $1 million.

The second index of quality is the subjective star rating given by the New York film critics which pertains to the intrinsic artistic appeal of the film. These data come from the book, *TV Movies*, by Leonard Maltin.[37] While obviously any such measure of quality must be subjective in nature, as long as the methods of evaluation are consistent, it will nonetheless give a measure of *relative quality*, which is what is desired here. The two measures of quality are generally highly correlated but not in all cases. An artistically well-made film may appeal to the movie-going audience while receiving low ratings on television. The data come in the form of star ratings from "bomb," which has been assigned a one-star rating to four-star rated pictures.

There are 13 complete contracts in the sample and three incomplete ones. The incomplete contracts come from newspaper accounts which generally list only a certain percentage of films in the deal

(usually about 50 percent). Since the newspaper sources list the highest quality films in the package (those earning at least $1 million in rentals), it has been assumed that the remainder of unnamed films earned less than $1 million and are assigned the rental values according to the assumptions noted above. Obviously, this is a very conservative approach, so the true value of these packages may be understated. There are also four contract proposals (deals which were never completed). The reason for including these rejected deals is to test whether the network in-house packages are of higher quality than these deals. If true, then little can be inferred since the latter deals were considered inferior and thus rejected. However, if the rejected deals are of higher quality, then this might be further evidence of self-preference (i.e., the networks refusing better deals than their own).

Table 8.2 summarizes all of the relevant variables involved in this analysis:

(1) Column 1 lists the 20 contracts included in the sample. They have been identified by code to protect the confidentiality of the sources. Packages 9A and 9B are the network in-house deals.

(2) Column 2 lists the year in which the contract was either signed or else rejected.

(3) Column 3 lists the number of pictures in the various packages.

(4) Column 4 gives the average star rating for the various packages (total star rating points/number of pictures in the package).

(5) Column 5 gives the percentage of pictures in each package which have earned over $1 million in theatrical rentals.

Table 8.2. Quality Estimates of Various Network Film Licensing Deals

(1) Package	(2) Date	(3) Number of Pictures	(4) Average Star Rating	(5) % Earning ≥ $1 million
I. Complete Information Deals				
1	1967	11	2.409	27
2	1966	17	2.760	70
3	1966	32	2.625	65
4	1965	3	2.670	67
5	1967	27	2.635	74
6	1967	26	2.680	50
7	1966	15	2.800	87
8	1969	19	2.684	74
9A*	1967-69	31	2.364	32
9B*	1967-69	38	2.103	32
10	1967	11	2.611	27
11	1967	10	2.650	70
12	1965	20	2.875	65
II. Incomplete Information Deals				
13	1966	32	--	15
14	1968	19	--	26
15	1964	30	--	50
III. Rejected Deals				
16	1965	20	--	35
17	1971	5	2.100	40
18	1971	20	2.441	55
19	1968	15	2.663	53

Table 8.2 (continued)

(6) Average Quality/ Film (Rentals)	(7) Average Price/ Unit of Quality	(8) Adjusted Average Price/Unit of Quality (1967-69 = 100)
1.426-1.608	.392-.442	.392-.442
7.042-7.115	.161-.163	.234-.236
2.911-2.966	.211-.215	.307-.313
3.588-3.629	.092-.093	.147-.148
3.549-3.614	.241-.246	.241-.246
3.656-3.781	.212-.219	.212-.219
4.057-4.091	.098-.099	.143-.144
4.460-4.526	.207-.210	.207-.210
1.510-1.620	.374-.401	.374-.401
1.183-1.524	.457-.485	.457-.485
1.371-1.553	.290-.328	.290-.328
4.120-4.195	.207-.211	.207-.211
3.009-3.097	.170-.174	.272-.278
2.812-3.023	.207-.222	.301-.323
3.340-3.525	.246-.260	.246-.260
3.193-3.318	.084-.088	.254-.266
1.794-1.956	.204-.223	.326-.357
1.898-2.048	.342-.369	.322-.347
2.320-2.430	.373-.391	.351-.368
2.695-2.811	.289-.302	.289-.302

(6) Column 6 gives the average theatrical rentals per film (total theatrical rentals/number of films in the package).

(7) Column 7 gives the average license price per unit of theatrical rental value (total package price/total theatrical rentals). Hence .30 would mean that the network paid out 30¢ for every dollar of theatrical quality (which has been adjusted to reflect the change in admission prices).

(8) Column 8 shows column 7 which is further adjusted to reflect the rising prices paid by the networks over the years for the average picture.

8.6.2. The Evidence

What does the evidence show? First of all, in terms of average star ratings, the network in-house packages 9A and 9B have averages of 2.364 and 2.103, respectively. Only one other package, and that was a rejected deal, has a smaller average quality rating. Secondly, the network in-house deals have 32 percent hit shows while four other packages have a lower percentage. Note, only one of these other deals (#1) is a complete information deal. Thirdly, in terms of average quality per film, the network in-house packages have ranges of 1.51-1.62 and 1.18-1.55, respectively. Only two other deals (#1 and #10) come within the ranges of the low quality in-house deals.[38] Fourthly, with respect to the average adjusted price/unit of quality, the in-house packages are listed at .374-.401 and .457-.485, respectively. With the sole exception of the first package, these two contracts are significantly higher than the other deals. What does this mean? Simply stated, *the networks paid a*

higher price for a constant quality of film when they acquired their own films as compared to films from independent movie companies. This is precisely the definition of self-preference or discrimination against independent producers.[39]

There are good reasons for looking very closely at this last series of data (Column 8). First, quality per se need not be a very good indication of whether or not the networks have discriminated against independent producers since the networks could adjust the price to reflect the quality evaluation. Hence price needs to be included to make a more reliable standard of comparison. Secondly, there is evidence that the networks actually figure license prices as a function of domestic and foreign theatrical rentals. For example, the license price or "TV formula" of a film is usually figured as being 15 percent of domestic and 10 percent of world box office gross.[40] The gross rentals a film earns will be directly proportional to the rentals accruing to the distributor and hence the methods employed here will give us a good approximation of reality.

