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FCC REGULATION OF THE TELECOMMUNICATIONS PRESS†

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OUTLINE

* Chief Judge, United States Court of Appeals for the District of Columbia. As will be clear from a reading of this paper, many of the points discussed herein are implicated in pending appeals in my court. I have avoided any discussion of points which might be necessary to decision of these pending cases except to the extent my discussion repeats that already published in my opinions in this area. I note that many of my previously published views repeated herein are not contained in majority opinions. I gratefully acknowledge the aid of my law clerk, Peter Hoffman, A.B. 1971, Drew University; J.D. 1974, Yale University, in the preparation of this Article.

[Ed. Note: This Article is substantially derived from Chief Judge Bazelon's *Brainerd Currie Lecture*, delivered at the Duke Law School, April 5, 1975.]

> The main, main thing is The Post is going to have damnable, damnable problems out of this one. They have a television station. . . . And they're going to have to get it renewed.
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> Taped Statement of Richard Nixon to H.R. Haldeman and John Dean, Sept. 15, 1972.[1]

This statement is indicative, albeit an unusual example, of the First Amendment problems raised by a comprehensive system for the licensing of speakers. Individuals who must obtain permission to engage in activity protected by the First Amendment are vulnerable to the various sub silentio pressures that prior approval permits and which Richard Nixon threatens in the statement quoted above.[2] They may,

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THE FOLLOWING CITATIONS WILL BE USED IN THIS ARTICLE:

E. BARNOUW, A HISTORY OF BROADCASTING IN THE UNITED STATES (1968) [hereinafter cited as E. BARNOUW];

R. NOLL, M. PECK & J. MCGOWAN, ECONOMIC ASPECTS OF TELEVISION REGULATION (1973) [hereinafter cited as R. NOLL];

Multiple Ownership of Standard, FM and Broadcast Stations [Newspaper-Broadcast Cross Ownership], 32 P & F RADIO REG. 2D 954 (1975), *appeal docketed sub nom.* National Citizens Comm. for Broadcasting v. FCC, No. 75-1064 (D.C. Cir., Jan. 28, 1975) [hereinafter cited as Multiple Ownership];

Prime Time Access Rule, 32 P & F RADIO REG. 2D 697, *appeal pending sub nom.* National Ass'n of Independent Television Producers & Distribs. v. FCC, No. 75-4021 (2d Cir. Jan. 30, 1975) [hereinafter cited as Prime Time Access];

The Handling of Public Issues Under the Fairness Doctrine and the Public Interest Standards of the Communications Act, 48 F.C.C.2d 1 (1974), *appeal docketed sub nom.* National Citizens Comm. for Broadcasting v. FCC, No. 74-1700 (D.C. Cir., July 3, 1974) [hereinafter cited as The Fairness Doctrine and Public Interest Standards].

1. *Quoted in* SENATE SELECT COMM. ON PRESIDENTIAL CAMPAIGN ACTIVITIES, FINAL REPORT, S. REP. NO. 981, 93d Cong., 2d Sess. 149 (1974). This threat nearly came true. See note 11 *infra*.

It has recently been disclosed that the litigation culminating in Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969), may also have had a political motivation. *See* Friendly, *What's Fair on the Air*, N.Y. Times, Mar. 30, 1975, § 6 (Magazine), at 11.

2. It would seem idle to suppose that the Court today is unaware of the evils of the censor's basic authority, of the mischief of the system against which so many great men have waged stubborn and often precarious warfare for centuries . . ., of the scheme that impedes all communication by hanging threateningly over creative thought.

Tolstoy once wrote:

"You would not believe how, from the very commencement of my activity, that horrible Censor question has tormented me! I wanted to write what I felt; but all the same time it occurred to me that what I wrote would not be permitted, and involuntarily I had to abandon the work. I abandoned, and went on abandoning, and meanwhile the years passed away." Times Film Corp. v. City of Chicago, 365 U.S. 43, 66 & n.6 (1961) (Warren, C.J., dissenting).

See id. at 73-75; Emerson, *The Doctrine of Prior Restraint*, 20 LAW & CONTEMP. PROB. 648, 658-60 (1955); Lockhart & McClure, *Literature, The Law of Obscenity and the Constitution*, 38 MINN. L. REV. 295, 314-16 (1954). For a rare example of FCC sensitivity to this problem, see Starr WNCN, Inc., 48 F.C.C.2d 1221, *stay denied sub nom.*

therefore, find it easier to tailor their views to the wishes of the licensor rather than risk its displeasure. The manner in which the licensor conveys its wishes or exercises pressure on the speaker under a comprehensive licensing scheme often is disguised in an apparently noncoercive action, which might seem innocuous to others not subject to the licensing scheme. Control of these pressures is thus particularly difficult. The motivation for communicating pressure may involve the rather crass political concerns voiced by Richard Nixon in the statement quoted above. The motivation may range from racial discrimination to a laudable desire to upgrade the quality of the particular speech involved. But under the First Amendment, the licensor's motivation should be irrelevant: the exercise of power over speech leads the government knee-deep into regulation of expression. And that, we have always assumed, is forbidden by the First Amendment. The Supreme Court has so held, time and again.[3]

But traditional assumptions do not apply to the regulation of telecommunications speech. The licensing scheme mandated by the Federal Communications Act[4] permits a wide-ranging and largely uncontrolled administrative discretion in the review of telecommunications programming. That discretion has been used, as we might expect and as traditional First Amendment doctrine presumes, to apply sub silentio pressure against speech in the following instances: to discourage broadcast of song lyrics that allegedly promote the use of drugs,[5] to halt radio talk shows that deal explicitly with sex,[6] to discourage specialized or highly opinionated programming,[7] to force networks to

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WNCN Listeners Guild v. FCC, No. 74-1925 (D.C. Cir., Oct. 25, 1974) (Bazelon, C.J., concurring).

3. *See* Steffel v. Thompson, 415 U.S. 452 (1974); Lewis v. City of New Orleans, 415 U.S. 130 (1974); Gooding v. Wilson, 405 U.S. 518 (1972); Blount v. Rizzi, 400 U.S. 410 (1971); Shuttlesworth v. City of Birmingham, 394 U.S. 147 (1969); United States v. Robel, 389 U.S. 258 (1967); Dombrowski v. Pfister, 380 U.S. 479 (1965); NAACP v. Button, 371 U.S. 415 (1963), and many authorities cited in these cases. *See also* Kalven, *"Uninhibited, Robust, and Wide-Open"—A Note on Free Speech and the Warren Court*, 67 MICH. L. REV. 289, 297-99 (1968).

4. 47 U.S.C. §§301 *et seq.* (1970).

5. *See* Yale Broadcasting Co. v. FCC, 478 F.2d 594, 603 (D.C. Cir.) (separate statement of Bazelon, C.J.), *cert. denied*, 414 U.S. 914 (1973).

6. *See* Illinois Citizens Comm. for Broadcasting v. FCC, No. 73-1562 (D.C. Cir. Mar. 13, 1975) (statement of Bazelon, C.J., as to why he voted to grant rehearing en banc).

7. *See* Lee Roy McCourry, 2 P & F RADIO REG. 2D 895 (1964), *discussed in* Robinson, *The FCC and the First Amendment: Observation on 40 Years of Radio and Television Regulation*, 52 MINN. L. REV. 67, 115, 123-24 (1967). This policy is implicit in the Fairness Doctrine. *See generally* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16 (D.C. Cir. 1972), *cert. denied*, 412 U.S. 922 (1973).

schedule "adult" programming after 9:00 p.m.,[8] and to restrict, through Executive Office pressure, adverse commentary on presidential speeches.[9] The methods of communicating these pressures are by now familiar to FCC practitioners: the prominent speech by a Commissioner, the issuance of a notice of inquiry, an official statement of licensee responsibility couched in general terms but directed against specific programming, setting the licensee down for a hearing on "misrepresentations," forwarding listener complaints with requests for a formal response to the FCC, calling network executives to "meetings" in the office of the Chairman of the FCC or of some other Executive Branch officials, compelled disclosure of future programming on forms with already delineated categories and imposing specific regulatory action on a particularly visible offender against this background.[10] All these actions assume their *in terrorem* effect because of the FCC power to deny renewal of broadcast licenses or to order a hearing on the renewal application.[11] Recently, there have been indications that the threat of antitrust or Internal Revenue Service actions has served to buttress certain "raised eyebrow" suggestions.[12] I do not mean by

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8. Broadcast of Violent, Indecent and Obscene Material, 32 P & F RADIO REG. 2D 1367, 1370-74 (Feb. 19, 1975).

9. *See* Memorandum from Charles W. Colson to H.R. Haldeman, Sept. 25, 1970, reprinted as Appendix A of this Article from SENATE SELECT COMM. FINAL REPORT, *supra* note 1, 281-84; Whiteside, *Annals of Television*, NEW YORKER, Mar. 17, 1975, at 41 *et seq.*; 120 CONG. REC. S17,502-04 (daily ed. Sept. 25, 1974) (remarks of Senator Proxmire); Cohn, *How Liberals Rediscovered Free Speech*, Washington Post, Dec. 22, 1974, § B, at 3, col. 1.

10. See sources cited in notes 5-9 *supra*. *See also* Jack Straw Mem. Foundation, 21 F.C.C.2d 833, *hearing ordered*, 24 F.C.C.2d 266 (1970), *license renewed*, 29 F.C.C.2d 334 (1971); Palmetto Broadcasting Co., 33 F.C.C. 250 (1962), *aff'd sub nom.* Robinson v. FCC, 334 F.2d 534 (D.C. Cir.), *cert. denied*, 379 U.S. 843 (1964). *See generally* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 69-70 & nn.28-30, 77-78 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973); Scalia, *Don't Go Near the Water*, 25 FED. COM. B.J. 111 (1972). The Program Reporting Form is found at Form 303, Section IV-B, Part III, P & F RADIO REG. 98:303-18. For early uses of the "raised eyebrow" techniques, see 2 E. BARNOUW 32-33.

The recent disclosure of a political motivation for the *Red Lion* litigation, see note 1 *supra*, does not suggest any "raised eyebrow" tactics. *Red Lion* involved explicit application of established doctrine.

11. *See* Citizens Communication Center v. FCC, 447 F.2d 1201, 1214 (D.C. Cir. 1971); Kalven, *Broadcasting, Public Policy and the First Amendment*, 10 J. LAW & ECON. 15, 20-23, 46-47 (1967); Robinson, *supra* note 7, at 111-25. President Nixon reportedly used the license renewal process for his political advantage by arranging for challenges to "unfriendly" stations by his political friends. *See* Whiteside, *supra* note 9, at 62; Editorial, *A Bill of Complaint*, Boston Globe, Jan. 21, 1973, § A, at 6, col. 1 (challenges to WJXT, Jacksonville, by head of the finance chairmen of the Florida Nixon Re-election Committee; and to WPLG, Miami, by a partner of Nixon and Rebozo in a real estate deal).

12. *See* SENATE SELECT COMM. FINAL REPORT, *supra* note 1, at 132-43, 145, 267-

recitation of these examples to alert you to a great danger or to engage in any sort of journalistic effort to inform the public. This has been fully accomplished by persons more able than myself. My only concern is with the legal implications of these examples in the context of our traditional constitutional order.

I should perhaps admit that, in at least one incident, appellate judges also have engaged in such "raised eyebrow" tactics. I speak of a speech I gave to the Federal Communications Bar on the Fortieth Anniversary of the FCC.[13] There, as in part I do here, I criticized the performance of the broadcast media and suggested in general terms that the media devote more attention to the public interest, as they themselves know the public interest. It is certainly easy to criticize the broadcast media, and I am sure many readers of this Article have experienced the desire to "chill" the media into adopting one policy or another. I criticize not the seductiveness of this enterprise—because, after all, that is free speech too—but rather the background against which the criticism echoes and which makes the criticism, at least when made by the FCC, much more potent than its persuasiveness would require. I am aware that unless we are willing to do away with the entire system of program regulation, the line between permissible regulatory activity and impermissible "raised eyebrow" harassment of vulnerable licensees will be exceedingly vague. The fact remains, however, that the use of "raised eyebrow" tactics presents serious issues which should at least engage our undivided attention as we review communications policy and the Constitution.

Beyond these various forms of "raised eyebrow" regulation, the Federal Communications Act permits more overt forms of speech regulation: these include the Fairness Doctrine (encompassing also the equal time and editorial reply rules)[14] and review of programming at

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68; *Hearings Before House Comm. on Judiciary Pursuant to H. Res. 803*, 93 Cong., 2d Sess., Book 5, pt. 1, at 314-20 (1974); Whiteside, *supra* note 9, at 77-80.

The Arab League boycott office has indicated that the Arab states intend to subject television news reporting by American networks to much more than "raised eyebrows." According to the *New York Times*, "CBS and NBC would be allowed to operate in the Arab states 'on the condition that this activity is beneficial to the Arab cause and under supervision of Arabs.'" N.Y. Times, March 4, 1975, at 3, col. 1. The networks rejected these conditions. *Id.*; *see* The Christian Science Monitor, March 3, 1975, at 4, col. 3; *cf. id.*, Feb. 26, 1975, at 3, col. 1 (large Mideast publisher wants to buy medium-size American newspaper).

13. Reprinted in 120 CONG. REC. S20,143-44 (daily ed. Nov. 26, 1974).

14. *See* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969); The Fairness Doctrine and Public Interest Standards; Applicability of the Fairness Doctrine in the Handling of Controversial Issues of Public Importance, 40 F.C.C. 598 (1964). The Fairness Doctrine has been coercively applied in Brandywine-Main Line Radio, Inc. v.

license renewal and at assignment to determine whether past and proposed future programming meets the FCC's criteria of balance.[15]

I think it is beyond cavil that we would not tolerate this sort of regulation in any context other than telecommunications; the First Amendment would forbid it. But somehow telecommunications speech is different and permits, many think, a different First Amendment regime. I seek here to raise questions about this assumption through an exploration of the justifications generally offered to support this different First Amendment regime for telecommunications speech. After exploring those justifications, I will offer some alternative strategies for reforming telecommunications regulation in a manner which both eliminates present intrusion into protected speech and forwards the First Amendment interest of diversity of ideas.

I. Historical Justifications for FCC Regulation of the Telecommunications Press

As you know, many justifications have been offered for the present First Amendment state of affairs. But most are in my view simply *post hoc*. This does not, of course, deprive them of their persuasive-

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FCC, 473 F.2d 16 (D.C. Cir. 1972), *cert. denied*, 412 U.S. 922 (1973); Banzhaf v. FCC, 405 F.2d 1082 (D.C. Cir. 1968), *cert. denied*, 396 U.S. 842 (1969). *See also* Friends of the Earth v. FCC, 449 F.2d 1164 (D.C. Cir. 1971); Retail Store Employees, Local 880 v. FCC, 436 F.2d 248 (D.C. Cir. 1970); Accuracy in Media, Inc., 40 F.C.C.2d 958 (1973), *rev'd sub nom.* National Broadcasting Co. v. FCC, No. 73-2256 (D.C. Cir., Sept. 27, 1974).

Of course, the actual adverse decisions regarding the Fairness Doctrine provide only the tip of the iceberg; of far more consequence are the numerous complaints and proceedings before the FCC regarding specific news programming. For example, fourteen such proceedings involving recent news telecasts are cited in Brief of National Broadcasting Co., at 22-23 n.*, National Broadcasting Co. v. FCC, *supra*. In 1972, the FCC received 2,800 Fairness Doctrine Complaints. H. Geller, The Fairness Doctrine in Broadcasting 23 (Rand Corp. 1973). *See also* 120 Cong. Rec., *supra* note 9, at S17,503; The Fairness Doctrine and Public Interest Standards 8, *citing* Allen C. Phelps, 21 F.C.C.2d 12 (1969). The financial burden imposed by constant compliance efforts is itself a form of "raised eyebrow" regulation. *See* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 69-70 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973); H. Geller, *supra*, at 40-43. *Compare* Grosjean v. American Press Co., 297 U.S. 233, 246-47 (1936). For a discussion of some recent FCC Fairness Doctrine decisions, see Comment, *The Regulation of Competing First Amendment Rights: A New Fairness Doctrine After* CBS?, 122 U. Pa. L. Rev. 1283, 1293-1318 (1974).

15. *See* Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 278-80 & n.45, nn.59-63 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result); Alabama Educ. Television Comm'n, 32 P & F Radio Reg. 2d 539, 552-56 (1975); Children's Television Report and Policy Statement, 50 F.C.C.2d 1 (1974); Suburban Broadcasters, 30 F.C.C. 1021 (1961), *aff'd sub nom.* Henry v. FCC, 302 F.2d 191 (D.C. Cir.), *cert. denied*, 371 U.S. 821 (1962).

ness, to the extent they are persuasive. However, this fact warns against viewing the justifications outside of their historical context. Thus, in discussing the justifications that have been offered, I intend to view them as historical causes and to consider them in their historical context. In this manner I hope to demonstrate the ways in which changes in historical context may further change or, indeed, eliminate the existence of at least some asserted justifications. This is simply to say that past historical necessity should not embed legal rules in concrete. To paraphrase Justice Holmes, I can think of no worse justification for a legal rule than the argument that it was necessary fifty years ago and therefore must be necessary today.[16]

A. Lack of Journalistic Effort in the Beginnings of the Telecommunications Press

The main factor in my mind that explains the different First Amendment regime applied to TV and radio is the lack of genuine journalistic effort in the beginning of telecommunications news.[17] Radio and TV news at first was not considered a source of serious journalism; it was, many thought with justification, simply a rebroadcast of information and opinions obtained from the printed media. The main function of radio and TV was entertainment, and entertainment programming was not considered at the core of the First Amendment scheme. Indeed, for a short time the FCC declared that the licensees should not "editorialize."[18] The Commission later rejected this rule but only in favor of the Fairness Doctrine, which is today the most overt form of program regulation in which the FCC engages.[19] The image one gets, looking backward, is that the radio or TV licensee was a mere

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16. *See* Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897).

17. Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 71-73 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973); 1 E. BARNOUW 138-42; 2 *id.* at 17-22, 74-83, 135-42, 146-51, 185-87, 204-05, 219, 241; 3 *id.* at 40-56, 73, 116, 155-60, 180-83, 186-87, 208, 210-11, 217-27, 244-45, 270, 301. The use of radio to communicate news during World War II may have been the turning point towards a true concept of broadcast journalism and away from simple reliance on the AP or UPI ticker. But the real growth of TV news teams and TV news technology occurred in the period from 1960 to 1963. In 1963, for the first time most Americans named TV as their major source of news. On the rise of TV news, see F. FRIENDLY, DUE TO CIRCUMSTANCES BEYOND OUR CONTROL . . . (1967); W. WOOD, ELECTRONIC JOURNALISM 1-20 (1967); P. WHITE, NEWS ON THE AIR 30-49 (1947).

18. *See* Mayflower Broadcasting Corp., 8 F.C.C. 333 (1941). *See also* Barron, *The Federal Communications Commission's Fairness Doctrine: An Evaluation*, 30 GEO. WASH. L. REV. 1, 1-4 (1961).

19. *See* Editorializing by Broadcast Licensees, 13 F.C.C. 1246 (1949); Mayflower Broadcasting Corp., 8 F.C.C. 333, 339-40 (1941).

conduit of news, a common carrier of sorts, and not the independent journalistic institution which the First Amendment protects as the "press."

But if this image were ever true, it surely is not true today. Independent TV and radio news and opinion teams are the main sources of information for the American people.[20] If they have not completely overshadowed the printed media in areas such as investigative reporting, it is not because they are mere conduits. TV and radio journalism is now an independent press surely within the intendment of the First Amendment.

The fact that the telecommunications industry still relies heavily on entertainment programming does not mean it is any less a part of the independent journalistic institution the First Amendment protects. First, entertainment programming is protected speech, and, as an individual speaker, the licensee is entitled to First Amendment protection.[21] Second, there is no reason why the press clause of the First Amendment refers only to the political press. We do not need Professor Charles Reich[22] to tell us that music, fiction and art occupy a status in the "marketplace of ideas" completely equal to political opinion. While it may have been once true that TV was not the source of high quality entertainment programming deserving of full First Amendment protection, it surely is no longer true. A different First Amendment regime cannot be justified on that basis.

B. The Nature of the Medium

Another factor which has gained prominence in recent years may explain the continuing vitality of the special First Amendment regime for telecommunications. This is the particularly powerful nature of telecommunications as a medium for speech.[23] TV and radio offer ac-

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20. ROPER ORG., INC., AN EXTENDED VIEW OF PUBLIC ATTITUDES TOWARD TELEVISION AND OTHER MASS MEDIA, 1959-71, at 2 (1971); BROADCASTING, Nov. 2, 1970, at 48.

21. Times Film Corp. v. City of Chicago, 365 U.S. 43, 76 (1961) (Warren, C.J., dissenting), *citing* Winters v. New York, 333 U.S. 507, 510 (1948); *see* Jenkins v. Georgia, 418 U.S. 153 (1974); Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 271 n.9 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result) and authorities cited. This was not always the case. *See* Mutual Film Corp. v. Industrial Comm'n, 236 U.S. 230 (1915).

22. Charles A. Reich is a Senior Fellow at Yale Law School and author of *The Greening of America* (1970).

23. Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 275 & nn.31-32 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result) and sources cited.

cess to immense numbers of listeners with at least part of the immediacy of person-to-person communications. This all-pervasive immediate form of press commentary gives tremendous leverage to speakers who have access to it. And for that reason, there is great pressure to expand the number of voices which have this access.

It is simply impossible to exaggerate the impact of TV in particular on our lives and the lives of our children.[24] It is often said, but nonetheless worthy of repetition, that TV has altered our consciousness, our manner of relating to other people and the world, our decisions about the expenditure of our wealth and the use of our leisure time. It has both broadened and numbed our experiences with persons and events outside our normal range of acquaintance. TV is an acculturizer—even more so than public schools—and thus has an immense but largely unascertainable impact on the motivations and beliefs of our children. TV has so reordered our lives that we do not yet recognize the change. And the change was wrought almost inadvertently: nobody expected it, nobody foresaw the effect, and the people as a whole did not make a democratic choice to embrace it. But it is here to stay, and its power has led many individuals to question the validity of the traditional First Amendment regime.

One might profitably compare the impact of television on human perception, learning and communication with the discovery of atomic power and with recent developments in our understanding of human genetic structure, control of the brain and human biology in general. These three Twentieth Century revolutions in our knowledge and control of ourselves and the environment in which we live are awesome, at once bringing great promises and great perils. Rational evaluation of their growth is made difficult by the speed with which these developments have come upon us. While human kind has certainly experienced in previous centuries such world-shattering developments, in no other century have so many such developments come upon us so quickly and with such devastating impact.

But what follows from a recognition of the immense power of TV (and, to a lesser extent, radio) speech? We may assume that nothing in the First Amendment prohibits a reasonable regulation of the time, place and manner of speech in order to ensure that all speakers may

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24. *See* L. BOGART, THE AGE OF TELEVISION (3d ed. 1972); M. MCLUHAN, UNDERSTANDING MEDIA—THE EXTENSIONS OF MAN (1965); SIGHT, SOUND AND SOCIETY (D. White & R. Averson eds. 1968); 1 TELEVISION AND SOCIAL CHANGE (Surgeon General's Science Advisory Comm., G. Comstock & E. Rubinstein eds. 1972).

be heard.[25] And we might further assume that marginally protected speech which significantly impinges upon individual privacy may be forbidden consistent with the First Amendment.[26] But it is something else again to suggest that the force of a particular mode of speech in and of itself permits a generalized regulation of speech. To some extent, TV viewing is involuntary and thus privacy interests are involved which may justify some regulation of TV speech.[27] But this involuntary aspect should not be exaggerated to justify the assumption that all TV programming is an invasion of privacy which can be regulated. In the final analysis, the assumption that the power of the telecommunications press justifies regulation strikes at the root of the First Amendment's guarantee of an independent journalistic institution: this assumption argues instead that the press is too powerful to be free. But it is important to distinguish between the power gained by oligopoly in the production of news and entertainment programming for radio and TV and the power inherent in the medium. I suspect that the former is the real concern, and I address it later in this Article. The latter form of power may be amenable to regulation to the extent, and only the extent, that the power itself causes a cognizable injury which we might deem worthy of suppression. A helpful analogy would be to the limitation on the use of bull horns. But to regulate on the basis of the content of the speech because of the added power given by a particular medium of communication seems to me a wholly different proposition which, if justifiable at all, cannot be defended on the basis of the particular power of the medium alone.[28]

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25. *See* Lehman v. City of Shaker Heights, 418 U.S. 298, 311 (1974) (Brennan, J., dissenting); Times Film Corp. v. City of Chicago, 365 U.S. 43, 75-78 (1961) (Warren, C.J., dissenting).

26. *Cf.* Gertz v. Robert Welch, Inc., 418 U.S. 323 (1974); New York Times Co. v. Sullivan, 376 U.S. 254 (1964). *Compare* Trinity Methodist Church, South v. Federal Radio Comm'n, 62 F.2d 850 (D.C. Cir. 1932), *cert. denied*, 288 U.S. 599 (1933).

27. Banzhaf v. FCC, 405 F.2d 1082, 1100-01 (D.C. Cir. 1968), *cert. denied*, 396 U.S. 842 (1969).

28. Times Film Corp. v. City of Chicago, 365 U.S. 43, 77-78 (1961) (Warren, C.J., dissenting):

> It is true that "each method [of expression] tends to present its own peculiar problems." Joseph Burstyn, Inc. v. Wilson [343 U.S. 495, 503 (1952); *see also* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 386-87 & n.15 (1969)]. The Court has addressed itself on several occasions to these problems . . . . The Court [has] recognized that sound trucks call for particularized consideration . . . . But, the Court's decision today does not follow from this. Our prior decisions do not deal with the *content* of the speech; they deal only with the conditions surrounding its delivery. *These* conditions "tend to present the problems peculiar to each method of expression." Here the Court uses this magical phrase to cripple a basic principle of the Constitution.

Cf. 120 CONG. REC. S18,810-12 (daily ed. Oct. 10, 1974) (remarks of Senator Proxmire) and authorities cited.

C. *Scarcity of Broadcast Facilities*

(1) Scarcity of Frequencies

A third factor leading to a different First Amendment regime for telecommunications, a factor which has emerged as the most widely accepted justification today, is the scarcity of telecommunications outlets and thus the scarcity of broadcast speakers.[29] The initial source of this scarcity was the concept of a license which in turn was caused by a limitation on the number of broadcast frequencies. Thus, as a permissible regulation of the manner of speech designed to permit all speakers to be heard, the government must allocate frequencies in order to avoid destructive interference. But the key to scarcity is the *limited number of frequencies* and not the mere existence of licensing, and it may be doubted whether today there is a scarcity of broadcast frequencies.[30] The emergence of cable TV, perfection of UHF technology and more efficient usage of the VHF broadcast spectrum promise an end to scarcity of broadcast frequencies.[31] Even if one focuses only on broadcast TV, present figures indicate that a great portion of the UHF band is not presently in use.[32] Of course, UHF and cable are not sufficiently developed to be an effective alternative to VHF at present. But their possibility of development does suggest that *physical limitations* on the number of frequencies are not that severe.

In 1969 the Supreme Court in *Red Lion Broadcasting Co. v. FCC*[33] found that scarcity was then still a reality. However, the figures discussed in *Red Lion* are not necessarily probative in this regard and, indeed, demonstrate a confusion inherent in discussions of scarcity. The only conclusion the figures utilized in *Red Lion* indicate is that the VHF television channels with high market penetration are completely filled. Thus the scarcity lies in this—there are very few VHF television channels linked to a nationwide network with good market penetration. This scarcity, it will be noted, is not premised on a limited number of frequencies per se. Otherwise, *Red Lion* relies only on the past—the fact that the original justification for regulation was the problem of scarcity and the resulting interference.

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29. *See* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 388-90, 396-400 (1969).

30. In New York City, for example, there are currently thirty-seven radio (AM) and television (VHF) stations as compared to three newspapers of general circulation. Letter to the author from Elie Able, Dean of the Columbia University School of Journalism, Feb. 27, 1975.

31. *See* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 75-76 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973); R. NOLL 4.

32. See authorities cited in note 31 *supra*.

33. 395 U.S. 367, 396-400 (1969).

(2) Scarcity of Investment Capital

Further confusion of the concept of scarcity is suggested by the following argument advanced by Mr. Henry Geller in support of FCC program regulation: Mr. Geller notes that there are two VHF licensees for TV service in Jackson, Mississippi and without the Fairness Doctrine those licensees may well broadcast racist programming.[34] It is noteworthy that Mr. Geller does not mention radio, nor the fact that the stations broadcast network news. But be that as it may, another omission from his analysis is whether there are other available TV frequencies, cable, UHF or VHF, which are open to potential broadcasters in Jackson. We may assume that there are other potential frequencies (since UHF has sixty odd channels and the VHF has at least ten) but that, for presumably financial reasons, no other persons find broadcasting in Jackson to be feasible. This "scarcity," if it may be so called, is not a result of a limited number of frequencies and is indeed no different than that associated with newspapers. Scarcity of investment capital in the broadcasting industry seems hardly meet as a justification for a different First Amendment regime for TV alone. It should be added that even if Mr. Geller's argument is convincing, it justifies only program regulation in local viewing markets where there are few broadcasters. For some major markets where there are sixty or more radio stations and six TV stations, Mr. Geller's argument is inapplicable.[35]

And this leads to a more troubling question, because all economic resources are scarce.[36] When we say there is a scarcity of frequencies, to what are we comparing this scarcity? In other words, what is the contrasting "multitude" that is the implicit premise of discussions of scarcity? Broadcast frequencies are scarce in relation to what? Consider the following figures: as of December 31, 1974,[37] there were

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34. Geller, *Communications Law*, 63 GEO. L.J. 39, 46 (1974).

35. *Cf.* Fidelity Television, Inc. v. FCC, No. 73-2213, at 30-31 (D.C. Cir., Mar. 6, 1975); Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 284 n.79 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result). The observation in the text would mean that the Fairness Doctrine is not applicable to at least New York, Los Angeles, Chicago, and Philadelphia. *See also* Jaffe, *Program Control*, 14 VILL. L. REV. 619-20 (1969).

36. *See* Coase, *The Federal Communications Comm'n*, 2 J. LAW & ECON. 1, 13-19 (1959). Of course, the scarcity of investment capital in the telecommunications industry for UHF and cable development is a result partly of government controls and not solely the product of a free market.

37. BROADCASTING, Feb. 17, 1975, at 64. For figures in recent years, see Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 75 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973); G. ROBINSON & E. GELLHORN, THE ADMINISTRATIVE PROCESS 154-57 (1974).

7,785 radio stations on the air and 952 TV stations, serving nearly every part of the country. As of January 1, 1971, daily newspapers totalled only 1,749. And the broadcast spectrum is still not completely filled. How is there a "scarcity" of broadcast frequencies? How many do we think could realistically be filled considering the capital market for broadcast facilities? Even if the previously stated figures seem "scarce" by some unknown standard, the potential of cable television is so enormous that it alone could, if properly developed, outnumber newspapers. "Scarcity," indeed!

Of course, the number of non-daily newspapers and periodicals, as well as book sales, has increased regularly in recent years.[38] Professor Emerson is thus led to suggest that the real comparison is not between the number of daily newspapers and the number of radio and TV stations, but between the number of printing presses and the number of broadcast frequencies.[39] This comparison of "theoretical" scarcity, if it may be so named, does produce a conceptual limitation on telecommunications not present in regard to the printed media. However, this conceptual limitation is really of no serious significance now that cable TV produces a "theoretical" expansion of the broadcast frequencies that must certainly parallel the "theoretical" number of printing presses for any realistic purpose we might impute to communications policy. Furthermore, most discussions of scarcity of broadcast frequencies really are premised on an "effective" scarcity and, if newspaper and the telecommunications press are to be compared, we must look also to the "effective" scarcity of newspapers, which leads inexorably to a comparison between the number of daily newspapers and the number of radio and TV stations.

So, looking only to the "effective" scarcity that *Red Lion* proved, it is clear that this is a scarcity that is not really a product of the Federal Communications Act or the forces that gave impetus to that Act. Rather, it is a result of government policies which have permitted the development of VHF television prior to perfection of technology for cable and UHF to the commercial detriment of the latter.[40] Even

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38. *See* STATISTICAL ABSTRACT OF THE UNITED STATES, 502, 505 (1973).

39. *See* T. EMERSON, THE SYSTEM OF FREEDOM OF EXPRESSION 662 (1970); *cf.* Fairness Doctrine and Public Interest Standards 4-7.

40. On this subject, see H. GELLER, A MODEST PROPOSAL TO REFORM THE FCC 3-12 (Rand Corp. 1974). *See also* Multiple Ownership 1029 (Robinson, Comm'r, concurring in part, dissenting in part).

Former FCC Chairman Newton Minow, who was kind enough to offer his comments on the arguments made in this Article, stated that the shortage of VHF outlets in the major market areas has produced a severe economic scarcity with the result that business people are virtually standing in line for an open frequency in those areas.

though the government is somewhat responsible for the dominance of the limited number of VHF licensees, the Failing Newspaper Act[41] and repeated antitrust division approvals of mergers of newspapers have implicated the government in the scarcity of high circulation newspapers in major markets. But that fact was apparently not enough to institute a new First Amendment regime for newspapers.[42]

I suggested in an opinion in 1972 that the FCC reconsider the concept of scarcity to determine whether its vitality continues undiminished in light of recent technological developments.[43] While the FCC has recently purported to accept my invitation, one may certainly question whether its effort was an in depth re-evaluation of the concept of scarcity.[44]

(3) Implications of Scarcity for Government Regulation

Even assuming the existence of a scarcity of broadcast speakers, it is not immediately apparent to me why this scarcity (either in gen-

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There is no such line, he points out, for newspapers in major market areas because newspapers are simply not as profitable. The true scarcity, he concludes, lies in the inability to meet the significant *demand* for VHF outlets in major market areas. A similar argument has been made by Albert Kramer in a draft report to the American Civil Liberties Union. I have no doubt about the accuracy of these arguments. My point, as developed in the text, is that this concept of scarcity is not a result of the limitation on frequencies but rather the market power gained by VHF licensees through FCC policies on allocation of frequencies and relative development of alternative technologies. My suggestions for reform discussed in Part III of this Article attempt to meet these policies head on, rather than through regulation of speech. But if such reform efforts do not move ahead, I can perceive an argument that past FCC allocation and development policies are themselves a denial of the free press rights of those whose demand for frequencies cannot be met under the present scheme. A lesser form of this argument was rejected in Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm., 412 U.S. 94 (1973), but that case is surely not definitive. The present entrenchment of VHF licensees and the concommitant network domination of programming were, of course, the justifications I offered for a limited content regulation in Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 272-76 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result).

41. 15 U.S.C. §§ 1801 *et seq.* (1970); *see* Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm., 412 U.S. 94, 145 (1973) (Stewart, J., concurring).

42. *See* Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241 (1974). The continuing concentration of the newspaper industry—partly the result of the Failing Newspaper Act—undermines some of the assumptions of the *Tornillo* decision. Most disturbing is the fact that only 2.5 percent of American cities have more than one daily newspaper. B. BAGDIKIAN, THE EFFECT CONSPIRACY AND OTHER CRIMES OF THE PRESS 11 (1972); *see* E. SACHAR, THE NEWSPAPER INDUSTRY—1973, at 3-9 (1973); N.Y. Times, Mar. 26, 1975, at 20, col. 1. But new technology in the printing press area may reverse this trend. *See* E. SACHAR, *supra* at 17-22.

43. Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 75-76 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973).

44. *See* The Fairness Doctrine and Public Interest Standards 6-7.

eral or in terms of high-market penetration VHF television licensees) is ground for a different First Amendment regime for telecommunications. Here too is a significant confusion on the concept of scarcity. This confusion may be illustrated by a comparison of two perspectives on scarcity. One perspective is that scarcity produces the comparative hearing in which, by the nature of the Communications Act, the government must choose among or between speakers on the basis of the content of their speech. The second perspective on scarcity is that a limited number of speakers in and of itself (or because of some government intervention that causes the limitation) is ground for imposing public duties on the speakers. This second perspective may be coupled with a reference to a prior comparative proceeding in which the speaker was successful, this success imposing a public obligation to speak not only for himself but for the loser as well. In the language of *Red Lion*, the speaker is a fiduciary for the public and has corresponding public duties which it must meet to fulfill this fiduciary obligation.[45]

The logic of this second perspective would be compelling but for the fact that the First Amendment, it would seem, does not limit its protection of an independent press to an independent *and numerous* press. When we consider the limited number of newspapers, this conclusion is clear, and the Supreme Court has just recently reaffirmed it.[46] If government involvement in the process of limitation of speakers is short of that needed to find "state action," then the existence of that much government involvement should not change this result.[47] Thus, this line of argument suggests, the existence of scarcity does not alter the constitutional provision for an independent press. Scarcity might indicate that the press should assume on its own a fiduciary obligation to the public—and I would be one who encourages them to do so—but it cannot alone justify *governmental enforcement* of that obligation.

The fact that Congress could have made the licensees common carriers and not independent programmers themselves does not permit, as *Red Lion* seems to suggest,[48] the conclusion that the independent press can be subject to public duties. To permit this logic, it would seem that any duty could be imposed upon the private press simply because of a potential legislative power. Similarly, it cannot be main-

45. 395 U.S. 367, 389 (1969).

46. Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241 (1974).

47. *See* Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm., 412 U.S. 94, 114-21 (opinion of the court), 150-65 (Douglas, J., concurring in judgment) (1973).

48. *See* 395 U.S. at 390-91 (1969).

tained with any real force that "nothing in the First Amendment . . . prevents the government from requiring a [newspaper] to share [its space] with others and to conduct [itself] as a proxy or fiduciary with obligations to present those views . . . ."[49] This suggestion would permit any kind of regulation of the press, yet it was said in *Red Lion*, and eight Justices apparently approved it, when one substitutes the word "licensee" for "newspaper" and the word "frequency" for "space."

More than this, what is the relation of scarcity to regulation of speech? The suggestion of *Red Lion* is that regulation is necessary to encourage a diversity of ideas. Thus, scarcity is apparently a problem in need of regulation because it produces less diversity. But there is no evidence that in all the various media of communication there is a deficiency of diversity. Rather, the argument is that there is a deficiency in ideas communicated *through the telecommunications media.* This suggests that the problem is not scarcity of frequencies but rather the particularly powerful nature of TV communication. Indeed, there may well be a scarcity of political pamphleteers in the nation, but we would hardly think that was cause for regulating the ones that exist. Nor would we think to worry about the diversity of ideas presented by the pamphleteers that exist. So the key to the scarcity argument is that TV produces greater access to an audience than other modes of communication, and thus it can be regulated to ensure a diversity of ideas in that medium alone. But this argument is seemingly rejected by the promulgation of the First Amendment, since newspapers have a far greater access than other speakers to an audience; this fact is inherent in the concept of a "press" which is distinct from ordinary speakers, and we are back again to the point suggested above—if the press is too powerful to be free, do we not need a constitutional amendment to alter the scheme established by the First Amendment?[50]

Another problem with this second perspective on scarcity is that we are left with no understanding of what program or speech regulation is permissible. One could argue all speech is unprotected because of

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49. *Id.* at 389.

50. Times Film Corp. v. City of Chicago, 365 U.S. 43, 77 (1961) (Warren, C.J., dissenting):

> The contention may be advanced that the impact of motion pictures is such that a licensing system of prior censorship is permissible. There are several answers to this, the first of which I think is the Constitution itself. . . . This is the traditional argument made in the censor's behalf; this is the argument advanced against newspapers at the time of the invention of the printing press. The argument was ultimately rejected in England and has consistently been held to be contrary to our Constitution. No compelling reason has been predicated for accepting the contention now.

scarcity, but the "diversity of ideas" justification for the use of the scarcity argument indicates that only nondiverse speech may be proscribed in favor of diverse speech. But FCC doctrine makes no such inquiry. Rather, it regulates in favor of diversity *within the licensee's own programming* and not in terms of the diversity in the viewing market as a whole.[51] Thus the regulation supposedly justified by the scarcity argument extends well beyond the actual bounds of the real justification. One might ask whether this is an overbroad regulation of protected activity.