One caveat which should be noted in this entire analysis is that the prices that wholly-owned subsidiaries charge themselves may be arbitrary and either reflective of market conditions or designed to manipulate the market such as through price squeezes. Hence, it would have been perfectly plausible to discover that the networks were paying the market price for their own product. If that were true, then it would have been necessary to test for more subtle forms of discrimination and self-preference such as using in-house films when comparable independent ones are available at

identical prices or giving preferred playing times to network produced films. However, since the more blatant form of discrimination has been shown (paying higher prices for a constant unit of quality), this is a sufficient condition for proving economic discrimination by the networks in favor of their own product.

8.7. The First Amendment and the Mass Media

This section examines the importance to consumers of self-preference in the broadcasting industry. Whereas in other industries the purchase of intermediate products from one source as opposed to another is irrelevant, the broadcasting industry has the special characteristic that it touches the marketplace of ideas and thereby involves First Amendment considerations.

8.7.1. *U.S. v. Associated Press*

Although the First Amendment precludes government from making any laws abridging freedom of speech or of the press, the question of whether the antitrust laws applied to the business practices of the publishing industry remained unsettled until the historic case, *United States v. Associated Press* (52 F. Supp. 362 [1943]). In this case, Judge Learned Hand ruled that the First Amendment did not exempt the publishing business from the antitrust laws. In a much quoted dictum, Hand noted the special character of the newspaper business:

> That industry [newspapers] serves one of the most vital of all general interests--the *dissemination of news from as many different sources and with as many different facets and colors as is possible. This interest is closely akin to, if not the same as, the interest protected by the First Amendment;* it presupposes that

> right conclusions are more likely to be gathered out of a multitude of tongues than through any kind of authoritative selection.[41] [italics mine]

In the Supreme Court affirmation of Hand's decision, Frankfurter noted:

> Truth and understanding are not wares like peanuts or potatoes...[restraints on the free trade of ideas] calls into play considerations very different from comparable restraints in an enterprise having merely a commercial aspect.[42]

The Associated Press Case thus states that in an industry which is so crucial to the foundation of democratic discourse, *the government has a positive role to play, a positive responsibility for ensuring that the private sector not destroy the marketplace of ideas.* In short, the First Amendment can cut both ways: it can shield the content of news and other fare from interference by a power-hungry government while simultaneously justifying government intervention to promote the proper structure of the marketplace of ideas and thus forestall monopolization in this crucial area. While the *Associated Press* precedent applies to all forms of the mass media, the case for positive government intervention in the broadcasting field is even stronger since the scarce licenses are given out under the obligation to perform according to the "public interest, convenience, and necessity."

8.7.2. Broadcasting and the First Amendment

In the broadcasting area, the First Amendment has entered into the Commission's deliberations in two significant areas: The first area deals with the regulation of ownership. The F.C.C. has followed a policy of maximizing the number of outlets held in separate hands

so as to both maximize the sources of news and the competition for advertising. This policy is based on the idea that the public interest standard requires the limitation on private accumulation of power in broadcasting and that by setting the proper structure, the public would be rewarded by a diversity of ideas.

After initially setting a maximum of three television stations for any one owner, the limitation was raised to five in 1944 and finally set at seven in 1955. Of the seven stations under common ownership, not more than five can be in the VHF band.[43] Similar maximums (seven each) were set for AM and FM radio stations in 1953. Embedded in the multiple ownership report of 1953 is the rationale behind such limitations.

> The fundamental purpose of this facet of the multiple ownership rule is to promote diversification of ownership in order to maximize diversification of program and service viewpoints as well as to prevent any undue concentration of economic power contrary to the public interest.[44]

The second interpretation of the public interest criterion involves the recognition that certain barriers exist to structural diversity and only through indirect interference with content can the proper marketplace of ideas and thoughts be maintained. From this rationale has emerged the controversial "fairness doctrine" whereby broadcasters are required to present both sides of controversial issues--allowing the listener to ferret out the truth in the marketplace of ideas. According to the Commission:

> *It is the right of the public to be informed* rather than any right on the part of the government, any licensee, or any individual member of the public to broadcast his own particular views on any matter which is the foundation stone of our American system of broadcasting.[45] [italics mine]

In sum, the Commission has taken a very activist approach in trying to preserve and create a marketplace of ideas which was the intended logic behind the passage of the First Amendment. The shield of the First Amendment has been turned into a sword justifying direct government involvement in both the structure and performance of the broadcasting industry.

8.7.3. Vertical Integration and the First Amendment

Utilizing such anticompetitive practices as "option time" and "must buy" while at the same time owning and operating television stations in the most populated and lucrative markets, the networks have created a position of power whereby they virtually control television programming during the most crucial prime-time viewing hours. While the affiliated stations are free to reject any network program, the risk of disaffiliation always hangs over the air and causes stations to temper any such radical actions. The three networks thus have control over the formative public opinion process in our country; they can determine to a great extent what ideas flow through the marketplace of ideas and thoughts. This fact was brought to light during the television hearings of the 1950's and 1960's and finally resulted in the Prime-Time Access Rules, which sought to break up the network strangle hold in the marketplace of ideas by limiting their access to three out of the four prime-time hours. The situation has changed very little since enactment of these rules--the networks seem as potent a force as ever in the television medium.

An essential point of this dissertation is that, given the triopolistic structure and dominance in this industry, vertical integration across all three stages of production denies the public the chance to see and hear a diversity of viewpoints from a variety of sources. Most of the fare the public sees is funneled across the desks of the three network programming directors. *Under such a centralized and concentrated system, all program sources should have an equal opportunity to compete for access to the marketplace of ideas.* Those ideas which are the best should win out according to the Holmesian conception of how such a market should operate. But when the networks are put in the position of having to decide on products in which they have a creative or financial interest, the temptation is to sacrifice quality, and the public inevitably suffers. Also, when the entire programming chain is confined to a single organization, it tends to coalesce viewpoints and stultify new ideas. As Nicholas Johnson points out in regard to the very similar problem of conglomerate ownership of the media:

> The most substantial threat comes from a far more subtle, almost unconscious process; that the questionable story idea or news coverage would never even be proposed, whether for reasons of fear, insecurity, cynicism, realism or unconscious avoidance.[46]

In short, word eventually filters down through an organization as to what ideas or programs are acceptable to the high command. The word may be spread directly through memos or more likely through indirect actions signifying approval of one's work such as praise or lack of it, promotions, transfers, etc. The end result is a lack of creativity, a tendency to imitate what has worked in the past rather than experimenting with new ideas.

In sum, vertical integration in the field of broadcasting represents a special harm for it may limit the vitality of the marketplace of ideas. While normally the product of one's upstream producers is indistinguishable and interchangeable, and thus self-preference is irrelevant, in television broadcasting it has special importance. *The decision to prefer one's own product is a decision to exclude other ideas and thoughts from the marketplace of ideas and to artificially influence the outcome of such competition.* If there were a multitude of television networks, the problem of vertical integration would be inconsequential since the size of the foreclosure would be very small and consumers would have the choice of a multitude of viewpoints. But when there are only three networks which have demonstrated in the past and present both the power and intent to dominate prime-time television viewing, then what is true in the large no longer holds in the small; the differences in degree become so great as to amount to differences in kind.

8.8. Conclusions

Therefore, this chapter has shown that vertical integration by the networks into the programming sphere has created the power of self-preference. Such creation of power, whether exercised or not, is contrary to the public interest because it provides the opportunity to tamper with the open marketplace of ideas and to significantly influence public opinion. The American people have a right to expect that such an institution as broadcasting, which is clothed with a public interest, remains free from even the power

or appearance of such manipulation. The fact that the evidence points to the networks' use of this power merely strengthens the argument and makes the cure much more urgent. Consequently, the wisest policy to follow to provide a greater system of checks and balances is to put into separate hands the production and distribution of television programs. This divorcement prescription would then place broadcasting within the same structural limitations as have been applied to other segments of the entertainment industry (see Appendix B).

FOOTNOTES FOR CHAPTER VIII

1. The pilot costs of its in-house production are lost since the pilot has no value if it is not shown on this network. This is further explained in Chapter VI.

2. Federal Communications Commission, *Pay Cable Hearings*, 1973, pp. 365-367.

3. Evidence exists that one network was willing to accept a rating on one of its movie nights 25 percent less than on its other night. Confidential source.

4. This is not the typical case in prime-time television. If one network overwhelmingly kills the other two on a single night, this could enable it to win the ratings for the entire week. Hence networks usually fight fire with fire and counterprogram their best against the best of the other networks.

5. William J. Baumol, *Business Behavior, Value, and Growth* (New York: The Macmillan Company, 1959), Chapters 6-8.

6. O. E. Williamson, "A Model of Rational Managerial Behavior," in Richard M. Cyert and James G. March, *A Behavioral Theory of the Firm* (Englewood Cliffs, New Jersey: Prentice-Hall, 1963), Chapter 9.

7. *Variety*, June 27, 1973, p. 39.

8. Les Brown, *Television: The Business Behind the Box*, p. 72.

9. *Ibid.*, p. 278. Also see *New York Times*, June 13, 1976, Section D, p. 29.

10. This very charge is made by the movie companies in bewailing the network imposed deficit financing policy.

11. Government Brief, *U.S. v. CBS, ABC, and NBC*, p. 54.

12. John J. McCall, "The Simple Mathematics of Information, Job Search, and Prejudice," in Anthony H. Pascal, *Racial Discrimination in Economic Life* (Lexington, Massachusetts: D. C. Heath and Company, 1972), p. 211.

13. In explaining the theory of economic discrimination, Arrow notes:

> "The excessive generality of utility hypotheses about economic behavior is then a drawback *but one that seems intrinsic in the nature of the case*....We offer no explanation of racial discrimination but simply refer the problem to an unanalyzed realm....Yet in a sense all scientific explanation involves the same process of musical chairs; all we ask is that the explanatory principles have some degree of generality and parsimony." [italics mine]

See Kenneth Arrow, "Models of Job Discrimination," in Anthony H. Pascal, *Racial Discrimination in Economic Life* (Lexington, Massachusetts, 1972), p. 89.

14. For further examples of self-preference, see Appendix B.

15. Federal Communications Commission, "Prime-Time Access Report and Order," Docket no. 12782, *Federal Communications Commission Reports,* 2nd, volume 23, pp. 385, 7, 9.

16. *Ibid.*, p. 389.

17. This trend becomes even more significant when it is realized that since 1971 the number of network hours has decreased. Hence the 15-1/2 hours/week in the second season of 1975 represents nearly 25 percent of the network prime-time hours.

18. *The Hollywood Reporter,* November 20, 1967, p. 1. Also see *Variety*, October 25, 1972, p. 1.

19. Confidential source.

20. Confidential source. *The Hollywood Reporter* notes that in late 1965, CBS engaged in exploratory negotiations with major movie companies concerning co-production of theatrical motion pictures. The network would advance 50 percent of the production cost toward first television exposure after theaters. The maximum production cost would be $1.5 million. See *The Hollywood Reporter,* November 30, 1965, p. 1; December 22, 1965, p. 1.

21. Confidential source.

22. Confidential source.

23. Confidential source.

24. Government Brief, *U.S. v. CBS, ABC, and NBC,* pp. 185-186.

25. *Ibid.*

26. *Ibid.*

27. *Ibid.*, p. 187.

28. Confidential source.

29. Confidential source.

30. Confidential source.

31. Confidential source.

32. Confidential source.

33. See for example, *Broadcasting Magazine*, October 3, 1966, p. 25; *Wall Street Journal*, July 9, 1975, p. 13; August 1, 1969, p. 8; *The Hollywood Reporter*, January 25, 1973, p. 1; July 23, 1969, p. 1.

34. *The Hollywood Reporter*, November 22, 1967, p. 1.

35. Confidential source.

36. *U.S. v. Loewe's, Inc.*, 371 U.S. 38 (1962).

37. Leonard Maltin, *TV Movies, 1975 Edition* (New York: New American Library, Inc., 1974).

38. These conclusions are consonant with the network's own evaluation of the packages. It figured an average share of 30.9 for its own package while two comparable packages averaged 32 and 33, respectively. Confidential source.

39. Assuming that each contract in column 8 is evaluated at the midpoint of its range, the 95 percent confidence interval for the mean of the outside deals is .234-.306. Since the mean of the in-house deals (.429) lies outside this interval, the hypothesis of no significant difference between the two groups must be rejected.

40. Confidential source.

41. *U.S. v. Associated Press* (52 F. Supp. 362, 372 [1943]).

42. *Associated Press v. U.S.* (326 U.S. 1, 28 [1945]), Frankfurter concurring.

43. 18 F.C.C. 288, 291 (1953).