(4) The Comparative Hearing

So only the first perspective on scarcity—the choice at a comparative hearing—truly involves a concept of scarcity which is unlike that found in other branches of the press and which does not depend, in the final analysis, upon the particular nature of telecommunications speech. A choice on the basis of the content of proposed or past speech would seemingly be necessary and acceptable if the criteria are designed to advance the ultimate values of the First Amendment.[52] But, we must be aware that the comparative hearing does not indicate that other frequencies are not available to the parties seeking the frequency in issue; rather, it may simply mean that the parties are not interested in those other available frequencies. This observation raises the question whether the concept of scarcity at a comparative hearing is entirely within the control of the parties and thus an insufficient basis for inquiry into the content of speech.

D. Subversion of Journalistic Judgment for Business Reasons

There is one final factor which probably has not served as an historical justification for a different First Amendment regime but is by

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51. Furthermore, the FCC should, if it were really serious about diversity, attempt to discern what sorts of diversity are desired by the viewing audience. The available evidence indicates that the viewing audience wants more options on existing types of programming rather than more diverse types of programming. *See* G. STEINER, THE PEOPLE LOOK AT TELEVISION 226-49 (1963). Full exploration of this idea of diversity should lead the FCC into an examination of program *quality* and not just program categories, as a measure of diversity. *See* Irion, *FCC Criteria for Evaluating Competing Applicants*, 43 MINN. L. REV. 479, 489-96 (1959). This raises extremely difficult problems. *See* sources cited in note 71 *infra*. Commissioners Robinson and Hooks in a recent concurring statement indicated that FCC regulation of obscenity may not be justified by a scarcity concept because regulation of obscenity is not designed to create diversity. *See* Pacifica Foundation, Station WBAI, 32 P & F RADIO REG. 2D 1331, 1343 n.* (F.C.C. Feb. 12, 1975) (Robinson & Hooks, Comm'rs, concurring).

52. *See* Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 279-81 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result).

far the most promising candidate for the future and has as among its proponents the true aficionado of regulation. This is a factor of infinite subtlety and causes me the most concern. The economics of broadcast TV require that programming be directed to a mass audience in order to ensure a sufficient viewing audience (and hence sufficient advertising revenues) to finance the operation.[53] Limited or specialized appeal programming will not sell enough advertising to be economically viable. There are two important corollaries to this point. First, producers of programming must be ensured of large-scale distribution of their programs in order to make a profit. The difficulties in obtaining that distribution through individual dealings with licensees led to the use of the three networks and a few large-scale entertainment corporations such as MCA and to a lesser extent Westinghouse as brokers in the placement of programming both with advertisers and with the licensees. This development in turn led to the now well publicized "network domination" of production and placement of programming.[54] Second, news and public affairs programming does not attract as large an audience as entertainment programming. This sort of programming is thus a perennial loss leader and arguably without FCC intervention to insist upon it, a requirement found in the Fairness Doctrine,[55] licensees might just do away with it. Network evening news is apparently an exception to this economic premise of broadcasting.[56]

This concern with the economics of TV programming leads us into the most difficult quagmire of all: since the telecommunications press is a business and, thus, its decisions are "business" decisions in large part, does the First Amendment, which is concerned with journalistic

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53. *Id.* at 267-68; R. NOLL 49-53; Steiner, *Program Patterns and Preferences, and the Workability of Competition in Radio Broadcasting*, 66 Q.J. ECON. 194 (1952).

54. R. NOLL 59-79; Prime Time Access 724-40 (Robinson, Comm'r, dissenting).

55. *See* Public Communications, Inc., 32 P & F RADIO REG. 2D 319 (F.C.C., Dec. 10, 1974), *aff'g* 49 F.C.C.2d 27 (Broadcast Bureau 1974); Editorializing by Broadcast Licensees, *supra* note 19, at 1249-51; Comment, *Enforcing the Obligation to Present Controversial Issues: The Forgotten Half of the Fairness Doctrine*, 10 HARV. CIV. RIGHTS-CIV. LIB. L. REV. 137 (1975). On the interior economic viability of news and public affairs programming, see R. NOLL 52-53 n.31, 68-69; Formulation of Policies Relating to the Broadcast Renewal Applicant, Stemming from the Comparative Hearing Process, 43 F.C.C.2d 1043, 1045, 1049 (1973). *See also* 3 E. BARNOUW 116, 244-45; Maines & Ottinger, *Network Documentaries: How Many, How Relevant?*, 11 COLUM. JOURNALISM REV., March-April, 1973, at 36. On general failure of local broadcasters to provide public affairs programming, see Renewals of Broadcast Licenses for Ark., La. & Miss., 42 F.C.C.2d 1, 16-25 (1973) (Johnson, Comm'r, dissenting); Renewal of Standard Broadcast and Licenses for Okla., Kan. & Neb., 14 F.C.C.2d 1 (1968) (Johnson & Cox, Comm'rs, dissenting).

56. *See* BROADCASTING, Feb. 11, 1974, at 43, for figures on the viewing market shares of network news.

judgment, protect these business judgments? Or put another way, should programming, news or otherwise, which is generated by a purely economic appraisal of the viewing "market" be enshrined as the sort of public discussion protected by the First Amendment? I have no problem conceptually with a "no" answer to these questions. The First Amendment does not sanctify the process of making money through titillating speech, and it does not protect economic propaganda of whatever form.[57] Furthermore, the networks and the licensees have demonstrated a tremendous capacity to ignore the public interest when their private economic interests are at stake. Perhaps the most graphic examples are the failure to give any news coverage to the license renewal bill that Representative Staggers did us the courtesy of killing last session of the Congress[58] and the failure to provide balanced coverage of the debate over pay TV.[59] There is the depressing but nonetheless illustrative comment of Senator John Pastore of Rhode Island, Chairman of the Senate Subcommittee on Telecommunications, who, upon observing TV cameras at his hearings into violence on TV, stated as I paraphrase: "I don't know why they bring those cameras here; I know the networks don't intend to show a single second of what goes on here." And, of course, he was right. Nothing substantial was run on the hearings. The networks just do not report what they feel is injurious to their economic interests. Douglass Cater once quoted to me the remark of a candid network executive to the effect that if a

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57. *Cf.* Pittsburgh Press Co. v. Human Relations Comm'n, 413 U.S. 376 (1973); Donaldson v. Read Magazine, Inc., 333 U.S. 178, 189-92 (1948). *See also* Miller v. California, 413 U.S. 15 (1973); Ginzburg v. United States, 383 U.S. 463 (1966). On the excessive commercialization of the broadcast media, see 2 E. BARNOUW 227-36; L. BROWN, TELEVISION, THE BUSINESS BEHIND THE BOX (1971); H. SKORNIA, TELEVISION AND THE NEWS 11-68 (1968).

58. *See* Public Communications, Inc., 32 P & F RADIO REG. 2D 319 (F.C.C., Dec. 10, 1974). On the renewal bill which would have been one of the most important amendments to the Federal Communications Act since its passage, see H.R. REP. No. 93-961, 93d Cong., 2d Sess. (1974).

59. National Cable Television Ass'n, 48 F.C.C.2d 501 (1974) (Broadcast Bureau); *cf.* Local 880, Retail Store Employees v. FCC, 436 F.2d 248 (D.C. Cir. 1970). *See also* National Citizens Comm. for Broadcasting, 49 F.C.C.2d 83 (1974) (Broadcast Bureau) (joke by Johnny Carson about Crest toothpaste, an NBC sponsor, bleeped off the air); H. SKORNIA, *supra* note 57, at 82-93. On coverage of pay TV developments, see *id.* at 135-56. A particularly ominous example of advertiser censorship is the coverage of the 1974 California gubernatorial election. A forthcoming Article in the *California Journal* documents these assertions: Advertisers associated with local stations decided it was not good business to cover the gubernatorial election. Thus, there was very little coverage of the election and the candidates experienced difficulty in even buying air time. In the final week of the campaign, every TV station in San Francisco, except the public station, refused to carry a debate between the Republican and Democratic candidates.

broadcaster had to choose between the license renewal bill or abolition of the Fairness Doctrine, the broadcaster would choose the renewal bill and forego First Amendment rights. We should expect nothing else from corporations which hire as their executives not journalists or even professional broadcasters but successful businessmen. And we should also expect that every business decision will be defended as an exercise of journalistic discretion protected by the First Amendment when not one gram of journalistic discretion is involved.[60]

Perhaps more important than these particular incidents of the promotion of economic self-interest to the derogation of the public interest is the existence of a network-imposed licensing scheme upon its own journalists. While this network censorship is even broader than that imposed by the FCC, it operates in a very similar fashion. I am informed that reporters from at least one network and from some major newspapers have a clause similar to the following in their contracts:

> Artist recognizes that the employment hereunder is a full-time employment and that Artist's other activities must be such as never to cast doubt on the fairness or objectivity of [the network] or reflect unfavorably upon Artist or Producer. Accordingly,
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> (a) From the date hereof, Artist will render services exclusively to and for Producer and Artist will not render any services to others, or on Artist's own behalf, directly or indirectly, in any capacity or media whatsoever (including without limitation granting rights to use Artist's name or likeness or both, or to use any performance or other services which Artist rendered for others prior to this agreement) and Artist shall not negotiate concerning such services with others than Producer prior to the expiration of the term hereof.

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60. Perhaps the most widely known example of this behavior is the decision of CBS network TV chief John Schneider to forego live broadcast of George Kennan's testimony on Vietnam in favor of a re-run of *I Love Lucy* and *The Real McCoys*. Fred Friendly states in his book that this depressing incident led to his resignation as news president. Friendly said to Schneider: "You are making a news judgment but basing it on business criteria, and I can't do this job under these circumstances." F. FRIENDLY, *supra* note 17, at 233. See the statement of Edward R. Murrow quoted in *id.* at 250-51 as part of Friendly's letter of resignation. Such "business decisions" affected much of TV reporting on Vietnam. *Id.* at 213-65; 3 E. BARNOUW 271-303; Broadcast Bureau Actions: National Citizens Comm. for Broadcasting, 49 F.C.C.2d 83 (1974); Student Ass'n of the State Univ. of N.Y., 40 F.C.C.2d 510 (1973); Mark Lane, 36 F.C.C.2d 551 (1972); Judy Collins, 24 F.C.C.2d 741 (1970). Schneider's position was that excerpts of the Kennan testimony should be shown in the evening. This, of course, is not necessarily an unreasonable position.

On the subject of network or licensee censorship of the news, see Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm., 412 U.S. 94, 187 (1973) (Brennan, J., dissenting); National Broadcasting Co. v. FCC, No. 73-2256 at 2-3 (D.C. Cir., Sept.

(b) From the date hereof, any business, commercial, professional or similar activities of Artist shall be subject to Producer's prior approval, after disclosure by Artist of full details with respect thereto.[61]

Like many FCC policies, this clause appears unobjectionable on its face. In operation, however, it can be used to prevent network reporters from disclosing news items which they have uncovered but which the network has decided not to report. For the reporter to disclose such items would seemingly violate this "exclusive services" clause. There are certainly many legitimate business reasons for such clauses, but the possibility of abuse is also manifest. One must consider whether such clauses, when administered to prevent a reporter from disclosing newsworthy information without economic gain to himself—or herself—are contrary to public policy represented by the First Amendment and hence unenforceable. But even if this were settled, the "chilling effect" of such clauses surely maintains the networks' monopoly on the sources as well as the actual reporting of news, and thus the network may prevent the reporting of information it considers damaging to its economic or other interests. Upon an examination of these clauses, we confront the following dilemma: an enterprise whose lifeblood is freedom of expression seeks to limit the personal freedom of expression of its employees.

But I am more than a little concerned with how the distinction between programming motivated by true journalistic integrity and programming motivated by crass economic desires can be judicially or administratively maintained without a terrible "chilling effect" on the journalists.[62] Perhaps some of the "chilling effect" might be reduced by carefully and narrowly drawn rules designed to prevent a complete

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27, 1974) (Tamm, J., dissenting); R. MACNEIL, THE PEOPLE MACHINE 280 (1968); H. SKORNIA, *supra* note 57, at 93-101, 123-35.

61. It is worth noting that such contracts also contain the following public morals clause:

> If at any time the conduct of Artist, either while rendering services hereunder or in Artist's private life, is without due regard to the best interests of Producer and any sponsor or licensee of the programs, or to social conventions or public morals or decency, or if Artist commits any act or becomes involved in any situation, or occurrence, tending to degrade Artist in society, or to bring Artist into public disrepute, contempt, scandal or ridicule, or tending to shock, insult, or offend the community, or tending to reflect unfavorably upon Artist or producer or any sponsor or licensee of the programs, or if publicity is given to any such conduct, commission or involvement on the part of Artist, which occurred previously, Producer shall have the right to terminate this agreement. Producer may delete any credit given to Artist in connection with any services theretofore or thereafter rendered, regardless of whether Artist's services are terminated.

62. *See* Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 272 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result).

surrender of journalists' integrity to entrepreneurial attitudes of both network reporters and executives.[63] Certainly a complete failure to operate as a journalistic institution would take a licensee out of the protection of the First Amendment and would arguably be grounds for denial of a broadcasting license under the Federal Communications Act.[64] After all, it is clear that Congress intended that licensees be given air space to be journalists and not simply to sell products. But the difficulties of weeding out journalistic efforts from commercial pap are so severe that, in the normal case, the distinction is not manageable. And this fact is one reason why the First Amendment commands the government to stay out of the regulation of speech.[65]

II. The Purpose of the Free Press Guarantee

When all these justifications are shaken down, I at least am left with the impression that they all demonstrate mostly the fragility of our First Amendment traditions. Somehow we do not really think that the press should be free; they are too powerful, they are arbitrary, they are self-serving. If the subject were a discussion of the mistakes, bad judgment and excessive commercialism of the press—both printed and electronic—I would have much to say against the press. I have said before and I repeat it now that the press has abused its tremendous power, particularly the power of TV, largely for its own private profit, at the expense of the public interest. But I do not personally believe in the efficacy of, nor do I think the First Amendment permits, government intervention to cure those abuses. Is this belief a mere relic of happier times when the press was not so powerful or so arrogant? I do not think so. I think the First Amendment retains its vitality and

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63. *See id.* at 280-81 (arguing that consideration of programming proposals that meet an unfulfilled specialty need in the community in a comparative hearing may be permissible under the First Amendment). *Compare* Banzhaf v. FCC, 405 F.2d 1082 (D.C. Cir. 1968), *cert. denied*, 396 U.S. 842 (1969); DeVore & Nelson, *Commercial Speech and Paid Access to the Press*, 26 Hastings L.J. 745 (1975) and sources cited. This specific guideline would parallel consideration of programming content justified by the scarcity rationale. See text accompanying note 52 *supra*.

64. *See* KFKB Broadcasting Ass'n v. Federal Radio Comm'n, 47 F.2d 670 (1931), *discussed in* Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 277 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result); *cf.* Program Length Commercials, 39 F.C.C.2d 1062 (1973), *explained*, 44 F.C.C.2d 985 (1974). It is, of course, well established that a licensee must maintain a regular broadcast schedule or forfeit his license. *See* 47 C.F.R. § 73.651(a) (1974); Palladium Times, Inc., 43 F.C.C. 546 (1950). *See also* Simmons v. FCC, 169 F.2d 670 (D.C. Cir.), *cert. denied*, 335 U.S. 846 (1948).

65. *See* Hannegan v. Esquire, Inc., 327 U.S. 146, 157-58 (1946); *cf.* Paris Adult Theatre I v. Slaton, 413 U.S. 49, 73 (1973) (Brennan, J., dissenting); Murdock v. Pennsylvania, 319 U.S. 105, 111 (1943). See also note 71 *infra*.

speaks a wisdom relevant to concerns we recognize today. But I think its truly practical wisdom needs reaffirming and in the process of this reaffirmation, I think we can better understand why the Framers felt so strongly about an independent journalistic institution. There is no better beginning point than the activities of the administration of Richard Nixon. A memorandum from Charles Colson to H.R. Haldeman describing a meeting between Colson and various network executives is attached as an appendix to this Article.

There is, to be sure, more than a little bit of self-serving in Mr. Colson's description of the meeting. But even so, the point is clear enough: Richard Nixon's assistants were enforcing a "Fairness Doctrine," a doctrine which, to paraphrase *Red Lion*,[66] forces the licensees through the networks to share their frequencies with Richard Nixon. Of course, there is no reason why this doctrine should be limited to Richard Nixon; it could be extended to the NAACP or the American Civil Liberties Union or Duke University. The result, however, is always the same. By forcing the press to share its space, its medium, with persons of the government's choosing, we are restricting the journalistic discretion which it is the purpose of the First Amendment to protect. If one group has a right of access or a right to have the licensee present that group's point of view, there is no independent press; there is only a multitude of speakers. That might be permissible if the First Amendment protected only free speech. However, it also protects the press.[67] It might perhaps be feasible for the licensee to set aside an hour or so of air time of the licensee's own choice during the day for various speakers to present their points of view,[68] or to re-

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66. *See* 395 U.S. 367, 389 (1969).

67. Address of Justice Potter Stewart to the Yale Law School Sesquicentennial Convocation, Nov. 2, 1974, entitled "Or of the Press," *excerpted in* Washington Post, Nov. 11, 1974, § A, at 20, col. 3, *and reprinted in* 120 CONG. REC. S19,593 (daily ed. Nov. 19, 1974):

> This basic understanding [that the free press clause of the First Amendment extends protection to a journalistic institution] is essential, I think, to avoid an elementary error of constitutional law. It is tempting to suggest that freedom of the press means only that newspaper publishers are guaranteed freedom of expression. They *are* guaranteed that freedom, to be sure, but so are we all, because of the Free Speech Clause. If the Free Press guarantee meant no more than freedom of expression, it would be a constitutional redundancy. . . . By including both guarantees in the First Amendment, the Founders quite clearly recognized the distinction between the two.

However, there is some doubt that entertainment programming could be characterized as a function of the "press." Thus, programming of this nature might only be protected by the free speech clause. *See generally* Nimmer, *Introduction—Is Freedom of the Press a Redundancy: What Does It Add to Freedom of Speech?*, 26 HASTINGS L.J. 639 (1975).

68. *See* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 75 n.51 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973). *But see* Miami

quire the licensee to sell advertising time without discrimination on the basis of the content of the proposed message.[69] In this case, one could argue with more force that the independent journalistic discretion protected by the First Amendment is not contravened. But to require that a licensee be "fair" in presenting opinionated programming, or present a reasonable "balance" of programming as defined by a government agency, or not offer programming which a majority of listeners do not want to hear nullifies that journalistic discretion which the Framers thought indispensable to our constitutional order.

The excerpt from the Colson memorandum amply demonstrates the reason why the Framers thought this independent journalistic discretion so important. If the government may eliminate this discretion, it has a much greater control over the information the people receive about their government and the views of their fellow citizens. As Alexander Meiklejohn has so persuasively argued,[70] the free flow of this information is absolutely essential to self-government, to democracy. A government which can dictate what is "fair" reporting can control information to the public in a manner which subverts self-government. The press must be free to tell the truth as it sees it, to criticize the government, to denounce politicians and judges, and to publish opinions.

Truth and fairness have a too uncertain quality to permit the government to define them.[71] Certainly it is not fair to print that which

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Herald Publishing Co. v. Tornillo, 418 U.S. 241 (1974). The Court in Columbia Broadcasting Sys., Inc. v. Democratic Nat'l Comm., 412 U.S. 94, 131 (1973), left open the issue of whether Congress or the FCC might legitimately impose a right of access. Professor Emerson's treatment of the First Amendment and telecommunications centers on access. *See* T. EMERSON, *supra* note 39, at 653-67. His arguments on scarcity are centrally linked to the access problem, and thus his defense of the Fairness Doctrine, which is not based on access, seems difficult to reconcile with his condemnation of such efforts in regard to newspapers. *Id.* at 667-71. His scarcity arguments are generally a repeat of *Red Lion* and suffer from the defects noted in Part I of this Article. There is an overtone in his discussion that access rights are permissible in any context because, like antitrust enforcement, they do not censor particular content but act to expand the multitude of voices. This is indeed a difficult First Amendment problem which is not completely closed by *Tornillo* in my mind. *Cf.* 418 U.S. at 258: "[The] Florida statute fails to clear the barriers of the First Amendment because of its intrusion into the function of editors." *Compare id.* at 255-56, *distinguishing* Pittsburgh Press Co. v. Human Relations Comm'n, 413 U.S. 376 (1973) *and* 47 U.S.C. § 315 (1970). See note 71 *infra*. My only point here is to argue that newspapers and the telecommunications press be treated as equals in analyzing the issue. *See generally* Barron, *Access to the Press—A New First Amendment Right*, 80 HARV. L. REV. 1641 (1967).