44. *Ibid.*, p. 291-292.

45. "In the Matter of Editorializing by Broadcast Licensees," 13 F.C.C. 1246, 1247 (1949). In 1967, the "fairness doctrine" reached the U.S. Supreme Court in the highly publicized *Red Lion Case* (395 U.S. 367 [1969]). In a unanimous opinion, the Court upheld the jurisdictional power of the Commission under the public

interest licensing standard and went on to say that the inherent scarcity in the broadcast medium made it "idle to posit an unabridgible First Amendment right to broadcast comparable to the right of every individual to speak, write, or publish" (Id. at 388). With respect to the "fairness doctrine", the Court said:

> "There is nothing in the First Amendment which prevents the Government from requiring a licensee to share his frequency with others and to conduct himself as a proxy or fiduciary with obligations to present those views and voices which are representative of his communities and which would otherwise by necessity be banned from the airwaves." (Id. at 389)

46. Nicholas Johnson, "The Media Barons and the Public Interest," *The Atlantic Monthly*, June 1968, p. 46.

CHAPTER IX

SUMMARY AND CONCLUSIONS

This dissertation examines the effect that network vertical integration into the production, station ownership, and affiliation spheres has on various criteria of programming performance as well as on diversity in the marketplace of ideas. The major conclusion is that such integration was in the past and continues to be an important cog in the engine of power and control that has been amassed by the three networks. In the introduction, four general questions concerning different aspects of vertical power are posed. These questions are then put within the framework of the two major schools of thought on vertical integration in Chapter II and testable hypotheses are formulated. This chapter summarizes the evidence presented earlier and also provides a brief glimpse into the future structure of broadcasting and the effect on diversity of changing the basic technological paradigm of scarcity.

The first major area of concern is the affiliation agreement which is really vertical integration by contract. While the networks no longer have options over local stations' time, the affiliation agreement is so valuable that the affiliates, fearing disaffiliation, clear in excess of 90 percent of their respective network's programs. In reality, then, the affiliation agreement is an all or nothing contract whose net effect has been to create a very profitable

group of stations (the VHF affiliates) and a group of independent UHF stations which are relegated to the fringes of the market and as a group suffer net losses. In Chapter IV, it is shown how independent stations, whether VHF or UHF, can more easily compete during the non-network hours when the advantage of affiliation is reduced. A plan has been suggested to eliminate affiliation ties and substitute a program by program bidding process. This would enable the independent stations to compete on a more equal footing with the present affiliates and a more equal distribution of wealth would then stimulate the entry of full-fledged or partial networks. Such entry will of course increase the menu of program choices available to the American viewing public.

The second major area of concern involves integration into the ownership of television stations. The evidence presented in Chapter V demonstrates that inevitable conflicts of interest arise whenever an entity wears both a network and station owner's hat, and the public interest becomes subservient to the welfare of the vertical network organization. This means that the network owned stations will surrender their fiduciary responsibility and clear virtually 100 percent of their parent network's programs. Such a surrendering of licensee responsibility was formerly condemned in the option-time rulings. As Chapter IV notes, even the modest 2-1/2 hour option policy was rejected by the Commission as being contrary to general antitrust policy and to the public interest standard. Licensees could then accept or reject network programs according to merit without having to prove that substitute programs better served the local interest.

The network owned stations as a group also have been shown in Chapter V to possess significant buying power in the syndication industry. This power gives them a special type of leverage which they have used whenever the need has arisen. For example, this buying power can be used to reinforce an exclusionary decision at the network level (e.g., "Mary Hartman, Mary Hartman") or as a method of hampering the entry of new networking organizations (e.g., "Space 1999"). In short, the station level may be used to protect the networking operation. Also, the affiliation agreement between the network and its owned stations is forever sheltered from the forces of competition, and this may lead to stagnation in the management of these stations as well as the other stations in the market excluded in this fashion. Lastly, it becomes apparent that a new firm seeking full-fledged entry into networking must come in at both the station and network level in order to guarantee automatic clearances of programs and to escape the possible implementation of a single or a double squeeze.

Because of all of these actual and potential competitive abuses, it seems reasonable to measure the effect of a divestiture order of the owned and operated stations from the parent networks. The results of multiple regression analysis in Chapter V suggest that network owned stations do not perform significantly different from similarly situated stations in seven categories of programming performance while performing significantly worse in four other categories. Since there are no real efficiency gains inherent in such vertical integration (see Chapter II), a divestiture policy will correct the above conflicts of interest and imbalance of power

while not causing any loss in the programming performance categories important to the Commission.

Finally, a subtheme of this dissertation is that consumers have been deprived of a more varied menu of programs because of conflicting F.C.C. allocation decisions and goals. Specifically, the Commission, desiring a diversity of voices, neglected the economic imperative of networking and allocated the spectrum to achieve the opposite result. The opportunity for modifying these allocations has come on numerous occasions, but the Commission has taken the usual regulatory policy of protecting its friends and hence the status quo. If this lack of network outlets and diversity is not bad enough, the problem becomes compounded when one realizes that the advertising influence on commercial television gives the networks an economic incentive to imitate each other and to appeal to the mass of viewers rather than to specialized tastes. The situation becomes exponentially worse when these three network sources are not open and free but rather influenced by self-preference--the power conferred by their vertical integration into programming.

Chapters VI, VII and VIII show the effect on diversity of ideas of the networks' entrance into the production sphere. The hypothesis is presented in Chapter VI that the networks wished to solidify their buying cartel in the areas of theatrical and made-for-television movies--these areas were the only ones where inter-firm rivalry was bidding up input prices. The evidence shows that, contrary to the Spengler theory of vertical integration, there is no increase in output and decrease in prices arising from such

integration. Rather, the monopsony power of the networks increases thereby increasing their share of profits. With respect to "quality," Chapter VII demonstrates that there is neither vertical nor horizontal diversity in the networks' schedules and the trends toward imitation of program types and increased reruns of regular programming have both increased during the time period in question. Hence, when the networks integrated into programming in order to solidify their buying league and depress prices, the cost savings were not passed along to the consumers in the form of lower prices, increased "quality" or increased output; rather, the dividend accrued to the networks in the form of increased rent.

Chapter VIII presents evidence supporting the hypothesis that the networks may have either a long term profit incentive or a utility function which causes the networks to prefer their own product over similarly priced fare from outside producers. Evidence from confidential sources shows that one network conceived of a game plan by which it would prefer its own theatrical movies on the network as well as its owned and operated stations. Using a discrimination model and data on various theatrical movie packages, the evidence demonstrates that the networks indeed paid a higher price per unit of quality for their own movies than for those of outside producers. This is the essence of self-preference and results in a significant foreclosure of product from outside sources.

Finally, the last section of Chapter VIII demonstrates that vertical integration into programming creates the power for self-preference, and if this power is used, it may significantly affect

the ideas flowing through the marketplace of discourse. With such few choices available because of the Commission's allocation policies, the further constriction of this narrow market caused by vertical integration into programming need not be tolerated and is easily remediable through divorcement of networks from this sphere. A free and open marketplace of ideas is essential to the perpetuation of democracy and especially in such a crucial public information system as television.

In summary, this dissertation looks at the questions of vertical integration, diversity, and the First Amendment within the framework of over-the-air technology. Within this technology of scarcity, there seems to be little hope for anything except a marginal improvement in diversity arising from a vertical divorcement-divestiture policy. This pessimism stems from the limited spectrum and the F.C.C.'s allocation decisions which jointly act as barriers to the emergence of new networks. However, once one lets down the blinders and observes some of the new broadcast technologies and developments such as cable, pay television, public television, and satellites, the opportunities for a more expanded and diverse menu of programs looks very bright. Unfortunately, the introduction of these alternatives has been blockaded by the regulatory tendency to protect the station owners and a general paranoia toward making radical departures from the present system.

Cable, the medium of abundance, possesses none of the classic economic reasons for being regulated; yet, this infant industry has been saddled with extremely rigid rules which could not help but deter entry.[1] The fact that carrying such a heavy burden on its

back, it has nevertheless achieved a subscription rate of 11.5 percent of all television homes suggests that it is clearly desired by the viewing public and profitable to the owner.[2] Pay television, which has sought to cater to the unfulfilled demand of minority viewers for specialized programs, has received even less favorable press than cable and must also suffer from the restrictions placed on cable since the two systems must be joined for pay television to be economically viable. Both cable and pay cable television have been labeled alternately as either "the devil incarnate" or even more flamboyantly as "a piranha tearing at the flesh of broadcasting."[3]

Public television, which was created to fill the "quality" programming void of the commercial networks, has struggled with financing and organizational problems since its inception a decade ago. Its programming has been of rather low quality, and it has received very small public acceptance.[4] The new satellite technology offers the distant hope of reducing interconnection charges present in the current terrestrial system and attracting new regional networks and/or broadcasting directly to viewers' television sets. This technology has been present since 1965, yet has been totally neglected by the Commission.

Therefore, new networks and more diversity will appear only if the backward looking policies of the F.C.C. and its licensees are replaced by innovative technologies and creative solutions. Some economic entities will be hurt in the process, but nothing was ever promised them in terms of protection forever from competition. Some of the reactionary armor is gradually being cracked by the sheer force of economic logic, and the future suggests a

broadcasting system more diverse and less regulated, in which the marketplace of ideas can be expanded from the present limitations. In the interim, a vertical divorcement-divestiture policy seems like a wise step.

FOOTNOTES FOR CHAPTER IX

1. These restrictions have included bans on distant signal importation in the top 100 markets, requirements to provide free access channels for public, educational interests, and the local government, and requirements to provide new programming. For more detail, see D. Bruce Pearson, "Cable: The Thread by Which Television Competition Hangs," *Rutgers Law Journal*, volume 27 (Summer 1974), pp. 808-812.

2. For more detail on the profitability of various size cable systems, see Roger G. Noll, Merton J. Peck, and John J. McGowan, *Economic Aspects of Television Regulation* (Washington, D.C.: The Brookings Institution, 1973), pp. 158-159.

3. Donald I. Baker testimony in U.S. Senate Subcommittee on Antitrust and Monopoly, *Hearings on Pay Cable Television Industry*, Ninety-fourth Congress, 1st Session, May 1975, p. 232.

4. See the evidence presented in Table 4.3 on the ratings of public television. Also see Bruce Owen, Jack Beebe, and Willard Manning, *Television Economics* (Lexington, Massachusetts: D. C. Heath and Company, 1975), p. 157. Owen *et al.* note that the hourly cost of public television is in the neighborhood of about $50,000 an hour while for commercial networking, it now exceeds $200,000 an hour.

APPENDICES

APPENDIX A

A MODEL OF NETWORKING

It is possible to describe a simplified model of a television network which is trying to maximize short-run profits. A network's profits (Π) will equal the total revenues it collects from its brokerage sale of all its affiliate's time plus the sale of all local and national spot time on its owned and operated stations minus the share of time sales which it remits to all its affiliates (except its owned and operated stations (K=1...5) where this is simply a bookkeeping entry) minus the costs of programming to the networks minus the costs of programming to the owned and operated stations minus the fixed costs of networking. This profit function can be represented mathematically by the following equation:

$$\text{A.1} \quad \Pi = \sum_{n=1}^{N} \rho_n R_n Q_n + \sum_{j=1}^{5} \sum_{\ell=1}^{L} \beta_{j\ell} R_{j\ell} Q_{j\ell} - \alpha \sum_{k=6}^{K} \sum_{n=1}^{N} \beta_k^2 C_{kn}$$

$$- \sum_{m=1}^{M} \sum_{n=1}^{N} \beta_{mn}^3 X_{mn} - \sum_{j=1}^{5} \sum_{m=1}^{M} \sum_{\ell=1}^{L} \beta_{jm}^4 Z_{jm\ell} - F$$

Definitions: assume each program is standardized at a half an hour.

ρ_n = anticipated price per thousand for each minute sold on the nth program. Assume each minute sold in a program sells for the same price and in part depends on the actual or expected ratings.

R_n = expected national rating (in millions of viewers) for the nth program. Note: the national rating also depends on local ratings and clearance patterns.

Q_n = number of minutes of advertising sold on the nth program.

$\beta_{j\ell}$ = anticipated national spot and local advertising price/1000 for each ℓth local program or adjacency on each jth station owned and operated by a network (O and O's).

$R_{j\ell}$ = expected local rating for the ℓth program on the jth owned and operated station.