69. Whitehead, Book Review, 83 YALE L.J. 1751, 1762-63 (1974).

70. *See* Meiklejohn, *The First Amendment Is an Absolute*, 1961 SUP. CT. REV. 245. *See also* Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241, 257 (1974), *citing* Mills v. Alabama, 384 U.S. 214, 218 (1966).

71. *See* Multiple Ownership 1015-17 (Robinson, Comm'r, concurring in part, dissenting in part); *cf.* Democratic Nat'l Comm., 31 F.C.C.2d 708, 712-13 (1971), *aff'd*,

you believe to be misleading, uninformative, irrational, or so lacking in factual justification as to be close to a pure falsehood. It is not fair to regard as "objective" news the propaganda of an incumbent politician. It is not "fair" to require the licensee to present a balance of only those views which the government considers "significant,"[72] regardless of the licensee's view. In sum, in order to determine what the "other side" is, one has to have an objective concept of truth against which to compare the challenged speech. And who in this country is in possession of this objective concept of truth?

III. Alternatives to Remedy Present Failures in Telecommunications Regulation

I do not mean by the foregoing to imply that I am satisfied with the performance of either the broadcast or the printed press. The many concerns voiced about the excessive power and meager commitment to the public interest which the private press have demonstrated are not without merit. My project so far has been to indicate that the solutions relied upon at present may be unwise and contrary to our constitutional traditions. I very much believe that there are other solutions which are not only consistent with these traditions but which can be more effective in achieving the goals which many concerned citizens thought could be achieved by program regulation.

Before outlining these solutions, I think it important to state exactly what I believe to be the major problem in the broadcast media.

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460 F.2d 891 (D.C. Cir.), *cert. denied*, 409 U.S. 843 (1972). *See also* Columbia Broadcasting Sys., Inc. v. FCC, 454 F.2d 1018 (D.C. Cir. 1971); 120 Cong. Rec. S19,449 (daily ed. Nov. 18, 1974); T. Emerson, *supra* note 39, at 670-71; N. Minow, J. Martin & L. Mitchell, Presidential Television (1973); Jaffe, WHDH: *The FCC and Broadcasting License Renewals*, 82 Harv. L. Rev. 1693, 1700-01 (1969). Several of these authorities cited deal with the power of the President over television and are relevant to our discussion in two different ways: on the one hand, they suggest the extremely difficult problems involved in erecting a Fairness Doctrine duty around Presidential appearances on TV and on the other hand, they demonstrate the dangers involved in this power over the private press. The President has no such access to the *Washington Post* or the *New York Times*.

72. *Cf.* Black United Front, 48 F.C.C.2d 1013, 1015 (1974), *citing* Dr. Benjamin Spock, 38 F.C.C.2d 316 (1972) (Fairness Doctrine applies only to "significant" viewpoints). *See also* 3 E. Barnouw 47; F. Friendly, *supra* note 17, at 3-12 (both discussing the problem facing Edward R. Murrow in his famous broadcast on the loyalty purge of Lt. Milo Radulovich, when the military refused to present the "other side" of the issue and network policy was not to telecast the program unless the two "sides" were presented). For another example, see 120 Cong. Rec. S20,475 (daily ed. Dec. 4, 1974) (article by Nat Hentoff).

This problem is not "scarcity," as that term has come to be defined in First Amendment jurisprudence, but rather simple, old-fashioned concentration of economic power and ownership of TV facilities. The situation would be bad enough if we considered only the actual licensees.[73] But the major concentration is caused by the dominance of the networks in the programming field.[74] The dominance of the networks makes enforcement of the diversification guides and stiff cross-ownership rules, further restriction of the group ownership rules, elimination of trafficking in licenses, combined with retroactive enforcement of these new policies, an insufficient effort to deal with the concentration of economic power in TV programming. The major project for reform, then, must be an increase in programming competition. This increase in programming competition, it should be noted, attempts to deal directly with the central evil that concentration allegedly creates—a lack of diversity of ideas. More competitors producing programming will increase the multitude of tongues, and our First Amendment faith holds that the multitude of tongues unrestricted in speech will produce more diversity of ideas than if the government chooses who will speak and on what subjects.[75] Actions designed to increase competition within the press and thereby to decentralize power are consistent with the First Amendment, and the Supreme Court has so held.[76]

There is one ironic aspect of efforts to reduce network domination of programming in favor of the First Amendment concept of a diversity of speakers: only the networks and the large economic organizations, like the *Washington Post* or the *New York Times*, have the power to stand up to big government efforts to "chill" their speech. I have noted before that one problem with the application of the Fairness Doctrine is that it imposes a stiff financial burden on "shoestring" operations.[77] This burden is even greater when a small licensee confronts a quasi-criminal forfeiture or revocation proceeding or confronts the poised force of the Oval Office. We are told that persons in the Nixon Administration believed that local stations were more pliable and re-

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73. Bennett, *Media Concentration and the FCC: Focusing with a Section Seven Lens*, 66 NW. U.L. REV. 159, 181-86 (1971).

74. The networks originate about sixty-four percent of all programming for their affiliated stations. The percentage is much higher during evening prime time hours. BROADCASTING YEARBOOK 70 (Broadcasting Magazine ed. 1974).

75. Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 270-72 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result); Multiple Ownership 1007-11 (Robinson, Comm'r, concurring in part, dissenting in part).

76. *See* Associated Press v. United States, 326 U.S. 1, 20 (1945).

77. *See* Brandywine-Main Line Radio, Inc. v. FCC, 473 F.2d 16, 69-70 (D.C. Cir. 1972) (Bazelon, C.J., dissenting), *cert. denied*, 412 U.S. 922 (1973). See note 14 *supra*.

sponsive to the Nixon viewpoint on the Watergate Affair; thus they sought to remove network reporters as the source of news and replace them with local journalists purportedly more attuned to the Nixon Administration world view.[78] From another perspective we might consider how a less secure economic organization would have reacted after it was publicly revealed that the President had warned that it was going to have "damnable, damnable problems" getting its radio and TV licenses renewed.[79] We know that the *Washington Post*, which suffered exactly this event, was not deterred from its presentation of the facts as its reporters saw them. But would all other licensees react similarly? The paradox I have just described may be more apparent than real since it may be partially resolved by getting the government out of the program regulation business. Without the FCC lever to manipulate, we could hope that there would be less chance that the licensees would be forced to kowtow to the wishes of an incumbent politician.

A. Reform of the FCC Itself

The first strategy to increase competition in the telecommunications broadcast field is to reform the FCC itself. Mr. Geller, former General Counsel of the FCC and an informed critic of the Commission's policy, has stated that the "root cause of dissatisfaction" with the FCC is its "overidentification with the industries regulated" as against the interests of "new emerging facets or technologies."[80] He is not alone in this assessment. There can be no promulgation or effective enforcement of policies designed to increase competition in programming unless we have an FCC which is not beholden to the vested interests of the VHF licensees. Mr. Geller makes what he terms a "modest" proposal that the number of Commissioners be limited to five, that they be given one fifteen-year term with no possibility for reappointment and that they be prohibited from employment in the communications field for ten years after completion of their terms.[81] I am not en-

78. *See* Memorandum for H.R. Haldeman from J.S. Magruder, Oct. 17, 1969, ¶ 4, *reprinted in* Appendix B.

79. See text accompanying note 1 *supra*. Because the *Washington Post* published the Pentagon Papers it was threatened with criminal prosecution. Mrs. Graham, the publisher of the *Washington Post*, said in a television interview in 1973 that "Mr. Kleindienst [then the Deputy Attorney General] had suggested [in the summer of 1971] that if the criminal cases against The Post were successful they might jeopardize the licenses of the paper's television stations." New York Times, July 30, 1973, at 16, col. 1.

80. *See* H. GELLER, *supra* note 40, at 2.

81. *Id.* at 48-49. *See also* COMMITTEE FOR ECONOMIC DEVELOPMENT, BROADCASTING AND CABLE TELEVISION: POLICIES FOR DIVERSITY AND CHANGE 80-88 (1975) and authorities cited.

tirely convinced by this proposal, but it, or something like it, would seem to be in order.

B. *Increasing Private Competition in the Production and Placement of Programming*

Assuming that this first strategy is successful, a further strategy—increasing *private* competition in the production and placement of programming—comes to mind. Several measures may be taken in this regard. The first step is to limit the networks' ability to sell blocks of programming to the licensees and to increase the feasibility of new networks.[82] Second, the Commission should act to encourage the development of cable, in both pay and nonpay forms, and the further development of UHF.[83] Part of the way to upgrade UHF might be to permit a return to selective de-intermixture. The ultimate aim must be

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82. The FCC has been battling over this issue for the past fifteen years. *See* Television Option Time, 34 F.C.C. 1103 (1963); Network Television Broadcasting, 45 F.C.C. 2146 (1965), *adopted in part*, Network Television Broadcasting, 23 F.C.C.2d 382 (1970), *on reconsideration*, 25 F.C.C.2d 318 (1970) (codified in 47 C.F.R. §§ 73.658 (j), (k) (1973)), *aff'd*, Mount Mansfield Television, Inc. v. FCC, 442 F.2d 470 (2d Cir. 1971), *reconsideration of Amendments*, Prime Time Access Rule, 37 F.C.C.2d 900 (1972), *amended*, 44 F.C.C.2d 1081, *rev'd and remanded*, National Ass'n of Independent Television Producers & Distribs. v. FCC, 502 F.2d 249 (2d Cir. 1974), *amended again*, Prime Time Access. *See also* Metropolitan Television Co. v. FCC, 289 F.2d 874 (D.C. Cir. 1961); H.R. REP. No. 281, 88th Cong., 1st Sess. (1963); Barrow, *The Attainment of Balanced Program Service on Television*, 52 VA. L. REV. 633 (1966). The purpose of these rules and other proposals discussed by the Commission has been to increase the number of brokers of programming. It seems that the limited prime time access of a half hour will have little effect in that regard; prior proposals which have limited networks to only fifty percent of prime time could have had more effect. For a discussion of the limits of efforts to increase the number of brokers involved in programming distribution for television, see Prime Time Access 724-40 (Robinson, Comm'r, dissenting); R. NOLL 58-79, 83-89. These commentaries suggest that the FCC must develop more local programming outlets before it can realistically attack the present dominance of three network brokers.

83. *See* R. NOLL 101-04, 129-82. The present inferiority of UHF can be arguably overcome if UHF were connected with a cable system (to create a better signal) and if the FCC would finally adopt a policy of de-intermixture (to overcome the entrenched advantage of the VHF licensees). Noll, Peck and McGowan are not sanguine about the possibilities of UHF development, largely because they think, with good reason, that the FCC will never take the actions necessary to overcome the present inferiority of UHF. *Id.* at 272-76. For some of the more visionary works on cable television and its possibilities, see SLOAN COMM'N ON CABLE COMMUNICATIONS, ON THE CABLE: THE TELEVISION OF ABUNDANCE (1971); R. SMITH, THE WIRED NATION (1972); Barnett, *State, Federal, and Local Regulation of Cable Television*, 47 NOTRE DAME LAW. 685 (1972); Barnett & Greenberg, *Regulating CATV Systems: An Analysis of FCC Policy and an Alternative*, 34 LAW & CONTEMP. PROB. 562 (1969). For a more pessimistic analysis, see Branscomb, *The Cable Fable: Will It Come True?*, 25 J. COMMUN. 44 (1975).

to equalize as much as possible the economic potential of the various bands of TV broadcasting. The broadcast industry is sure to fight these two suggestions tooth and nail. The industry was successful in crippling UHF development in the 1950's and today is battling to prevent pay cable from achieving economic self-sufficiency.[84] As with earlier industry efforts to restrict the competitive position of cable through local origination requirements, the issues are not simple. Creating more competition for advertising dollars might reduce the amount of genuine journalistic and artistic commitment that exists today.[85] It might create only a commercial monster larger than that now extant, resulting in the telecasting of more commercial pabulum and not the production of serious TV. We just do not know. The wisdom of the First Amendment is, however, that a multitude of tongues will produce the diversity of ideas and artistic achievement we all desire. In the absence of knowledge gained from experience with greater competition, I would follow this wisdom for the present.

C. *Public Broadcasting*

A third strategy was suggested many years ago by Max Lerner[86]—it is to create a "yardstick" public broadcasting company to compete

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84. On the crippling of UHF, see H. GELLER, *supra* note 40, at 3-12. For present restrictive FCC policies on cable television, see United States v. Midwest Video Corp., 406 U.S. 649 (1972); United States v. Southwestern Cable Co., 392 U.S. 157 (1968); 47 C.F.R. § 76 (1973). On present controversies over pay cable, see 47 C.F.R. § 76.225 (1973); Cablecasting of Programs for Which a Per-program or Per-channel Charge is Made, 35 F.C.C.2d 893 (1972); Program Origination by Cable Television Systems, 23 F.C.C.2d 825, 828 (1970). These rules require pay cable to abide by the restrictions on broadcast pay TV, upheld in National Ass'n of Theatre Owners v. FCC, 420 F.2d 194 (D.C. Cir. 1969), *cert. denied*, 397 U.S. 922 (1970). The Commission has recently called for further briefing and argument on even more restrictive conditions on the development of pay cable. 48 F.C.C.2d 453 (1974). Commissioner Robinson has criticized the restrictions on pay cable. Prime Time Access 740 (Robinson, Comm'r, dissenting). However, the Commission has recently relaxed to some extent the local origination requirements on cable TV. Program Origination by Cable Television Systems, 32 P & F. RADIO REG. 2D 123 (F.C.C. 1974).

85. *See* Citizens Comm. to Save WEFM v. FCC, 506 F.2d 252, 271 (D.C. Cir. 1974) (rehearing en banc) (Bazelon, C.J., concurring in the result); Multiple Ownership 1014-17 (Robinson, Comm'r, concurring in part, dissenting in part).

86. Lerner, *Propaganda's Golden Age*, 149 THE NATION 522 (1939), *excerpted in* NEW DEAL THOUGHT 179 (H. Zinn ed. 1966). *See also* CARNEGIE COMM'N ON PUBLIC TELEVISION, PUBLIC TELEVISION: A PROGRAM FOR ACTION (1967); R. NOLL 208-44; H. ASHMORE, FEAR IN THE AIR 89-111 (1973); Branscomb, *A Crisis of Identity: Public Broadcasting and the Law*, 3 PUBLIC TELECOMM. REV. 10 (1975). On present provisions for Public Broadcasting, see 47 U.S.C. §§ 390-99 (1970). For recently proposed amendments, see S. REP. No. 1113, 93d Cong., 2d Sess. (1974); 120 CONG. REC. S13,552 (daily ed. July 29, 1974). Two alternative systems for financing public broadcasting in a manner which prevents political interference of the sort

with VHF licensees and the networks. This idea has to some extent been consummated by the public broadcasting or noncommercial stations now in existence. But more should be done. First, these stations should have access to the VHF band, since now they are almost entirely relegated to the less powerful UHF bands. Second, there should be provision for common carrier public stations or common carrier time periods on regular public stations, to which access may be had by lottery or through bidding. This concept has already been applied to a limited extent in the cable TV regulations.[87] Third, public TV should take a more active role in producing programming. This requires either more government funds or a limited form of pay television. But it can be done, and if it is, there is the promise of a new outlet for creative and diverse programming.

D. *Altering the Economic Structure of the Telecommunications Industry*

A fourth strategy would be to directly attack the economics of TV programming and the institutional structure which creates that economic reality. The most obvious effort would be to increase the viability of minority taste programming by introducing some form of subscriber TV service.[88] At present, programming is paid for only by advertisers, unlike the material in newspapers which is partially paid for by subscribers, and unlike movies which are wholly paid for by subscribers. The result is that the dictates of the advertisers—mass circulation—are the prime factor in evaluating the economic viability of programs. A limited form of subscriber TV would alter this situation, since at least in part the programming would be directed to those who would be willing to pay and who would most likely comprise a highly motivated, minority audience, instead of the low motivation, mass audience gained by so-called "free" TV. Government subsidy of programs for the poor might be necessary. Another line of attack would be to limit drastically the amount of commercial time which may be sold on television.[89] This approach would of necessity reduce the dominance

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demonstrated in regard to present broadcast TV are (1) an excise tax on all TV and radio sets sold in the country; and (2) allocation of a portion of revenues from communications satellites. On satellites, see R. NOLL 245-55.

87. *See* 47 C.F.R. § 76.251(a) (1973).

88. *See* R. NOLL 32-33, 50, 129-34; Minasian, *Television Pricing and the Theory of Public Goods*, 7 J. LAW & ECON. 71, 75 (1964).

89. *See* Jaffe, *supra* note 71, at 1693, 1700-01. David Sarnoff suggested in the twenties that advertising be banned from telecommunications. F. FRIENDLY, *supra* note 17, at 266. *See generally id.* at 266-300. The FCC presently employs a case-by-case analysis of the amount of commercial time broadcast by a licensee. *See* Commercial

of advertising concerns and force programmers into a search for alternative sources of cash.

If these strategies are diligently pursued, they and others like them offer an opportunity to turn away from program regulation in all the diverse forms in which the FCC presently employs it in favor of a direct attack on the vested power of the VHF licensees and the networks. This change in policy direction is strongly supported by the First Amendment interests that are involved in program regulation. So, we would in effect be vindicating the First Amendment in two ways—by avoiding program regulation and by increasing the number of speakers in order to realize First Amendment values more fully. If these strategies I have discussed are effective, I think the FCC can confidently dismantle the entire system of program regulation it has erected in the past forty years and thereby recognize the broadcast media as true components of the American press. If these strategies are not pursued, there will continue to be pressure to impose public duties on these monopolistic entities, the networks and the licensees—pressure which will come under the guise of "fiduciary duty" or "scarcity of frequencies" or "power of the medium" but which will be essentially a traditional fear of monopoly power. I think the fear is reasonable but should be confronted on its own ground and not chased back

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Advertising Standards, 1 P & F RADIO REG. 2D 1606 (F.C.C. 1964).

Still another effort would be to explicitly license the networks as brokers and limit their involvement in programming to this brokerage role. This brokerage role of the networks is described by Commissioner Robinson, dissenting in Prime Time Access 724-40. It has been noted that the market in programming *production* is reasonably competitive (sixty-five to seventy firms sold regular series; mortality of firms is high; no firm has more than ten percent of the network series programming). R. NOLL 5, 44-49. This observation suggests that the problem of market dominance lies in distribution. The propriety of some FCC jurisdiction over networks is established by National Broadcasting Co. v. United States, 319 U.S. 190 (1943). *See* Mount Mansfield Television, Inc. v. FCC, 442 F.2d 470 (2d Cir. 1971).

With explicit recognition of the networks' roles as programming directors, many duties now somewhat mechanically imposed upon licensees could be realistically imposed on the networks. These duties would include the "ascertainment requirement," Suburban Broadcasters, 30 F.C.C. 1021 (1961), *aff'd sub nom.* Henry v. FCC, 302 F.2d 191 (D.C. Cir.), *cert. denied*, 371 U.S. 821 (1962), and the various "balanced programming" responsibilities discussed at the beginning of this Article. This suggestion assumes that the constitutionality of such requirements is established. To legitimize this brokerage role, the FCC would have to back away from its traditional support of "local service." *See* R. NOLL 99-120. Furthermore, the FCC might in such circumstances be given the authority to regulate the network brokerage fees which are today enormous and which result in the very high profits of the industry. *Id.* at 15-17. The suggestion made here to license the networks as brokers might free up competition in the production of programming and permit minority program producers to have a better shot at a nationwide distribution.

into the hoary swamps of government regulation of speech.[90]

IV. APPENDICES

Appendix A

FOR: HERB KLEIN

FROM: CHUCK COLSON

FYI—EYES ONLY, PLEASE

September 25, 1970

MEMORANDUM FOR H.R. HALDEMAN

The following is a summary of the most pertinent conclusions from my meeting with the three network chief executives.