$Q_{j\ell}$ = number of minutes of advertising sold on the ℓth program for the jth owned and operated station.

α = percentage or share of each affiliate's contribution to the national time sales which is remitted to the affiliates if they carry a network show. Assume this = 30% for all shows carried.

β_k^2 = kth station advertising rate (or its contribution to national time sales). Assume this is constant for each prime-time show regardless of its popularity. K is the number of affiliated stations, the first 5 of which are network owned.

C_{kn} = whether the nth show is cleared by the kth station. This variable depends on the ratings of the program.

β_{mn}^3 = price of the mth input used in the nth network program.

X_{mn} = number of units of mth input used in the nth network program.

β_{jm}^4 = price of the mth input used in each local program on the jth owned and operated station.

$Z_{jm\ell}$ = number of units of the mth input used on the ℓth local program for the jth owned and operated station.

F = fixed costs of running a network.

It is also known that the expected national ratings for each program R_n = f (quality of the network show and the quality of the competing shows on the other two networks). It is widely assumed that the quality of a show depends on the amount-quality of inputs purchased for that show (i.e., actors, sets, location, directors, etc.). Hence $R_N = f(\vec{X}, \vec{X}^2_n, \vec{X}^3_n)$ where $\vec{X}$ is a vector of all inputs used in the Nth show. The rating of network one for each time period will depend on its own expenditure for inputs and the expenditure of its two rival networks.

$\beta^{1,2}$ depends on the population of the local market and the number of competing television stations.

$$\frac{\partial \beta^{1,2}}{\partial \text{ population}} > 0 \qquad \frac{\partial \beta^{1,2}}{\partial \text{ number of stations}} < 0$$

To maximize profits, the network must decide on the optimal quantity of inputs to purchase for both its network and owned and operated stations. There are also three constraints on this maximization calculus. The first two are the constraints that the network and station produce a minimum amount of public affairs programs. The third constraint is that the number of minutes of advertising not exceed three per half hour. Constraints:

(1) $X_{mn} \geq \gamma_{mn}$ for $m=1,....M^1$, $n=1,....N^1$ where the first N^1 network programs must be public affairs using at least a minimum amount of the first M^1 inputs (obviously $M^1 < M$; $N^1 < N$)

(2) $Z_{jm\ell} \geq \delta_{jm\ell}$ for j=1,...5, m=1,...M^1, ℓ=1,...L^1 where the first L^1 programs of network owned stations must be public affairs using at least a minimum of the first M^1 inputs.

(3) $Q_{n\leq\varepsilon}$; $Q_{j1\leq\omega}$ Assume ε,ω=3.

The Lagrangean equation will then look like this:

$$\text{A.2}\quad L = \Pi + \sum_{m=1}^{M^1}\sum_{n=1}^{N^1} \lambda_{mn}\,(X_{mn} - \gamma_{mn}) + \mu_n\,(\varepsilon_n - Q_n) + \phi_{j1}(\omega_{j1} - Q_{j1})$$

$$+ \sum_{j=1}^{5}\sum_{m=1}^{M^1}\sum_{\ell=1}^{L^1} (Z_{jm\ell} - \delta_{jm\ell})\,\Psi_{jm}$$

The First Order conditions for profit maximization will be:

$$\text{A.3}\quad \frac{\partial L}{\partial X_{mn}} = \left[\frac{\partial \rho n}{\partial R_n} R_n\, Q_n + \rho_n\, Q_n + \rho_N\, R_N \frac{\partial Q_N}{\partial R_N}\right.$$

$$\left. - \alpha \sum_{k=6}^{K} \beta_k^2 \frac{\partial C_{kn}}{\partial R_n}\right] \cdot \left[\frac{\partial R_n}{\partial X_{mn}} + \sum_{i=1}^{M}\left(\frac{\partial R_n}{\partial X_{in}^2}\right.\right.$$

$$\left.\left.\frac{dX_{in}^2}{dX_{mn}} + \frac{\partial R_n}{\partial X_{in}^3}\,\frac{dX_{in}^3}{dX_{mn}}\right)\right] - \beta_{mn}^3 - \mu_n \frac{\partial Q_n}{\partial R_n} \cdot \frac{\partial R_n}{\partial X_{mn}}$$

$$+ \lambda_{MN} \leq 0 \quad \text{if } m = 1,\ldots, M^1)$$

$$n = 1,\ldots, N^1)$$

otherwise $\lambda_{MN} = 0$

$$\text{A.4}\quad \frac{\partial L}{\partial Z_{jm\ell}} = \left[\frac{\partial \beta_{j\ell}^1}{\partial R_{j\ell}} R_{j\ell}\, Q_{j\ell} + \beta_{j\ell}^1\, Q_{j\ell} + \beta_{j\ell}^1\, R_{j\ell} \frac{\partial Q_{j\ell}}{\partial R_{j\ell}}\right] \cdot$$

$$\frac{\partial R_{j\ell}}{\partial Z_{jm\ell}} - \beta_{jm}^4 - \phi_{j\ell}\left(\frac{\partial Q_{j\ell}}{\partial R_{j\ell}}\,\frac{\partial R_{j\ell}}{\partial Z_{jm\ell}}\right) + \Psi_{jm\ell} \leq 0 \quad \text{if } m = 1\ldots, M^1$$

$$\ell = 1\ldots, L^1$$

otherwise $\Psi_{jm\ell} = 0$

Explanation for A.3: Bracket #1: The first three terms are the effect of a change in ratings of the nth program on revenues; the fourth term is the effect of a change in ratings on remittances to the affiliates. Bracket #2: The first term is the direct effect on the ratings of a network of a change in the quantity of program inputs purchased for the nth show (the marginal product). The second and third terms are the conjectural variations concerning the reaction of a network's rivals to a change in expenditure on inputs for the nth show. β^{3}_{mn} = price of the input (m) charged on the Nth program. The final terms are lagrangian multipliers arising out of the Kuhn-Tucker condition that networks carry a certain number of public interest programs using the specialized inputs associated with producing them, and the fact that by custom and agreement the number of ads per hour is fixed.

Explanation for A.4: The three terms in the bracket measure the effect of a change in ratings of the ℓth program on revenues for the jth owned station. The term outside the bracket $(\frac{\partial R_{j\ell}}{\partial Z_{jm\ell}})$ is the direct effect on the ratings of a change in the quantity of program inputs purchased for the ℓth show (the marginal product). β^{4}_{jm} = price of the input m used on all the programs for the jth owned station. The next term is a lagrangian multiplier and measures the effect of a change in inputs on advertiser minutes. The final term is a lagrangian multiplier arising out of the Kuhn-Tucker condition that network owned stations carry a certain number of public interest programs using the specialized inputs associated with producing them.

The conjectural variation term is a key part of analyzing the profit maximizing calculus of a television network. While no attempt will be made here to actually solve the equations, some leading suggestions and theories will be mentioned concerning the nature of this oligopoly game. Crandall claims that long lead time commitments to program producers and advertisers force each network to plan considerably in advance of the season and thus to take its rival's choices as given in attempting to maximize its profits. In this Cournot model, the conjectural variation terms are equal to zero since each network expects no reaction from its rivals to a change in the quality of its programs.[1] Widespread evidence exists that a Cournot assumption is not useful in this context. Networks frequently change their lineups during the season, switching programs from one time to another, bringing on famous guest stars, or scheduling special programs against those of other networks. Each network is cognizant of what its rivals are doing and will respond in kind to the threat of a loss in ratings.

Another suggestion is made by Les Brown when he mentions the strategy of CBS in the annual ratings war. It seems that CBS will spend as much money as is necessary to win the total ratings war and establish itself as the most popular network on television. He cites a certain year when CBS fell behind and had to stage a blitzkrieg of such magnitude that the other networks were just overwhelmed.[2] For such a market sharing model to work and be stable, both NBC and ABC would have to concede a certain plurality share of the market to CBS and either split up the remaining pie or fight it out, always making sure that neither one exceeded the CBS share.

Such a cartel would inevitably break down due to the difficulty of predicting a priori which programs the public would like and then placing these shows in the right time periods so that the established pattern would emerge. Furthermore, neither NBC nor ABC would willingly concede the ratings race to CBS. An alternative explanation would be that under such an unstable model, all three networks would continually increase programming expenditures. However, the evidence on the monopoly profits accruing to the networks belies this explanation.

Owen suggests that the networks collude or cooperate on certain dimensions that are so visible that measurement and detection of cheating are very easy.[3] These dimensions include price, quantity of advertising, and compensation payments to affiliates. However, the concept of program quality is hard to define and impossible to enforce; therefore, the incentive to cheat is so great that the prisoner's dilemma forces all networks to seek high levels of program inputs.

> In replacing cancelled series and altering continued ones, the incentives are to increase input levels either in the hope of getting an edge on his rivals or in the expectation that they will try to do so. Each will try to increase its quality, the minimum amount necessary to keep or even get slightly ahead.[4]

According to Owen, the networks will seek mechanisms to limit the adverse effect on profits of these incentives. These mechanisms include tacit agreements on the number of new episodes produced for each series, the timing of the season, and of the prime-time period. While Owen is essentially correct in these areas, a case can be made for including tacit collusion on the length of terms of the contracts

with program producers, the prices paid for theatrical movies, and other mutual drains on profits. With all of these possible variables on which to collude or compete, the mathematical solution to the above equations can indeed become quite complex.

FOOTNOTES FOR APPENDIX A

1. Robert Crandall, "F.C.C. Regulation, Monopsony, and Network Television Costs," *The Bell Journal of Economics and Management Science,* volume 3 (Autumn 1972), pp. 493-494.

2. Les Brown, *Television: The Business Behind the Box* (New York: Harcourt-Brace-Jovanovich, 1971).

3. Bruce Owen *et al., Television Economics* (Lexington, Massachusetts: D. C. Heath, 1974), pp. 108-111.

4. *Ibid.,* p. 107.

APPENDIX B

OTHER EXAMPLES OF SELF-pREFERENCE

B.1. Introduction

Since a different theory of vertical integration is proposed in Chapter VIII, one wonders about the general applicability of this idea of self-preference. Two cases immediately come to mind--*U.S. v. Broadcast Music Inc.* and *U.S. v. Paramount Pictures*--both in the entertainment industry and both showing strikingly similar resemblance to the structure of the television broadcast networks. Each case dealt with a vertical integration policy coincident with a policy of favoring their own product at the expense of others.

B.2. Broadcast Music Case

In 1939, Broadcast Music Inc. (BMI) was formed by over 250 television and radio station owners to counteract the monopoly practices of the American Society of Composers, Authors, and Publishers (ASCAP). Both of these organizations act as intermediaries and collection agents between the composer or writer of musical material and the ultimate user--the radio or television station, nightclub, theater, record company, or dancehall. BMI was solely owned by broadcasters with the three television and radio networks owning 25.6 percent and their affiliates owning 65 percent.[1] The television and radio stations which utilized BMI

music received a proportionate rebate after BMI collected enough money to cover its operational costs and a healthy reserve. Such discounts were not available to other users of copyrighted music.

The Celler Committee Report alleges that broadcasters in general have preferred BMI songs over those of ASCAP. It cites quotes from BMI officials as well as various pamphlets which urge the owner stations to prefer BMI songs. For example, in a pamphlet entitled, "Your Stake in BMI," the president of BMI said:

> We have set up a new quota for performances. Last year's figures show that we averaged some 8,000 performances per station....We are going to drive for an average of 12,000 performances per station by 1953. We can meet our new quota if we can get an increase of only 800 performances each year per station. Eight hundred additional performances per year means only about two additional performances per day per station. I know we can do this.[2]

Similar statements were made by a station owner:

> I hold no special brief for BMI except that we ourselves own it and we're not getting full value for the dollar. It seems to me the answer is simple. For the next 3 months, let each station start programming 70% ASCAP and 30% BMI in the popular field. For the following 6 months, change the percentage to 60-40. After that 50-50. By this means, the acceptance of the song hits America sings will veer over from ASCAP to BMI more equitably....*Don't forget one important angle. People can't like a song if they don't hear it. They won't be able to know all ASCAP songs because we won't be playing them. They will get to know, like, ask for and buy BMI songs.*[3] [italics mine]

The net result of this publicity campaign was a phenomenal increase in the use of BMI music between 1948 and 1953. In 1948, only one BMI song was on the Honor Roll of Hits as compared to 519 ASCAP songs. However, by the end of 1952, there were 291 BMI songs on the list and only 233 ASCAP.[4] Evidence is also presented that Columbia Records and RCA Victor Records, two of the largest record

companies and subsidiaries of CBS and NBC, respectively, preferred BMI music to ASCAP on some of their lines. It is also alleged that BMI made financial advances to disk jockeys who were of course in a position to give circulation to BMI songs.