1. The networks are terribly nervous over the uncertain state of the law, *i.e.*, the recent FCC decisions and the pressures to grant Congress access to TV. They are also apprehensive about us. Although they tried to disguise this, it was obvious. The harder I pressed them (CBS and NBC) the more accommodating, cordial and almost apologetic they became. Stanton for all his bluster is the most insecure of all.
2. They were startled by how thoroughly we were doing our homework—both from the standpoint of knowledge of the law, as I discussed it, but more importantly, from the way in which we have so thoroughly monitored their coverage and our analysis of it. (Allin's analysis is attached. This was my talking paper and I gave them the facts and figures.)
3. There was unanimous agreement that the President's right of access to TV should in no way be restrained. Both CBS and ABC agreed with me that on most occasions the President speaks as President and that there is no obligation for presenting a contrasting point of view under the Fairness Doctrine (This, by the way, is not the law—the FCC has always ruled that the Fairness Doctrine always applies—and either they don't know that or they are

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90. *Cf.* Prime Time Access 740 (Robinson, Comm'r, dissenting):

> Unless the Commission confronts the issue of network *economic power* head-on, it will simply sit as a constant arbitrator among groups competing for the scarcity rents which it has created by its allocation plan and the current access rule. . . . [The Commission] should carry out its authority to increase competitive outlets in a manner which prevents the development of monopoly power.

See also Multiple Ownership 1011, 1014-17 (Robinson, Comm'r, concurring in part, dissenting in part). Senator Proxmire has recently introduced a bill to remove the FCC from the program regulation business. S. 2, 94th Cong., 1st Sess. (1975).

willing to concede us the point.) NBC on the other hand argues that the fairness test must be applied to every Presidential speech but Goodman is also quick to agree that there are probably instances in which Presidential addresses are not "controversial" under the Fairness Doctrine and, therefore, there is no duty to balance. All agree no one has a right of "reply" and that fairness doesn't mean answering the President but rather is "issue oriented." This was the most important understanding we came to. What is important is that they know how strongly we feel about this.

4. They are terribly concerned with being able to work out their own policies with respect to balanced coverage and not to have policies imposed on them by either the Commission or the Congress. ABC and CBS said that they felt we could, however, through the FCC make any policies we wanted to. (This is worrying them all.)
5. To my surprise CBS did not deny that the news had been slanted against us. Paley merely said that every Administration has felt the same way and that we have been slower in coming to them to complain than our predecessors. He, however, ordered Stanton in my presence to review the analysis with me and if the news has not been balanced to see that the situation is immediately corrected. (Paley is in complete control of CBS—Stanton is almost obsequious in Paley's presence.)
6. CBS does not defend the O'Brien appearance. Paley wanted to make it very clear that it would not happen again and that they would not permit partisan attacks on the President. They are doggedly determined to win their FCC case, however; as a matter of principle, even though they recognize that they made a mistake, they don't want the FCC in the business of correcting their mistakes.
7. ABC and NBC believe that the whole controversy over "answers" to the President can be handled by giving some time regularly to presentations by the Congress—either debates or the State-of-The-Congress-type presentations with both parties in the Congress represented. In this regard ABC will do anything we want. NBC proposes to provide a very limited Congressional coverage once or twice a year and additionally once a year "loyal opposition" type answers to the President's State of the Union address (which has been the practice since 1966). CBS takes quite a different position. Paley's policy is that the Congress cannot be the sole balancing mechanism and that the Democratic leadership in Congress should have time to present Democratic viewpoints on legislation.

(On this point, which may become the most critical of all, we can split the networks in a way that will be very much to our advantage.)

Conclusion:

I had to break every meeting. The networks badly want to have these kinds of discussions which they said they had had with other Administrations but never with ours. They told me any time we had a complaint about slanted coverage for me to call them directly. Paley said that he would like to come down to Washington and spend time with me anytime that I wanted. In short, they are very much afraid of us and are trying hard to prove they are "good guys."

These meetings had a very salutary effect in letting them know that we are determined to protect the President's position, that we know precisely what is going on from the standpoint of both law and policy and that we are not going to permit them to get away with anything that interferes with the President's ability to communicate.

Paley made the point that he was amazed at how many people agree with the Vice-President's criticism of the networks. He also went out of his way to say how much he supports the President, and how popular the President is. When Stanton said twice as many people had seen President Nixon on TV than any other President in a comparable period, Paley said it was because this President is more popular.

The only ornament on Goodman's desk was the Nixon Inaugural Medal. Hagerty said in Goldenson's presence that ABC is "with us." This all adds up to the fact that they are damned nervous and scared and we should continue to take a very tough line, face to face, and in other ways.

As to follow-up, I believe the following is in order:

1. I will review with Stanton and Goodman the substantiation of my assertion to them that their news coverage has been slanted. We will go over it point by point. This will, perhaps, make them even more cautious.

2. There should be a mechanism (through Herb, Ron or me) every time we believe coverage is slanted whereby we point it out either to the chief executive or to whomever he designates. Each of them invited this and we should do it so they know we are not bluffing.

3. I will pursue with ABC and NBC the possibility of their issuing declarations of policy (one that we find generally favorable as to the President's use of TV). If I can get them to issue such a policy statement, CBS will be backed into an untenable position.

4. I will pursue with Dean Burch the possibility of an interpretive ruling by the FCC on the role of the President when he uses TV, as soon as we have a majority. I think that this point could be very favorably clarified and it would, of course, have an inhibiting impact on the networks and their professed concern with achieving balance.

5. I would like to continue a friendly but very firm relationship whenever they or we want to talk. I am realistic enough to realize that we probably won't see any obvious improvement in the news coverage but I think we can dampen their ardor for putting on "loyal opposition" type programs.

I have detailed notes on each meeting if you'd like a more complete report.

Charles W. Colson

Appendix B

MEMORANDUM

THE WHITE HOUSE

Washington

October 17, 1969

MEMORANDUM FOR: H.R. HALDEMAN

FROM: J.S. MAGRUDER

RE: The Shot-gun versus the Rifle

Yesterday you asked me to give you a talking paper on specific problems we've had in shot-gunning the media and anti-Administration spokesmen on unfair coverage.

I have enclosed from the log approximately 21 requests from the President in the last 30 days requesting specific action relating to what could be considered unfair news coverage. This enclosure only includes actual memos sent out by Ken Cole's office. In the short time that I have been here, I would gather that there have been at least double or triple this many requests made through various other parties to accomplish the same objective.

It is my opinion this continual daily attempt to get to the media or to anti-Administration spokesmen because of specific things they have said is very unfruitful and wasteful of our time. This is not to say that they have not been unfair, without question many situations that have been indicated are correct, but I would question the approach we have taken. When an editor gets continual calls from Herb Klein or Pat Buchanan on a situation that is difficult to document as to unfairness,

we are in a very weak area. Particularly when we are talking about interpretation of the news as against factual reporting.

The real problem that faces the Administration is to get to this unfair coverage in such a way that we make major impact on a basis which the networks-newspapers and Congress will react to and begin to look at things somewhat differently. It is my opinion that we should begin concentrated efforts in a number of major areas that will have much more impact on the media and other anti-Administration spokesmen and will do more good in the long run. The following is my suggestion as to how we can achieve this goal:

1. Begin an official monitoring system through the FCC as soon as Dean Burch is officially on board as Chairman. If the monitoring system proves our point, we have then legitimate and legal rights to go to the networks, etc., and make official complaints from the FCC. This will have much more effect than a phone call from Herb Klein or Pat Buchanan.

2. Use the anti-trust division to investigate various media relating to anti-trust violations. Even the possible threat of anti-trust action I think would be effective in changing their views in the above matter.

3. Utilizing the Internal Revenue Service as a method to look into the various organizations that we are most concerned about. Just a threat of an IRS investigation will probably turn their appraoch.

4. Begin to show favorites within the media. Since they are basically not on our side let us pick the favorable ones as Kennedy did. I'm not saying we should eliminate the open Administration, but by being open we have not gotten anyone to back us on a consistent basis and many of those who were favorable towards us are now giving it to us at various times, i.e., Ted Lewis, Hugh Sidiy [*sic*].

5. Utilize Republican National Committee for major letter writing efforts of both a class nature and a quantity nature. We have set-up a situation at the National Committee that will allow us to do this, and I think by effective letter writing and telegrams we will accomplish our objective rather than again just the shot-gun approach to one specific senator or one specific news broadcaster because of various comments.

I would liken this to the Kennedy Administration in that they had no qualms about using the power available to them to achieve their objectives. On the other hand, we seem to march on tip-toe into the political situation and are unwilling to use the power at hand to achieve our long term goals which is [*sic*] eight years of a Republican Administration. I clearly remember Kennedy sending out the FBI men to wake-

up the Steel Executives in the middle of the night. It caused an uproar in certain cases but he achieved his goal and the vast majority of the American public was with him. If we convince the President that this is the correct approach, we will find that various support groups will be much more productive and much more cooperative; and at the same time I think we will achieve the goals this Administration has set out to do on a much more meaningful planned basis.

PRESIDENT'S REQUEST—

TO:	ITEM:	DATE:
P. Flanigan	President's request that you take action to counter Dan Rather's allegation that the Hershey move was decided upon because of the moratorium. (Log 1733)	October 17
J. Ehrlichman	President's request that you talk to Ted Lewis concerning the present status of discipline within the Administration. (Log 1699)	October 15
P. Buchanan	President's request for a report on what actions were taken to complain to NBC, *Time* and *Newsweek* concerning a recent article coverage on the Administration. (Log 1688)	October 14
H. Klein	President's request for letters to the editor of *Newsweek* mentioning the President's tremendous reception in Miss. and last Sat. Miami Dolphin football game. (Log 1627)	October 10
H. Klein	President's request that you take appropriate action to counter biased TV coverage of the Adm. over the summer. (Log 1644) CONFIDENTIAL	October 14
H. Klein	President's request that you ask Rogers Morton to take action to counter Howard K. Smith's remarks concerning the three House seats lost by the GOP this year . (Log 1558)	October 8
P. Buchanan	President's request that appropriate columnists be informed of the extemporaneous character of Presidential press conferences. (Log 1551)	October 10

H. Klein	President's request that you demand equal time to counter John Chancellor's commentary regarding the Haynsworth nomination. (Log 1559)	October 7
H. Klein	President's request for a report on what action is taken concerning Sen. Muski's [*sic*] appearance on the "Merv Griffin Show."	October 8
A. Butterfield	President's request for a report what [*sic*] resulted from our PR efforts following up the Friday Press Conference. (Log 1496)	October 3
H. Klein	President's request that we have the CHICAGO TRIBUNE hit Senator Percy hard on his ties with the peace group. (Log 1495) CONFIDENTIAL	October 3
H. Klein	President's request for letters to the editor regarding *Newsweek's* lead article covering the President's U.N. speech. (Log 1443)	September 30
H. Klein	President's request that we counter Ralph Nader's remarks regarding Virginia Knauer accessability [*sic*] to the President. (Log 1404)	September 29
H. Klein Ron Ziegler	President's request that you attack *Life* Magazine's editorial accusing the Administration of creating a Coherence Gap. (Log 1366)	September 27
H. Klein	President's request that you contact Howard K. Smith and give him the true record on what the Administration has done. (Log 1367)	September 26
A. Butterfield	Sen. Kennedy's Boston speech alleging that the war in Vietnam remains virtually unchanged. (Log 1292)	September 23
P. Flanigan	Ralph Nader's charge that the President pays little attention to consumer affairs. (Log 1293)	September 24
Dr. Kissinger	Article by Jack Anderson which alleges that some U.S. officers in Vietnam favor Thieu's hard line over the President's moderate policy and are sabotaging the truce efforts. (Log 1281)	September 23

H. Klein	President's request that you inform Walter Trohan about our substantive programs and that you place the blame for inaction on the Democratic Congress. (Log 1246)	September 20
J. Ehrlichman	President's request for a report on possible answers to Evans-Novak charge of an Administration retreat on tax reform. (Log 1224)	September 23
Dr. Kissinger	President's request for a report on Walter Cronkite's comment that the South Vietnamese did not observe the truce resulting from Ho Chi Minh's death. (Log 1154)	September 16

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Policy Analysis

Chilling The Internet?
Lessons from FCC Regulation of Radio Broadcasting

by Thomas W. Hazlett and David W. Sosa

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Executive Summary

Congress included the Communications Decency Act in the Telecommunications Act, which was signed into law on February 8, 1996. The CDA sought to outlaw the use of computers and phone lines to transmit "indecent" material and provided jail terms and heavy fines for violators. Proponents of the act argue that it is necessary to protect minors from undesirable speech on the burgeoning Internet. The CDA was immediately challenged in court by the American Civil Liberties Union, and the special three-judge federal panel established to hear the case recently declared the act unconstitutional. Yet its ultimate adjudication remains in doubt.

Ominously, the federal government has long experimented with regulations designed to improve the content of "electronic" speech. For example, the Fairness Doctrine, imposed on radio and television stations until 1987, was an attempt to establish a standard of "fair" coverage of important public issues. The deregulation of content controls on AM and FM radio programming, first under the Carter Federal Communications Commission in early 1981 and then under the Reagan FCC (which abolished the Fairness Doctrine in 1987), led to profound changes in radio markets. Specifically, the volume of informational programming increased dramatically immediately after controls were ended--powerful evidence of the potential for regulation to have a "chilling effect" on free speech.

Introduction

Fearing that the anarchic nature of the Internet might unleash an "electronic red-light district," Sens. Jim Exon (D-Neb.) and Slade Gorton (R-Wash.) introduced the Communications Decency Act in February 1995. The CDA allows for fines of up to $250,000 and two years imprisonment for anyone who, "by means of a telecommunications device knowingly makes, creates, or solicits, and initiates the transmission of, any comment, request, suggestion, proposal, image, or other communication which is obscene or indecent, knowing that the recipient of the communication is under 18 years of age, regardless of whether the maker of such communication placed the call or initiated the communication." Spurred by conservative groups such as the Christian Coalition, and reflecting a desire on the part of lawmakers to avoid being labeled "pro-smut," the bill passed the Senate as an amendment to the Telecommunications Act of 1996 by a vote of 84 to 16. In a congressional conference committee, the language of the CDA survived several challenges, and it became law when President Clinton signed the Telecommunications Act on February 8, 1996. [1]

Several significant criticisms of the legislation have been raised. First, there are serious questions about the constitutionality of the CDA. The act outlaws the transmission of "indecent" speech over the Internet, in spite of the fact that indecency is a category of speech that the Supreme Court has previously ruled deserving of protection under the First Amendment. Indecency differs from obscenity, which is not afforded First Amendment protection, in that--while both appeal to the prurient--indecent speech, when considered in its entirety, possesses some "serious artistic, literary, political or scientific value." [2] Interestingly enough, the U.S. Department of Justice, which is now in the position of defending the CDA in a court challenge, previously held the position that the CDA might "threaten important First Amendment and privacy rights." [3]

Indeed, the CDA had to overcome serious congressional resistance on the way to becoming law. Recognizing the difficulties of criminalizing a form of speech generally afforded First Amendment protection, many members of the House were initially not amenable to sponsoring a bill bordering on censorship. House Speaker Newt Gingrich (R-Ga.) declared the Exon amendment "clearly a violation of free speech and a violation of the right of adults to communicate with each other." [4] In an effort to sidestep constitutional concerns, Reps. Christopher Cox (R-Calif.) and Ron Wyden (D-Ore.) drafted a more moderate proposal, [5] and on August 4, 1995, the House voted 421 to 4 to attach the Cox-Wyden amendment to the House Telecommunications Reform Bill. An attempt was made in conference committee to reconcile the House and Senate versions by replacing the indecency standard with a "harmful to minors" standard, but a last-minute proposal by Rep. Bob Goodlatte (R-Va.) reinstated the indecency standard, which passed by a one-vote margin.

Anticipating legal challenges to the CDA, Congress provided for an abbreviated review of the rule in the Telecommunications Act. The first lawsuit was to be heard by a special three-judge panel in Philadelphia, and any subsequent appeal would go directly to the Supreme Court. Indeed, a broad coalition of civil libertarian groups and high-tech firms, for which the American Civil Liberties Union was the lead plaintiff, filed a lawsuit seeking to overturn the CDA the day President Clinton signed the bill. On February 15, 1996, Judge Ronald Buckwalter granted the ACLU's request for a temporary restraining order against the CDA, [6] and on June 11 the three-judge panel issued its ruling, striking down the CDA on constitutional grounds. [7] The Department of Justice sequently announced that it would appeal to the Supreme Court.

Second, some people consider the CDA unnecessary legislation. The Department of Justice has argued that existing obscenity laws are sufficient to target pornographic material on the Internet. In fact, it noted that "the Department's Criminal Division has, indeed, successfully prosecuted violations of federal child pornography and obscenity laws which were perpetrated with computer technology." [8]

A third problem with the legislation is that, while the Internet is not devoid of graphic discourse and erotic imagery, it may not be the smut hub that political alarmists allege. In mid-1995 *Time* was forced to retreat from an incendiary cover story that drastically overstated the availability of pornography on the Internet. [9] Moreover, software programs that allow parents to exclude access to off-color material are available from a number of vendors. Subsequent reports suggest that X-rated material is not prolific on the Internet and that it is rarely available to browsing innocents. Usually, one must pay a fee to partake of more intimate images and language. [10] In fact, the Senate had a choice between the CDA and a proposal by Pat Leahy (D-Vt.) to commission a study of Internet speech. [11] The Leahy bill, which did not pass in the Senate, would have ordered the Department of Justice to evaluate whether pornography

on the Internet was a problem that needed fixing. [12]

Beyond those oft-cited criticisms lies a more compelling argument against interfering with Internet speech, whether in the form of the CDA or some yet-to-be-crafted mandate that attempts to curb undesirable Internet communication. The CDA is the most recent incarnation of a regulatory tool typically applied to broadcasters, content regulation. Content regulations attempt to control the flow of information by imposing sanctions on content providers (licensees in broadcasting, networks and individuals on the Internet) should certain communications be deemed inappropriate. Previous content rules, as applied to broadcasters, range from "non-entertainment guidelines" to the Fairness Doctrine to the "equal time" rule for coverage of political candidates.

Because content regulation carries the danger of a "chilling effect" on speech, it has always walked a constitutional fine line. Relying on a dubious analysis of "physical scarcity" and a fanciful history of the "chaos" in the 1920s radio market, [13] the Supreme Court has determined that the electronic press enjoys less protection from government regulation than does the print press. [14] The Court has also held, however, that its views of the matter would change markedly if evidence of a chilling effect of regulation were to be found.

In a landmark 1969 case, *Red Lion Broadcasting Co. v. FCC*, the Supreme Court ruled that provisions in the Fairness Doctrine obliging broadcasters to provide free airtime to individuals who wished to respond to a personal attack did not violate the First Amendment. The Court's eight-to-zero decision assumed that the doctrine was effective in increasing the coverage of controversial issues by broadcasters, but it also noted the potential for a chilling effect.

> It is strenuously argued . . . that if political editorials or personal attacks will trigger an obligation in broadcasters to afford the opportunity for expression to speakers who need not pay for time and whose views are unpalatable to the licensees, then broadcasters will be irresistibly forced to self-censorship and their coverage of controversial public issues will be eliminated or at least rendered wholly ineffective. Such a result would indeed be a serious matter, for should licensees actually eliminate their coverage of controversial issues, the purposes of the doctrine would be stifled. . . . And if experience with the administration of these doctrines indicates that they have the net effect of reducing rather than enhancing the volume and quality of coverage, there will be time enough to reconsider the constitutional implications. [15]

Several factors contribute to the potential "chill" of content regulation. Principal among them are that standards tend to be vague and broad (what constitutes "fairness" or "indecency"?) and economic penalties severe (broadcasters face potential loss of license for violating FCC rules; the CDA allows for up to $250,000 in fines and two years in prison). With such a pairing of incentives, content providers will tend to self-censor to avoid getting anywhere near the fuzzy line between acceptable and unacceptable (or even criminal) speech. Thus it is possible that legitimate (i.e., constitutionally protected) speech will not be transmitted, simply to avoid the risk of regulatory or legal sanction (and attendant litigation costs), thereby eliciting the chilling effect on speech the Court was concerned about. Indeed, in issuing a temporary restraining order against the CDA, Judge Ronald L. Buckwalter voiced his concern about the vague nature of the indecency standard.

> Where I do feel that the plaintiffs [ACLU et al.] have raised serious, substantial, difficult and doubtful questions is in their argument that the CDA is unconstitutionally vague. . . .

> This strikes me as being serious because the undefined word "indecent," standing alone, would leave reasonable people perplexed in evaluating what is or is not prohibited by the statute. It is a substantial question because this word alone is the basis for a criminal felony prosecution. [16]

Since 1969 at least three compelling "events" have produced evidence that FCC content rules have a chilling effect on controversial speech on radio and television, evidence the Court could not find in *Red Lion*. First, Fred Friendly's 1975 book, *The Good Guys, The Bad Guys and the First Amendment*, showed that the very application of FCC regulation, at issue in *Red Lion*, was (unbeknownst to the Supreme Court) an effort at suppressing free speech by filing Fairness Doctrine challenges. Second, the FCC itself issued a study in 1985 that demonstrated, under the "public interest" standard of the 1934 Communications Act, that the Fairness Doctrine had served as a disincentive to broadcasters' airing controversial news and public opinion programming. Finally, since FCC repeal of the Fairness Doctrine in 1987, we can observe the effect of deregulation on radio markets--a stunning increase in the provision of informational programming. As shown below, that explosion in news, talk, and public affairs formats, on both AM and FM, is powerful evidence that the FCC's previous efforts to regulate broadcast content did indeed result in a chilling effect. Thus, by the Supreme Court's own legal analysis, content controls on electronic speech should be unconstitutional. [17]

A recent case suggests that the indecency standard of the CDA might well extend its chill all the way into the dead center of social discourse. Consider the case of breast cancer discussion groups carried by America Online, the largest Internet service provider. In December 1995 AOL came under fire for declaring the word "breast" obscene and censoring user profiles and chat room titles devoted to breast cancer survivors. Apparently, however, that was not AOL's first encounter with that particular problem. Earlier in the summer, breast cancer survivors, blocked from creating a forum with the word "breast" in the title, created a "hooter cancer survivor" forum. [18]

In an effort to comply with the anticipated indecency standard of the CDA, the company had decided to eliminate "vulgar" words such as breast from the network. That is an illustration of decent, constitutionally protected speech chilled by the mere anticipation of a vague indecency standard. The more uncertain the speaker (in this case AOL) is about whether or not a particular issue will trigger official sanction and the harsher the anticipated sanction (in economic costs and legal penalties), the more likely the speaker is to self-censor.

This paper concentrates on the effects content regulation has had on the provision of broadcast news and informational programming offered the American public--effects that suggest that federal regulation of content can sharply constrain the quality and quantity of public debate. Strong parallels can be drawn with the CDA; our previous experience with regulating electronic speech offers warning signals today.

Content Regulation in Broadcasting

The 1927 Radio Act created the Federal Radio Commission, establishing federal control over the airwaves. The 1927 law, which was designed to be provisional, was renewed every year until 1934 when Congress passed the Communications Act, which replaced the FRC with the Federal Communications Commission. [19] Spectrum access continues to be governed by the 1934 act. [20] The FCC was charged with licensing and overseeing broadcasters according to "the public interest, convenience or necessity." In addition to developing a federal licensing system for broadcasters, [21] the FRC, later the FCC, determined that certain types of speech were required by the public interest standard, as the FCC

enunciated in its 1949 report, *Editorializing by Broadcast Licensees*.

> It is axiomatic that one of the most vital questions of mass communication in a democracy is the development of an informed public opinion through the public dissemination of news and ideas concerning the vital issues of the day. . . . The Commission has consequently recognized the necessity for licensees to devote a reasonable percentage of their broadcast time to the presentation of news and programs devoted to the consideration and discussion of public issues of interest in the community served by the particular station. And we have recognized, with respect to such programs, the paramount right of the public in a free society to be informed and to have presented to it for acceptance or rejection the different attitudes and viewpoints concerning these vital and often controversial issues which are held by the various groups which make up the community. [22]

The FCC argued that, in the absence of regulatory inducements, broadcasters would underprovide informative or controversial material, or both. The agency's 1949 report formalized its policy in the form of the Fairness Doctrine, which consisted of two requirements. First, licensees were required to provide coverage of "vitally important controversial issues of interest in the community served by the broadcaster." Second, licensees received a mandate to "provide a reasonable opportunity for the presentation of contrasting viewpoints on such issues." [23]

The FCC had a two-stage enforcement process for the Fairness Doctrine. In the first stage the FCC would request that a licensee respond to a complaint filed with the commission. That could eventually lead to a hearing and a ruling by the FCC either in favor of the plaintiff or in favor of the licensee. The penalties associated with a Fairness Doctrine complaint ranged from the legal and research costs of responding to the FCC's inquiry to giving the plaintiff free airtime. [24] The second stage of enforcement was the most potent weapon the FCC had, the power to revoke a license or refuse renewal for an uncooperative licensee.

Interestingly, the two prongs of the Fairness Doctrine yielded distinct economic incentives for broadcasters. The first prong can be characterized as an affirmative obligation, on the part of broadcasters, to increase the amount of informational programming. However, the FCC was careful to point out in most Fairness Doctrine proceedings that licensees had broad discretion over how they chose to satisfy that aspect of the rule. [25] The second prong, on the other hand, had more dramatic effects on format choice. The equal access provision, while intended to ensure that audiences were exposed to more than one viewpoint, had the perverse effect of penalizing broadcasters for airing controversial programming by leaving them vulnerable to litigation and demands for free airtime to voice opposing opinions.

While we might consider that the first prong had a potentially "warming effect" on the supply of controversial speech, the second prong had tremendous potential to chill constitutionally protected speech. In the following sections we review some of the more notable abuses of the Fairness Doctrine that suggest that its net effect on controversial speech was chilling rather than warming.

Content Regulation pre-"Fairness"

Efforts to use content regulation as a form of political control began with the advent of radio regulation. In 1928 the FRC renewed the license for WEVD, owned by the Socialist Party, only with the stern warning that the New York station must "operate with due regard for the opinions of others." [26]

Regulators had determined that programming that reflected the Socialist Party's agenda was not in the public interest. The following year the FRC refused an application by the Chicago Federation of Labor to increase the power and hours of its station WCFL, because the station was run "for the exclusive benefit of organized labor." The FRC ruled that since only a limited number of stations could broadcast, "all stations should cater to the general public and serve the public interest as against group or class interest." [27]

A decade later conservative broadcasters were pressured when the FCC sought to protect President Roosevelt from pro-business commentators. The regulatory target then was a regional network in New England, the unabashedly right-wing Yankee Network, which controlled three radio stations and ran commentary from the likes of Father Charles Coughlin, a controversial figure of the far right who was fond of referring to FDR as "Franklin Double-crossing Roosevelt." [28] In 1939 the Mayflower Broadcasting Company submitted a competing application to be granted a license to operate WAAB, one of the Yankee Network's Boston stations. [29] The license renewal challenge charged that Yankee broadcast political endorsements and partisan coverage of controversial issues with no concern for fairness or balance. Although the Mayflower application was thrown out for misrepresentation, the FCC took the opportunity to review Yankee's record in a formal hearing. The FCC's finding asserted that it was protecting the public from the unbalanced coverage.

> The record shows without contradiction that . . . it was the policy of Station WAAB to broadcast so-called editorials from time to time urging the election of various candidates for political office or supporting one side or another of various questions in public controversy. Radio can serve as an instrument of democracy only when devoted to the communication of information and the exchange of ideas fairly and objectively presented. Indeed, as one licensed to operate in the public domain the licensee has assumed the obligation of presenting all sides of important public questions, fairly, objectively and without bias. The public interest--not the private--is paramount. [30]

Yankee managed to hang on to its license only by promising no further editorialization. The ruling in that case gave birth to the Mayflower Doctrine, which forbade broadcasters to editorialize, until the FCC reversed course and virtually imposed an obligation to editorialize in the 1949 report, *Editorializing by Broadcast Licensees*. [31] In the meantime, the FCC's decision shielded Roosevelt's New Deal from broadcast criticism.

Red Lion: The Rest of the Story

From the Supreme Court's perspective in 1969, the Red Lion case began with a feisty octogenarian, the Reverend John Norris, owner of the Red Lion Broadcasting Company, in Red Lion, Pennsylvania. On November 25, 1964, Norris's station, WGCB, broadcast a commentary by the Reverend Billy James Hargis, an Oklahoma evangelist preacher. Hargis's "Christian Crusade" was carried on many stations catering to the religious right. During the 15-minute broadcast, Hargis unleashed a scathing 2-minute attack on a liberal journalist, Fred Cook, in response to Cook's recently published book, *Goldwater: Extremist on the Right*. Cook subsequently wrote to several stations that had carried Hargis's program requesting free airtime to respond under the personal attack rules of the Fairness Doctrine. [32] Norris refused to grant Cook free airtime, though he did offer him access at the same rate paid by Hargis ($7.50 for a quarter hour). Cook subsequently filed a Fairness Doctrine complaint with the FCC, which ruled that WGCB was obligated to give Cook free airtime. By 1969 the case had found its way to the Supreme

Court.

In a landmark decision, the Court upheld the FCC's ruling, ordering WGCB to give Cook free time to respond to the attack. In the majority opinion, Justice Byron White concluded that "the specific application of the Fairness Doctrine in *Red Lion* . . . enhances rather than abridges the freedoms of speech and press protected by the First Amendment." [33] The logic of the Court's decision in *Red Lion* has been thoroughly examined by legal scholars and economists and is well beyond the scope of this paper. What is important, however, is that the Court did not know at the time that the case before it was the product of a well-orchestrated campaign by the Democratic National Committee to silence pro-Goldwater forces before the 1964 presidential elections.

In 1962 President Kennedy's policies were under sustained attack from conservative broadcasters across the country. Of particular concern to the president were vocal right-wing opponents of the nuclear test ban treaty being considered by the Senate at the time. The administration and the DNC seized upon the Fairness Doctrine as a way to "counter the radical right" in their battle to pass the treaty. [34] The Citizens Committee for a Nuclear Test Ban Treaty, which was established and funded by the Democrats, orchestrated a very effective protest campaign against hostile radio editorials, demanding free reply time under the Fairness Doctrine whenever a conservative broadcaster denounced the treaty. Ultimately, the Senate ratified the treaty by far more than the necessary two-thirds majority.

Flush with success, the DNC and the Kennedy-Johnson administration decided to extend use of the doctrine to other high-priority legislation and the impending 1964 elections. Democratic Party funding sources were used to establish a professional listening post to monitor right-wing radio. The DNC also prepared a kit explaining "how to demand time under the Fairness Doctrine," which was handed out at conferences. [35] As Bill Ruder, an assistant secretary of commerce under President Kennedy, noted, "Our massive strategy was to use the Fairness Doctrine to challenge and harass right-wing broadcasters in the hope that the challenges would be so costly to them that they would be inhibited and decide it was too expensive to continue." [36]

By November 1964, when Johnson beat Goldwater in a landslide, the Democrats' "fairness" campaign was considered a stunning success. The effort had produced 1,035 letters to stations, resulting in 1,678 hours of free airtime. [37] Critical to the campaign was the fact that much of the partisan commentary came from small, rural stations. In a confidential report to the DNC, Martin Firestone, a Washington attorney and former FCC staffer, explained,

> The right-wingers operate on a strictly cash basis and it is for this reason that they are carried by so many small stations. Were our efforts to be continued on a year-round basis, we would find that many of these stations would consider the broadcasts of these programs bothersome and burdensome (especially if they are ultimately required to give us free time) and would start dropping the programs from their broadcast schedule. [38]

Democratic Party operatives were part of the *Red Lion* Fairness Doctrine challenge from the very beginning. Cook had been retained by the Democrats to write several "controversial" pieces about the right, including "Hate Clubs of the Air," a critical profile of conservative broadcasters, which appeared in the *Nation*. [39] Wayne Phillips, a DNC staffer who had worked with Cook, recalled,

> Thousands of copies of Cook's article were sent to state Democratic leaders and to every

> radio station in the country known to carry right-wing broadcasts, together with a letter from Sam Brightman of the DNC pointing out that claims for time would be made in the event of attacks on Democratic candidates or their programs. [40]

The DNC also funded Cook's book on Goldwater, preordering 50,000 copies to ensure publication. When Hargis attacked Cook on the air, it was the DNC, not Cook himself, who was listening. Cook was alerted to the broadcast and received considerable help from the DNC in filing Fairness Doctrine complaints. The efforts paid off; the majority of stations stopped carrying Hargis's commentary, thus providing the very chilling effect the Supreme Court had failed to find evident in the case. [41]

Nixon's Chill

Soon after the 1968 elections, the Nixon administration adopted a policy of responding to all media reports deemed unfair or inaccurate. Staffers wrote weekly press analyses entitled "Little Lies," which detailed unfavorable media coverage and assigned responsibility for an official response. However, by October 1969, Nixon's chief of staff, H. R. Haldeman, recognized that the countercriticism campaign was ineffective and the administration was rapidly falling behind. It needed a more targeted approach--what White House aide Jeb Magruder dubbed the "rifle" approach to the media. That strategy, the cornerstone of which was the Fairness Doctrine, was twofold. First, in an attempt to affect network programming, administration staffers used threats of Fairness Doctrine challenges in meetings and phone calls with top executives at CBS, NBC, and ABC. Second, the Republican National Committee initiated a private campaign of direct pressure on broadcasters through Fairness Doctrine complaints and license renewal challenges.

The first component of that campaign was initiated by White House aide Charles Colson. With the approval of Haldeman and the president himself, Colson visited the New York headquarters of the three television networks in September 1970, and for the next two and a half years Colson called CBS chairman William Paley or president Frank Stanton about once a month and occasionally arranged meetings in Washington or New York. He called ABC and NBC executives as well, albeit less frequently. In a July 1971 White House meeting between Stanton and Colson, "Colson chuckled that he could never hope for constant fairness from CBS, but maybe they could agree on an 'occasional fairness doctrine.' Stanton smiled appreciatively and said he wanted Colson to feel free to pick up the phone any time he felt he had reason to complain." [42] Later in 1972 Colson phoned Stanton to inform him that the administration was considering a five-point plan of action against the networks. The plan included a proposal to license the networks themselves [43] and a campaign to disturb the license renewal process for television stations. [44]

The strategy was to directly intimidate broadcast executives in the hope that they would eventually tone down the unfavorable coverage of the administration by their news units, and in mid-1973 the effort finally paid off. After a meeting at the White House between Paley and Haldeman, CBS announced plans to drop its policy of presenting news analysis immediately after presidential statements. Although it was widely believed that CBS had been "silenced, or intimidated, or subverted" by the administration, [45] Paley denied it, stating that his only objective was "better, fairer, more balanced" coverage. [46]

In a 1972 hearing before the Senate Constitutional Rights Subcommittee on Freedom of the Press, CBS correspondent Daniel Schorr summed up the effects of the Nixon administration's pressure on broadcasters. "I do not think that many reporters will be directly intimidated. We generally cannot be deterred by Government, but only by our employers. And it is our employers who feel the real

pressure--especially in the regulated broadcast industry, where networks can be subjected to pressure in many ways." [47]

The first element of Magruder's "rifle" strategy was all the more effective because of the second element, real rather than threatened Fairness Doctrine challenges to broadcast licensees. In early January 1970 White House staffers began organizing a campaign to monitor the media and challenge the license renewals of "unfriendly" broadcasters. The strategy, developed by Magruder, involved having FCC chairman "Dean Burch 'express concern' about press objectivity" and organizing "outside groups [to] petition the FCC and issue public 'statements of concern' over press objectivity." [48] One early outcome of the campaign was a Fairness Doctrine complaint against CBS brought by the RNC.

After five televised speeches by Nixon on Vietnam policy, CBS offered airtime to the DNC to respond. [49] After the first DNC broadcast the RNC, arguing that the DNC had addressed issues other than Vietnam, demanded time for rebuttal under the Fairness Doctrine. The petition was refused by CBS and the case went before the FCC, which ruled in favor of the RNC. The D.C. Circuit later overturned the FCC's ruling in a blistering opinion, noting that "the [FCC] is functioning in the midst of a fierce political battle, where the stakes are high and the outcome can affect in a very real sense the political future of our nation." [50]

The principal targets of license renewal challenges were the five television stations owned and operated by CBS and three television stations owned by the *Washington Post*. While the administration, in private meetings with network executives, repeatedly threatened to make CBS's renewals more expensive, the *Post* felt the most pressure, largely because of its aggressive Watergate reporting. Although the newspaper's publishing operations were relatively immune to political retaliation, President Nixon recognized that its broadcast properties--two television stations in Florida and one in Washington, D.C--were vulnerable. As Nixon remarked to Haldeman in 1972, "The main thing is the *Post* is going to have damnable, damnable problems out of this one [Watergate coverage]. They have a television station . . . and they're going to have to get it renewed." [51] The Florida stations survived three costly challenges, mounted by administration allies, during the Nixon years. [52]

CBS, the *Washington Post*, and other Nixon "media enemies" felt pressure because the executive branch was able to manipulate the federal broadcast licensing system, "punishing" those whose coverage was deemed unfavorable through Fairness Doctrine challenges and competitive applications at the time of license renewal.

Extending the Chill beyond Washington Politics

Exploitation of the Fairness Doctrine was not limited to presidents or the major political parties. Many public-interest groups used the doctrine to influence debates on local and regional issues as well as commercial speech. For example, the 1985 FCC proceedings on the Fairness Doctrine recount a battle that ensued over a California referendum on a glass-recycling program. The beverage industry prepared an advertising campaign in opposition to the bottle bill. When the bottle bill lobby learned of the advertisements, they wired 500 stations demanding twice the amount of airtime free from any station accepting the commercials. Two-thirds of the stations subsequently refused the bottle industry's ads. [53]

The Fairness Doctrine went beyond public affairs; it affected commercial speech as well. Anti-smoking activists filed a successful fairness complaint against CBS in response to cigarette advertising, [54] and

the environmental group Friends of the Earth waged a fairness campaign against luxury automobile advertising. The Fairness Doctrine was invoked against ads for everything from snowmobiles and trash compactors to Crest toothpaste. [55]

The FCC Lifts Radio Regulation, 1979-87

By the 1970s such egregious abuses of the system by both politicians and special-interest groups were lessening support for content regulation of radio and television. In the final years of the Carter administration, the FCC reversed its position on broadcast regulation by arguing for more reliance on marketplace forces and less on content controls. [56] The FCC substantially reduced the burdens on broadcasters with its *Deregulation of Radio* in 1981, [57] which comprised the following:

- Nonentertainment program regulation. The FCC eliminated "guidelines" indicating how much informational programming each station should carry to have its license renewed, replacing it with "a generalized obligation for commercial radio stations to offer programming responsive to public issues."
- Ascertainment. Elimination of formal documentation of "community needs."
- Commercials. Abolition of FCC guidelines on maximum commercial time allowed on radio stations.
- Program logs. Elimination of program logs, to be replaced by "an annual listing of five to ten issues that the licensee covered together with examples of programming offered in response thereto." [58]

The nonentertainment guidelines required AM stations to offer 8 percent nonentertainment programming and FM stations to offer 6 percent. In simple terms, informational programs (i.e., nonentertainment) were considered to be news, talk, and public affairs, while entertainment programming consisted of music. The ascertainment process required stations to survey "community leaders" to determine issues of importance to their listeners and to then document the station's response to those concerns. The commercial guidelines set an upper limit on commercials: no more than 18 minutes per hour. The program logging rule required stations to record all programs broadcast.