One columnist said in the BMI music memo known as "Platter Chatter":

> I think it is very important that all BMI affiliates know about the swell top tunes you own. *Having financial interest in these tunes, it seems only sensible to me that we should do everything in our power to promote their success and get back of any new songs cleared through BMI.*[5] [italics mine]

Due to limitations of data and budget, the Celler Committee was unable to conclusively prove that self-preference was occurring in the use of BMI hit songs but nonetheless requested that the Justice Department take a closer look into this area to see if any antitrust violations occurred. It should be noted that both BMI and ASCAP were under 1941 consent decrees to modify their anti-competitive practices. While the ASCAP decree applied more toward equitable distribution of royalties for merit rather than as stock-holders and prevented exclusion of new composers from membership, the BMI decree prohibited them from charging discriminatory prices to non-broadcast users of its music. The charges that BMI forced its affiliated stations to meet certain quotas for BMI songs remained unresolved.

In December 1964, the Justice Department brought an antitrust suit against BMI charging them with attempting to monopolize both the acquisition of music performance rights from composers, publishers, and authors and the granting of licenses to broadcasters for

performing the music. A principal component of the suit was the self-preference issue. The suit asked for divestiture of the 517 broadcasters owning stock in BMI.[6] On November 29, 1966, the Justice Department agreed to a consent settlement which prohibited certain anticompetitive practices. Specifically, BMI may not have contracts which force other parties to record or perform any stated amount or percentage of music to which BMI has the license rights. Secondly, BMI was prohibited from publishing or recording music and distributing sheet music and recordings. Finally, the length of contracts between BMI and writer or publishers was limited to five years.[7]

The parallel to the network situation is obvious since the television networks like BMI act as intermediaries between the suppliers of television programs and the exhibitors of such fare. As intermediaries, these types of organizations should not be in the awkward position of having to act impartially with respect to programs in which they have a financial interest because the temptation to prefer and promote their own product is too great. Similarly, when the downstream stations are owned and operated by the networks, the natural tendency is to help the upstream subsidiary as much as possible. This explains why the Justice Department required BMI to divorce itself from promoting its own compositions; however, the divestiture of broadcasters from ownership of BMI was simply not politically feasible.

B.3. The Paramount Case

The second case (*U.S. v. Paramount Pictures et al.*, 334 U.S. 131 [1948]) involved the major movie companies and their plan to achieve monopoly control across production, distribution, and exhibition of movies. At the time of prosecution the seven defendants engaging in production made about 60 percent of all domestic feature films while the eight distributor defendants distributed 75 percent of all domestic features. The five fully integrated majors, the real focus of the case, produced about 45 percent of the domestic features and controlled about 17 percent of the domestic theaters which were in general in non-competiting circuits throughout the country. These theaters were the largest downtown and neighborhood theaters and allowed the majors collectively to control theater ownership in those cities of greater than 100,000 people.[8] These strategically situated theaters enabled the five integrated majors to collectively dominate the entire motion picture industry since they possessed the crucial bottleneck through which all must pass. This bottleneck gave them significant power over independent producers and distributors who needed their circuits in order to make profits. Banks even required a contract for release through one of the eight film distributor defendants before a loan for production would be made.[9]

The five fully integrated majors and the other defendants used their collective power at all stages of production to set up a system of discriminatory prices which classified theaters according to zones, runs, and clearance patterns and presumably maximized their collective profits.

> Since each integrated major was both the supplier and customer of the other four, each knew that attempts to circumvent the established local marketing patterns in the neighborhood of other major circuits would result in retaliation in their own circuit area.[10]

They needed each other. The five major integrated companies acting as distributors needed the large exhibition circuits of their rivals in order to obtain widespread circulation for their pictures. Similarly, when they wore their exhibition hats, they needed the quality pictures of their rivals in order to present a high quality and varied product to the public. *What emerged was then a reciprocal agreement whereby each exhibitor gave preferred access and screen time not only to his own pictures but also to those of his major competitors*. Therefore, while the defendants as exhibitors operated only 17 percent of all the theaters, they were somehow able to pay out 45 percent of all the rentals in the business.

The most important concern here is the fact that the majors followed a self-preference practice in which their own movies were of major importance while their rivals were of next highest priority and independents of secondary importance. As Conant notes,

> Since the production costs [of their own pictures] were irrevocably invested in a picture, *profits often could be maximized by giving preferred and extended screen time although pictures of another distributor might earn much higher gross revenues*.[11]

Thus the exhibitors recognized that company-wide and long-term profit considerations overshadowed short-term myopic decisions, and they followed the game plan. The Courts finally broke up this aggregation of economic power through a structural divestiture order which forced separation of exhibition facilities and production-distribution operations.

It should be recognized that the movie industry is structurally similar to the television broadcast industry. Production of copyrighted material occurs in both, distribution of movies is equivalent to the networking and syndication businesses, and exhibition occurs on the local television stations. While the major movie companies needed to resort to collusive conspiratorial agreements, these same types of negotiations are openly conducted in the broadcast industry through formal affiliation agreements. The affiliation agreements (which formerly were coupled with stringent option clauses) enable the three networks to clear well over 90 percent of their programs. What was hidden and inherently unstable in the movie industry is open and stable in this industry. Hence, the question which should be asked is, whether in the light of the Paramount experience, is an even stronger and more powerful vertical arrangement to be tolerated?

FOOTNOTES FOR APPENDIX B

1. *Celler Report*, p. 117.

2. *Ibid.*, p. 120.

3. *Ibid.*, p. 121.

4. *Ibid.*, p. 120.

5. *Ibid.*, p. 131.

6. *The Wall Street Journal*, November 30, 1966, p. 8. Also Bryce W. Rucker, *The First Freedom* (Carbondale, Illinois: Southern Illinois University Press, 1968), pp. 109-110.

7. *Ibid.*

8. Michael Conant, *Antitrust in the Motion Picture Industry* (Berkeley: University of California Press, 1960), pp. 82-83.

9. *Ibid.*

10. *Ibid.*

11. *Ibid.*

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