The 1981 deregulation was important because it represented a sea change within the FCC. It now advocated a reliance on marketplace forces to achieve public interest goals, rejecting the viability of regulation. In its 1981 Report and Order implementing the regulatory reforms, the FCC stated,

> We believe that, given conditions in the radio industry, it is time to . . . permit the discipline of the marketplace to play a more prominent role. . . . Simply stated, the large number of stations in operation, structural measures, and listenership demand for certain types of program (and for limitations on other types of programming, to wit: commercials) provide an excellent environment in which to move away from the content/conduct type of regulation that may have been necessary for other times, but that is no longer necessary in the context of radio broadcasting to assure operation in the public interest. [59]

The FCC recognized that, as Commissioner James Quello noted, "the process of license renewal appears to be a very expensive, time-consuming method of ferreting out those few licensees who have failed to meet a subjective 'public interest' standard of performance." The principal objective of the 1981 deregulation was to streamline the renewal process, with the conviction that "the enormous savings in time and money could be used for more constructive purposes in programming and news." [60]

While the 1981 deregulation represented a substantial change in broadcast policy, it left intact the most important form of content control, the Fairness Doctrine. [61] Yet by 1984 the FCC had begun an inquiry into the Fairness Doctrine, questioning its constitutionality and effectiveness. In 1985 the FCC issued a report, concluding, "We no longer believe that the fairness doctrine, as a matter of policy, serves the public interest." [62] The primary evidence relied on was testimony from broadcasters, including this statement from CBS reporter and anchorman Dan Rather:

> When I was a young reporter, I worked briefly for wire services, small radio stations, and newspapers, and I finally settled into a job at a large radio station owned by the Houston Chronicle. Almost immediately on starting work in that station's newsroom, I became aware of a concern which I had previously barely known existed--the FCC. The journalists at the Chronicle did not worry about it; those at the radio station did. Not only the station manager but the newspeople as well were very much aware of this Government presence looking over their shoulders. I can recall newsroom conversations about what the FCC implications of broadcasting a particular report would be. Once a newsperson has to stop and consider what a Government agency will think of something he or she wants to put on the air, an invaluable element of freedom has been lost. [63]

In an extension of the logic behind the 1981 deregulation, the FCC concluded that "the interest of the public in viewpoint diversity is fully served by the multiplicity of voices in the marketplace today." [64] Furthermore, on the basis of the "voluminous factual record," the FCC concluded that there was strong evidence that the Fairness Doctrine "actually inhibits the presentation of controversial issues of public importance." [65]

The report concluded that although the first prong was an affirmative obligation to cover controversial issues, the licensees had broad discretion in determining how to comply with the requirement. However, the second prong, which required broadcasters to provide equal access for the presentation of opposing viewpoints, did have a chilling effect on controversial speech. That was because any programming on a controversial subject would expose the broadcaster to potential Fairness Doctrine challenges or demands for free airtime under the equal access provisions. The FCC summarized the net effect of the doctrine:

> The fairness doctrine in its operation encourages broadcasters to air only the minimal amount of controversial issue programming sufficient to comply with the first prong. By restricting the amount and type of controversial programming aired, a broadcaster minimizes the potentially substantial burdens associated with the second prong of the doctrine while remaining in compliance with the strict letter of its regulatory obligations. . . . In net effect the fairness doctrine often discourages the presentation of controversial issue programming. [66]

However, because of uncertainty over the FCC's authority to abolish the Fairness Doctrine, the rule remained in effect until August 1987 when it was finally eliminated. [67]

That analysis is all the more significant in that it comes from the agency responsible for writing and enforcing broadcast regulation. That the FCC determined in 1981 and 1985 that content regulation was counterproductive to achieving public interest goals would suggest that the notion of effective content regulation has been thoroughly discredited.

Did the Fairness Doctrine Warm or Chill?

Despite the complaints leveled against content regulation, a critical litmus test is whether it achieves its objectives. In 1987 Senate hearings on the ill-fated Fairness in Broadcasting Act, Sen. Ernest Hollings (D-S.C.) noted that there are two important considerations in the regulation of broadcasters according to a public interest standard. "First, the regulation must be effective. It should accomplish the purpose for which it was designed. If not, it should be amended or replaced. Second, the regulation should be narrowly tailored so as to impose the minimal burden on the licensee." [68] The events of 1981 and 1987 offer a unique window onto the effects of content regulation, as judged by the behavior of broadcasters before and after the changes. If content controls did provide diversity in programming and initiate informative debate on controversial subjects, their merits might balance the potential for abuse. Did they? The postderegulation radio market offers a unique opportunity to answer that question with marketplace evidence. [69]

Programming Trends in Radio: 1975-95

There was a great deal of controversy surrounding the 1981 and 1987 deregulations. Many people argued that dropping content rules would drastically reduce the overall supply of informational programming and end balanced coverage of important public issues. [70] Yet radio has recently enjoyed a resurgence as both an influential medium for the discussion of policy issues and a dynamic business sector. [71] For example, in a major 1993 poll about talk radio, the Times Mirror Center for the People & the Press reported that one in six adults regularly listens to telephone talk shows about current events, issues, and politics. One in four adults had listened to a talk show the day Times Mirror called or the day before, and another quarter said they sometimes listen. [72]

In examining the U.S. radio market over the past two decades, there are three important "events" to consider. First, there was rapid growth in the overall number of radio stations, with the growth coming primarily in the FM band. FM, which had been long suppressed by FCC policy, [73] finally came into its own in the 1960s (after the FCC's authorization of stereo broadcasting on FM in 1961) and passed AM in listening share in 1979. [74] The increasing number of stations was a function of two interactive forces: public policy (more licenses were supplied by the FCC) and market demand (more stations were economically viable). The second "event" was the 1981 deregulation of radio, and the third was the FCC's abolition of the Fairness Doctrine in August 1987.

One of the advantages of studying radio markets is that stations typically have a distinct format throughout the daily program schedule, and those formats are reported by established industry sources. Hence, published format data can reveal what changes are taking place in radio programming over a given period.

To analyze the effects of content regulation on broadcasters' format choices, we obtained data on radio programming for both AM and FM broadcasters nationwide over the period 1975-95. [75] The formats for AM radio are summarized in Table 1.

There was a pronounced upward trend in the number of format categories reported over the period. Throughout the period, music was the dominant broad category. [76] In 1975 the music category was dominated by a few specific format types, such as country-western and adult contemporary. By 1995 the music category consisted of over 15 specific formats, including for example, urban contemporary, new

age, and bluegrass.

We aggregate the raw data into five broad format categories: music, information, religious, foreign language/ethnic, and mixed. [77] Consolidating the formats into five broad groups minimizes sampling error associated with categorizing programming. Using such broad categories over the entire period also protects against biasing a measure of diversity due to changes in format definitions.

In Figures 1 and 2 we have omitted the music shares, which form the residual category. While there appears to be an upward trend in each of the nonmusic categories over the entire 1975-95 period, the trend in informational programming is most dramatic. The share of informational formats on FM increased from 4.64 percent in 1975 to 7.39 percent in 1995, but the more dramatic increase was in the AM band where the share of informational programming went from 4.29 percent to 27.60 percent. Particularly impressive is the increase--20.89 percentage points--in the AM informational share between 1987 and 1995.

Figures 3 and 4 show the breakdown of the informational category into news, news/talk, public affairs, and talk. [78] We see that on AM the news/talk format drove the increases in informational programming. Interestingly, on the FM band it was a surge in news formats that drove the rise in the information category.

Table 1
Number of AM Radio Stations Broadcasting Various Formats, 1975 and 1995

Format	1975	1995	Format	1975	1995	Format	1975	1995
Adult Contemporary	944	583	News	75	295	Native American	5	3
Beautiful Music	52	94	News/Talk	0	854	Filipino	0	1
Big Band	1	129	Public Affairs	10	18	Foreign/ Ethnic	9	55
Black	165	108	Talk	130	396	French	3	3
Bluegrass	0	16	Gospel	0	315	Greek	2	5
Blues	0	21	Religious	142	597	Italian	3	1
Classical	21	17				Japanese	2	2
Classic Rock	0	48				Polish	2	4
Country	1199	1221				Portuguese	0	6
Disco	0	1				Spanish	62	286
Folk	0	1				Agriculture	13	66
Jazz	5	22				Children	0	16
Middle of the Road	1404	333				Comedy	1	1

New Age	0	7				Drama/ Literature	1	0
Nostalgia	0	85				Educational	0	19
Oldies	67	486				Other	0	34
Polka	4	4				Sports	0	325
Progressive	47	15						
Rock/AOR	168	53						
Top-40	254	70						
Urban Contemporary	0	102						
Variety	216	122						

Source: Broadcasting & Cable Yearbook. 1975, 1995.

Figure 1
Selected AM Format Categories: Nationwide, 1975-95

Figure 2
Selected FM Format Categories: Nationwide, 1975-95

Figure 3
AM Information Formats: Nationwide, 1975-95

Figure 4
FM Information Formats: Nationwide, 1975-95

The FCC's Economic Model

In its 1979 Notice of Proposed Rulemaking, the FCC outlined a model of economic behavior in which competition among broadcasters would transform radio into a specialty medium, increasing the flow of diverse and controversial material and better serving the diverse American audience. [79] Competition was hypothesized to result from a sharp increase in the supply of radio licenses, especially for FM stations, due to more liberal FCC licensing policies. Between 1975 and 1995 the number of AM stations increased by 11.1 percent, and the number of FM stations increased by 102 percent (see Figure 5).

The impact of enhanced radio competition, which forced stations to tailor their programs to narrower audiences, was already evident by--and a motivating factor in--the Deregulation of Radio proceeding. As the FCC noted in 1979,

> The growth of a viable FM presence has important policy implications. . . . If the new stations can and do capture significant audience shares from existing stations, then the older dominant stations must be responsive to the challenge of competition. If successful, innovative stations with experimental formats would place strong competitive pressures on existing stations, and would affect market conduct and performance. [80]

Figure 5
Number of AM and FM Stations: Nationwide, 1975-95

Econometric analysis of the data suggests that the FCC was correct in its observation that competition between broadcasters was an effective means of delivering public interest outputs. [81] The 1981 deregulation appears to have had little effect on the provision of informational programming. However, the elimination of the Fairness Doctrine in 1987 coincided with a statistically significant change in the structure of the AM radio market. [82] More precisely, after 1987 we see a dramatic increase in the amount of informational programming as the share of news and talk formats rises steadily. Further quantitative analysis also suggests that the repeal of the Fairness Doctrine allowed AM radio to exploit its comparative advantage over FM by substituting talk formats for music. [83]

Most fundamentally, the quantitative evidence strongly suggests that repeal of the Fairness Doctrine led to large increases in informational programming, an outcome entirely consistent with the FCC's 1985 conclusion that the doctrine constrained broadcasters by making the presentation of controversial issues economically risky. Marketplace evidence suggests that content controls imposed a tax on controversy by increasing the odds that a given radio station would be challenged for not providing adequate access to alternative viewpoints and be made to grant free airtime. Once the doctrine was repealed, broadcasters were free to provide more informational programming, especially on controversial issues, without the fear of Fairness Doctrine challenges. The format data show that they did provide more--lots more.

Content Controls and the Internet

The parallels between the content controls imposed via the FCC licensing process and the CDA are substantial. Fundamentally, both seek to impose sanctions on "bad" speech disseminated by a broadcaster or network provider. While the Fairness Doctrine sought to regulate biased news coverage, the CDA attempts to control "indecent" expression. However, just as it proved impossible for regulators, broadcasters, and the public to develop a working definition of what constituted "fair" or even "local" media coverage, [84] it is equally improbable that a diverse society can settle upon a clear definition of indecent speech.

The behavioral incentives of the CDA are similar to those of the Fairness Doctrine. Both operate by imposing economic penalties on networks or program providers that violate vague legal standards. We have already seen how various groups used the Fairness Doctrine to impose sanctions on controversial speech. In the case of the CDA, controversial speech will be a significant liability, not only to Internet service providers, but also to individuals posting content on the Internet. Whether the standard is "fairness" or "indecency," the end result can be a frigid chill on constitutionally protected speech, as fear of litigation discourages individuals from producing and disseminating controversial speech.

Moreover, the Fairness Doctrine has taught us to expect that political and public interest groups will be queuing up to exploit the vague indecency standard, assaulting those who offend them with legal challenges. As Steve Russell, a retired Texas state judge, noted in an article that was intended to violate the CDA, "You [Congress] have . . . handed the government a powerful new tool to harass its critics: a prosecution for indecent commentary in any district in the country." [85] In a democracy, however, robust public debate always involves offense. The CDA--much like the Fairness Doctrine before it--is an open invitation to respond to an opposing viewpoint not with an argument but with an economic

sanction.

Furthermore, content rules tend to silence the small players first, something also observed in the abuse of the Fairness Doctrine. The drafters of the CDA went to considerable lengths to provide complex legal defenses to CDA challenges. But, as the ACLU noted in a December 4, 1995, letter to House conference committee participants,

> Although corporations with large legal departments may fare better [under the CDA], the small independent content and access providers will be effectively frozen out of the [more complex] defenses, with a profound chilling effect on their own speech, for fear of offending the vague prohibitions and being sent to prison. The same is true for the individual user who communicates in chat rooms and on bulletins. Thus, [the CDA] . . . will harm the very people who have made cyberspace the incredibly rich source of information it is today. [86]

In that manner, content regulation deprives the audience of the very diversity of opinion that is often a policy objective.

Those factors imply that the introduction of the CDA could put controversial discourse on ice, reducing not only the breadth of speech but also the number of speakers, well beyond congressional intentions. Most service providers and speakers, large and small, would choose to self-censor to steer wide of CDA sanctions, and such self-censorship is the most costly aspect of content regulation. For example, during the recent court case involving the CDA, AOL announced that if the law was upheld, the company would consider eliminating chat groups from its service. [87] Chat rooms, which allow subscribers to engage in written "real-time" conversation, are one of the most popular features of AOL service.

The potential for such far-reaching effects is hugely ironic in that the arguments in favor of content regulation in the early days of broadcasting are so completely overwhelmed by the expansiveness of the Internet, which allows so many voices where so few once spoke. Content regulation was justified on the premise that access to the airwaves was physically limited. [88] Yet the ability to speak across the Internet is virtually unlimited--its crowning glory as a consumer service. The old regulator's saw that every broadcast voice cannot be heard does not apply to the Internet. The Internet is a medium for both one-way point-to-multi-point (broadcasting) and two-way point-to-point communications. One home page, news group, or bulletin board can reach millions of people with one-way communications, and the message is much richer than that of traditional broadcasting: text, sound, images, and full-motion video are all possible. Once outfitted with a computer and a phone line, anyone can find his way to the on-ramp and cruise the much-vaunted information superhighway. As Cox and Wyden note in their proposed amendment to the telecommunications reform legislation, "The Internet and other interactive computer services offer a forum for a true diversity of political discourse, unique opportunities for cultural development, and myriad avenues for intellectual activity." [89]

In the case of the Internet, content regulation is proposed, not for reasons of scarcity, but because of abundance: one person can communicate with any other. As with most powerful new communications technologies, there is a political reflex action to rein in the threat to existing paradigms. It was just such a reflex, however, that the stricture, "Congress shall make no law abridging freedom of speech, or of the press," was alertly crafted to control.

Conclusion

The marketplace evidence that the Fairness Doctrine visibly chilled broadcast speech is a crucial lesson to learn. In making its case for the CDA, the Department of Justice has argued that the public interest in controlling access by minors to indecent material outweighs the speculative harm to free speech. Yet we have seen repeatedly that content regulation lends itself to abuse by political interest groups and thereby imposes sharp disincentives on those who would air controversial opinions.

The first phase of the judicial review process for the CDA concluded on June 11 as the special three-judge panel in Philadelphia issued a ruling. In a splintered decision, the judges found the CDA unconstitutional, relying upon the notion of differential treatment for communications media. [90] Thus, Judge Stewart Dalzell labored to place the internet somewhere on a continuum between print and television, and Judge Dolores Sloviter concluded that "Internet communication, while unique, is more akin to telephone communication . . . than to broadcasting . . . because, as with the telephone, an Internet user must act affirmatively and deliberately to retrieve specific information on-line." [91]

The origins of the theory of media difference can be traced back to the establishment of federal control over broadcasting with the 1927 Radio Act and the 1934 Communications Act. Those laws advanced the notion of differential treatment (namely, lessened free press protections) for broadcasting because of its use of spectrum. That rationale, which blossomed as the "physical scarcity" (of spectrum) doctrine in the 1943 *NBC* case, [92] was used consistently by the judicial branch for several decades, even as evidence mounted against it. [93] The differential treatment approach to media had new life breathed into it by the Supreme Court's 1978 *Pacifica* decision. [94] In that case, the Court upheld the FCC's authority to regulate indecent programming on radio and television on the grounds that broadcasting is "uniquely pervasive." That approach has been applied in subsequent cases involving cable television and dial-a-porn. [95] The following passage from the panel's CDA decision highlights the intention of the courts to create ad hoc theories for each type of speech protected under the First Amendment.

> All parties agree that in order to apprehend the legal questions at issue in these cases, it is necessary to have a clear understanding of the exponentially growing, worldwide medium that is the Internet, which presents unique issues relating to the application of First Amendment jurisprudence and due process requirements to this new and evolving method of communication. [96]

While defenders of free speech on the Internet may well wish to play the differential treatment game, and may even be successful in arguing a "special case" for unregulated communications (as in the victory with the three-judge panel), it is a very risky contest. The First Amendment, rather than offering blanket protection to free speech and a free press, must be petitioned on an individual basis. The scope for political compromise, and regulatory mischief, is apparent from the history of radio broadcasting.

The Department of Justice has announced that the government will appeal to the Supreme Court, and the case will be decided in 1997. It is unclear what awaits the CDA. The highest court has recently shown itself to be confused and divided over the issue of First Amendment protections for electronic speech. In a case involving the Helms Amendment to the 1992 Cable Television Consumer Protection and Competition Act, the Court issued a contradictory ruling, permitting federal content regulation in some cases but not in others. [97]

In its defense of the CDA, Justice argued that the Internet should be treated like a broadcast medium for the purpose of content regulation, in part because "the Internet is becoming more like an entertainment

medium." [98] Given the government's concession of failure in regulating broadcast content--and the ugly episodes of political abuse along the way--that assertion should send a chill through all of us.

Notes

[1]. Telecommunications Act, 47 U.S.C. § 223 (1996).

[2]. Miller v. California, 413 U.S. 15, 34 (1973).

[3]. Kent Markus, acting assistant attorney general, letter to Sen. Patrick Leahy (D-Vt.), May 3, 1995.

[4]. Quoted in Steven Levy, "No Place for Kids?" Newsweek, July 3, 1995, p. 47.

[5]. Internet Freedom and Family Empowerment Act, H.R. 1978 (1995).

[6]. ACLU v. Reno, 24 Media L. Rep. 1379 (1996).

[7]. ACLU v. Reno, 929 F. Supp. 824 (1996).

[8]. Markus.

[9]. See Philip Elmer-Dewitt, "On a Screen Near You," Time, July 3, 1995, p. 38. The article was based on a discredited study by a Carnegie Mellon undergraduate.

[10]. The majority of sources of pornography on computer networks are bulletin board services that allow access only to paying customers. That places a generally insurmountable barrier between offensive material and the average child.

[11]. Patrick Leahy, "Study on Means of Restricting Access to Unwanted Material in Interactive Telecommunications Systems," S. 714, 104th Cong., 1st sess., Congressional Record 141, no. 65, (April 7, 1995): S 5549.

[12]. Indeed, Justice recommended "that a comprehensive review be undertaken of current laws and law enforcement resources for prosecuting online obscenity and child pornography, and the technical means available to enable parents and users to control the commercial and non-commercial communications they receive over interactive telecommunications systems." Markus.

[13]. See Thomas W. Hazlett, "The Rationality of U.S. Regulation of the Broadcast Spectrum," Journal of Law & Economics 33 (1990): 133.

[14]. For example, see Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969); and Turner Broadcasting System, Inc. v. FCC, 114 S. Ct. 2445 (1994). For compelling critiques of the state of the law, see David L. Bazelon, "FCC Regulation of the Telecommunications Press," Duke Law Journal (1975): 213; Lucas Powe, American Broadcasting and the First Amendment (Berkeley: University of California Press, 1987); and Robert Corn-Revere, "New Age Comstockery: Exon vs. the Internet," Cato Institute Policy Analysis no. 232, June 28, 1995, p. 1.

[15]. Red Lion, at 393.

[16]. ACLU v. Reno, 24 Media L. Rep. at 1379.

[17]. It could be argued that the evidence proves only that such FCC broadcast content rules as the Fairness Doctrine should be illegal. We would be quick to point out that the ability of the courts to differentiate chilling content controls from innocuous ones is not sufficiently in evidence to warrant such a conclusion.

[18]. Richard Knox, "Women Go Online to Decry Ban on 'Breast,'" Boston Globe, December 1, 1995, p. 12.

[19]. For a detailed account of the establishment of federal control over broadcasters, see Hazlett.

[20]. The 1996 Telecommunications Act left radio and TV station licensing virtually untouched.

[21]. AM radio was the only broadcasting service at the time of the 1934 Communications Act. The FCC allocated spectrum for FM and television in subsequent years.

[22]. Federal Communications Commission, Editorializing by Broadcast Licensees, 13 F.C.C. 1246, 1249 (1949).

[23]. Federal Communications Commission, The General Fairness Doctrine Obligations of Broadcast Licensees, 102 F.C.C. 2d 145, 146 (1985) (citing Federal Communications Commission, Editorializing by Broadcast Licensees).

[24]. The original directive that broadcasters provide "reasonable opportunity" for the discussion of various viewpoints evolved into the equal access provision in the early 1960s. Equal access required broadcasters to grant respondents free airtime if no one was willing to pay.

[25]. Federal Communications Commission, Editorializing by Broadcast Licensees at 1251; Federal Communications Commission, Fairness Report: The Handling of Public Issues under the Fairness Doctrine and the Public Interest Standard of the Communications Act, 48 F.C.C. 2d 33 (1974); and Federal Communications Commission, The General Fairness Doctrine Obligations of Broadcast Licensees at 160.

[26]. Federal Radio Commission, Order, 2 F.R.C. 156 (1928).

[27]. Federal Radio Commission, Great Lakes Broadcasting Co., 3 F.R.C. 36 (1929).

[28]. Powe, p. 109.

[29]. One of the owners of Mayflower Broadcasting Company was a former employee of Yankee Network who had previously complained to the FCC about WAAB's editorial policy.

[30]. Federal Communications Commission, Mayflower Broadcasting Co., 8 F.C.C. 333, 340 (1940).

[31]. Federal Communications Commission, Editorializing by Broadcast Licensees at 1246.

[32]. The personal attack rules were an addition to the Fairness Doctrine introduced in the 1960s.

[33]. Red Lion at 375.

[34]. Fred Friendly, The Good Guys, The Bad Guys, and the First Amendment (New York: Random House, 1976), p. 33.

[35]. Ibid., p. 35.

[36]. Quoted in ibid., p. 39.

[37]. Ibid.

[38]. Quoted in ibid., p. 42.

[39]. Quoted in ibid., p. 38.

[40]. Quoted in ibid., p. 38.

[41]. For the remainder of his career, the Fairness Doctrine made Hargis a potential liability to all broadcasters. In fact, over a decade after the historic broadcast, Hargis remarked that "many stations are still afraid to run [my program]." Quoted in ibid., p. 76.

[42]. Daniel Schorr, Clearing the Air (Boston: Houghton Mifflin, 1977), p. 48.

[43]. The FCC has licensed broadcast outlets--radio and television stations--but not the national networks that supply programming. However, each of the networks owns several TV stations in the largest markets; hence, the government does have some leverage over programmers through station license renewal and transfers.

[44]. Until 1981 radio and television licenses were issued for three-year periods. When the license expired, the licensee was required to file a renewal application with the FCC. At that point any third party could file a competing application for the license. Although renewals were, as a rule, granted, a competitive application would generally delay the renewal procedure and substantially raise the cost of renewal to the licensee through additional research and legal fees.

[45]. John Pastore, head of the Senate Communications Subcommittee, quoted in Schorr, p. 62.

[46]. Roger Mudd wrote a balanced but critical commentary on the network's decision, to be aired on CBS Radio the day after the announcement, but it too was eliminated. Only after a memo outlining the meeting between White House staffers and Paley was leaked four and a half months later did CBS return to the practice of instant analysis of presidential speeches. Powe, p. 139.

[47]. Schorr, p. 74.

[48]. Ibid., p. 42.

[49]. During his first 18 months in office Nixon made 14 televised speeches, as many as the total for Eisenhower, Kennedy, and Johnson over a comparable period. Columbia Broadcasting System Inc. v. FCC, 454 F.2d 1018, 1020 (D.C. Cir. 1971).

[50]. Ibid. at 1027.

[51]. Quoted in Schorr, p. 52.

[52]. The Post's Jacksonville station survived a license challenge in 1970 by the man who would be finance chairman of Nixon's 1972 campaign in Florida. The Miami station survived challenges, in 1970 and 1972, by Nixon allies. Powe, p. 131.

[53]. Federal Communications Commission, The General Fairness Doctrine Obligations of Broadcast Licensees at 143, 176.

[54]. Banzhaf v. FCC, 396 U.S. 842 (1969).

[55]. William B. Ray, FCC: The Ups and Downs of Radio-TV Regulation (Ames: Iowa State University Press, 1990),

p. 100.

[56]. A leading force in this was President Carter's assistant secretary of commerce for telecommunications, Henry Geller. A former FCC general counsel who had avidly pursued content controls through licensing, Geller has come to the view that "behavioral regulation sucks. The one thing that works is competition, and that's what I keep pushing for." Quoted in "Who's Who: Who Are You Gonna Call? Here Are the Bell Ringers," National Law Journal, May 1, 1995, p. A24.

[57]. Federal Communications Commission, Deregulation of Radio: Report and Order, 84 F.C.C. 2d 968 (1981).

[58]. Ibid. at 971. The FCC subsequently lifted the same rules applying to television station licensees in 1984.

[59]. Ibid. at 1014.

[60]. Federal Communications Commission, Deregulation of Radio: Notice of Proposed Rulemaking, 73 F.C.C. 2d 457, at 594 (1979).

[61]. Judge David Bazelon argued in 1975 that the Fairness Doctrine was "the most overt form of program regulation in which the FCC engages." Bazelon, p. 219.

[62]. Federal Communications Commission, The General Fairness Doctrine Obligations of Broadcast Licensees at 147.

[63]. Ibid. at 171.

[64]. Ibid. at 147.

[65]. Ibid.

[66]. Ibid. at 160.

[67]. Congress later attempted (unsuccessfully) to codify the Fairness Doctrine, which would have effectively reimposed the FCC's own regulation.

[68]. Fairness in Broadcasting Act of 1987, S.R. 100-34

(1987).

[69]. See Thomas W. Hazlett and David W. Sosa, "Was the Fairness Doctrine a 'Chilling Effect?': Evidence from the Postderegulation Radio Market," Journal of Legal Studies (1997, forthcoming).

[70]. The FCC received thousands of comments during its 1979-81 proceedings. For example, the ACLU and the National Organization of Women argued that "consumer satisfaction is not the appropriate criterion for judging performance of radio markets. Rather . . . public 'need' as distinguished from public 'want' should be the criterion." Federal Communications Commission, Deregulation of Radio: Report and Order at 1015.

Likewise, the 1987 elimination of the Fairness Doctrine sparked a maelstrom of protest from groups as diverse as the ACLU, Mobil Oil, and the NAACP, as well as conservative commentator Pat Buchanan.

[71]. Vincent M. Ditingo, The Remaking of Radio (Boston: Focal Press, 1995).

[72]. Douglas Davidoff, "Rock to Talk: Indiana AM Radio Saved by the Gift of Gab," Indiana Business, October 1, 1993,

p. 21.

[73]. Lawrence Lessing, Man of High Fidelity (Philadelphia: Lippincott, 1956).

[74]. Ditingo, pp. 18, 60.

[75]. The source was the Broadcasting and Cable Yearbook (New Providence, N.J.: Bowker-Saur), which publishes detailed information on broadcasters, including a list of stations by principal format. A principal format (as defined by the yearbook) is one that the station broadcasts for more than 20 hours per week. Under this definition it is possible for a station to have more than one principal format. Our data series begins in 1975 because that was the first year the yearbook compiled comprehensive data on radio stations by format.

[76]. Music accounted for 90.8 percent of AM programming in 1975 and fell to 51.7 percent in 1995. On FM the share of music formats fell from 89.8 percent to 79.6 percent over the period.

[77]. The "mixed" category consists of formats such as agriculture and drama/literature that neither fit well into one of the other categories nor have any clear relationship between them.

[78]. News/talk was introduced as a format in 1990. It appears, logically enough, to have drawn from both news and talk formats.

[79]. Federal Communications Commission, Deregulation of Radio: Notice of Proposed Rulemaking at 491-525.

[80]. Ibid., at 485.

[81]. Hazlett and Sosa.

[82]. We limited our quantitative analysis to AM radio because of changes in the way formats were reported for FM during the sample period.

[83]. AM will have a comparative advantage over FM for talk formats because of differences in cost of operation and sound quality.

[84]. In 1979 the FCC admitted, "Although the Fairness Doctrine requires stations to provide coverage of controversial issues of interest to the community, we [the FCC] have never defined the term

'community' as it applies to fairness issues." Deregulation of Radio: Notice of Proposed Rulemaking at 617.

Upcoming Events

[85]. Steve Russell, "The X-On Congress: Indecent Comment on an Indecent Subject," American Reporter, February 8, 1996, reprinted in Harper's, May 1996, p. 24, and as "Here Comes the Judge: One Jurist's Lament over and Challenge to the Recently Enacted Telecommunications Act," Philadelphia City Paper, February 15-22, 1996. The [illegible] condemnation of the CDA originally appeared on American Reporter, an online journal, as a deliberate challenge to the law. To underscore arguments that the electronic media are treated differently than print, two print publications, Harper's and Philadelphia City Paper, published the article and found (obviously) no prosecution in the offing.

May 14, 2008

The Rise of the Conservative Legal Movement
Cato Book Forum, 12:00 pm

May 15, 2008

Whatever Happened to Medicare Reform?
Cato Policy Forum, 12:00 pm

[86]. American Civil Liberties Union letter to House conference committee, December 4, 1995, at http://www.aclu.org/congress/cybrltr.html.

[87]. Pamela Mendels, "AOL May Abandon Chat if Decency Law Stands," New York Times, April 1, 1996, at http://www.nytimes.com/web/docsroot/library/cyber/week/0402decency.html.

May 15, 2008

Biennial Dinner: The Milton Friedman Prize for Advancing Liberty
Cato Special Event, 6:30 pm
The Waldorf=Astoria, 301 Park Avenue, New York, NY

[88]. This view has been thoroughly critiqued by economists and legal experts. See Ronald H. Coase, "The Federal Communications Commission," Journal of Law and Economics 2 (1959): 1; Hazlett; and Gregory J. Sidak, "Telecommunications in Jericho," California Law Review 81 (1993): 1.

May 16, 2008

Learning the Right Lessons from Iraq
Cato Capitol Hill Briefing, 12:00 pm

[89]. Internet Freedom and Family Empowerment Act.

[90]. ACLU v. Reno, 929 F. Supp. 824. Although the decision was unanimous, each judge wrote a separate opinion in the case.

May 21, 2008

[91]. Ibid. at 851-52.

The One-Drop Rule in Hawaii? The Akaka Bill and the Future of Race-Based Government
Cato Capitol Hill Briefing, 12:00 pm
S-115 Capitol Building

[92]. National Broadcasting Co. v. United States, 319 U.S. 190 (1943).

[93]. See, for example, Coase.

May 23, 2008

[94]. FCC v. Pacifica Foundation, 438 U.S. 726 (1978).

Botswana and Mauritius: African Success Stories
Cato Policy Forum, 12:00 pm

[95]. For telephone service, see Sable Communications of California, Inc. v. FCC, 492 U.S. 115, 126 (1989). For cable television, see Turner Broadcasting at 2459.

May 27, 2008

[96]. ACLU v. Reno, 929 F. Supp. at 844.

Relief from Gridlock: Surface Transportation Reauthorization in 2009
Cato Policy Forum, 12:00 pm

[97]. Denver Area Consortium v. FCC, 116 S. Ct. 2374 (1996).

[98]. "Print or Broadcast Model? Judges Pressure Justice Department on Telecom Decency Act," Washington Times Daily, May 13, 1996, p. 1.

May 29, 2008

Occupational Hazards: Success and Failure in Military Occupation
Cato Book Forum, 11:00 am

Upcoming Events

- **May 14, 2008**
  The Rise of the Conservative Legal Movement
  Cato Book Forum, 12:00 pm
- **May 15, 2008**
  Whatever Happened to Medicare Reform?
  Cato Policy Forum, 12:00 pm
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Federal Regulatory Policy and Communications Satellites: Investing the Social Dividend

Thomas P. Murphy

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Federal Regulatory Policy and Communications Satellites:

Investing the Social Dividend

By THOMAS P. MURPHY

TRADITIONAL SYSTEMS of interaction between the public and private sectors and the various regulatory systems are straining under the new competitive conditions inspired by the rapid technological change of the 1960s and shifting values of governmental administrators and regulatory officials. Different patterns of organization and governmental participation will need to be developed in several areas, as has been demonstrated quite sharply in the Interstate Commerce Commission and Federal Trade Commission investigations led by Ralph Nader and his associates.

Unfortunately there is no easy formula which defines the parameters of the government-industry partnership. Where private enterprise is deemed to be the best alternative to provide innovative development of a new technological area, the question of competition or monopoly still remains. To what extent should bigness be permitted to insure economies of scale? How can the benefits be passed on to the consumer? In other words, how can the socio-economic impacts be controlled in the public interest? Where the economic scope of projects such as the Apollo missions require substantial federal capital investment how can the Government protect its investment and insure that the participating corporations are not profiting unduly at the expense of the taxpayers?

Because of the extraordinary impact of technological advances in satellite technology, and because the Federal Government itself became in-

volved in competitive enterprise through the creation of the Communications Satellite Corporation (COMSAT) in 1962, no more cogent example of the force of technological change upon economic systems can be found than the study of the evolution of federal policies with respect to the burgeoning telecommunications industry. Accordingly, this brief survey of policy questions dealing with competition and regulation will treat the telecommunications rivalry of COMSAT and the common carriers in light of the alternatives available to the Nixon Administration and the Federal Communications Commission (FCC).

I

COMMUNICATIONS SATELLITES AND FEDERAL POLICY

THE FEDERAL COMMUNICATIONS COMMISSION (FCC) has operated reasonably well since its creation in 1934. It may not, however, offer the kind of oversight which will be necessary in a world of global communications. The traditional dimensions of regulatory questions involved issues fundamentally different from those of cooperation and competition with other national and regional communications entities beyond our shores. Regulatory commissions have always been tempted to excuse monopolistic excesses in the name of providing economies of scale and lower cost of service to the consumer. How will the regulatory equation be modified now that the United States is being challenged for technological superiority in communications by nations which have profited from our own investments?

From the technology standpoint, the federal involvement in the development of the communications satellites was considerable. Since the 1950s the Department of Defense has had an interest in the development of communications satellites for military purposes and has expended substantial sums on research relevant to communications. Additionally, in providing that the National Aeronautics and Space Administration (NASA) should be responsible for all American space activities other than those of a military nature, the National Aeronautics and Space Act specifically exhorted NASA to develop peaceful applications of space technology and to cooperate with other nations in extending such peaceful uses of space and space vehicles (1). Thus over a short period NASA spent in excess of $250 million for research and flight projects relating to communications satellite systems (2).

And now the nation is asking if it has received its money's worth. One of the more vocal spokesmen for the taxpayer has been Senator John O. Pastore (D.-Rhode Island), since 1955 chairman of the Senate Commerce

Subcommittee on Communications. Senator Pastore has apparently concluded that no one is watching out for our investments in telecommunications, and that, from the White House on down, there should be greater awareness of and capitalization on our opportunities.

When the Committee on Commerce reviewed Presidential nominations in 1970, the Senator from Rhode Island voiced the following opinion:

> For some years now, this committee has urged the Federal Communications Commission and other interested government agencies to formulate an overall telecommunications policy. The rapid advance of communications technology including satellite communications, and the concomitant increase in the use of communication services have made the formulation of such a policy imperative if we are to achieve our goal of a nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges. . . .
>
> On March 2, 1966, the FCC instituted a notice of inquiry into the establishment of domestic communication satellite facilities by non-government entities. I have repeatedly urged the Commission not to procrastinate in reaching a decision on this matter because the American people in the long run would be the losers. . . .
>
> Many authorities contend that we are no closer to a resolution of this issue than we were in 1966. Whether or not this is so, the fact remains that a domestic satellite system is still some time away and the American people are not receiving the full benefit of this dynamic technology (3).

This statement is reminiscent of the language and philosophy expounded a few months earlier by the Karth Subcommittee on Space Science and Applications in the House of Representatives. The Subcommittee's Report on an *Assessment of Space Communication Technology* hit home the point that our country was in danger of "falling behind the rest of the world" in its own technology. That is, other countries were moving ahead rapidly to establish satellite communication systems made possible by research funded by the United States. In fact, American rockets would be used to launch the foreign satellites (4).

A more surprising conclusion was reached by the Subcommittee in its evaluation of the causes of this oversight. The suggestion had been made that the efficient utilization of new technologies might have been primarily inhibited by the economic and political power of the telecommunications industry, a proposition which will be examined later. But, the finding of the Subcommittee—like that of Senator Pastore—was that the Government itself was very much at fault.

The stalemate has resulted not from the competition of private financial interests, though reaching policy decisions is admittedly not easy in the face of huge private investments in existing equipment which might be rendered more or less obsolete by the introduction of new facilities.

Rather, the evidence strongly suggests that the Government is not sufficiently well organized to formulate major policies, resolve issues, and make the necessary decisions. It is difficult to find such a diffusion of responsibility and lack of clear authority in any other major policy area. Whereas the goal of Government should be the removal of obstacles of efficient adaptation to change by the telecommunications industry, the opposite seems to have occurred. In the face of extraordinary technological advances Government indecision appears to have been the vehicle for frustrating progress (5).

II

THE FEDERAL COMMUNICATIONS COMMISSION

ONE CONCLUSION SUGGESTED by an observation of congressional pressure is that our national telecommunications policy (and the implied postures towards competition and regulation in the communications industry) will come under increasingly harsh review. Indications that the White House will support this kind of intensive re-examination have been in the air since President Nixon's election in 1968; with the release of a statement from the Nixon Task Force in the form of a memorandum signed by Presidential Assistant Peter Flanigan to the Chairman of the FCC, the speculation was confirmed.

On January 23, 1970, the White House revealed its policy memorandum to an anxious communications industry. The document supported the policy that domestic satellite systems should be operated by private interests "to the extent that private enterprise finds them economically and operationally feasible" (6). It also rejected COMSAT's argument that it should be the only satellite company authorized. The statement supported a new policy of less rather than more government control over the establishment of satellite communications systems and said potential operators "should be required to demonstrate only the financial and technical qualifications to implement their systems proposals" (7). Essentially, if the FCC and Congress were to adopt these positions, the traditional regulated monopoly system of land-based communications would be declared inapplicable to satellite communications.

Should this happen, it would be a radical departure from earlier Administration and FCC patterns. The policy of the Eisenhower Administration was that operation of an American communications satellite system should be the responsibility of private enterprise. But in the days of the Eisenhower Administration life in the field of communications was much simpler. COMSAT and the newer "record" carriers were unheard of in the 50s. The American Telephone and Telegraph (AT&T) had an unchallengeable domination of the telephone field and owned the Bell Telephone

Laboratories which built Telstar. It also owned most of the voice cables to Europe whose economic viability might be threatened by the development of a satellite system. With the AT&T monopoly clearly established, it is indeed surprising that we have gone this far without seeing the Bell Telephone System capture in its entirety the control of domestic satellite communications.

Indeed, as the *Saturday Review* noted in 1971:

> Some observers think that, in 1967, the FCC would have designated AT&T and COMSAT as the chosen entities. Authorization was delayed pending the report of President Johnson's Task Force on Communications Policy, which eventually suggested a pilot demonstration project. COMSAT and AT&T probably would have been the dominant twins in that arrangement as well (8).

It was only due to the creation of two Presidential Task Forces and other unforeseen circumstances that a decision favorable to the Bell System has not already been passed down.

But whatever the vagaries of chance (or of politics), new forces are at work in the regulatory field. Since the appointment in 1970 of Dean Burch as Chairman of the Federal Communications Commission, the pace of activity and interest has picked up considerably. Besides the all-important question of the ownership and regulation of domestic communications satellites, the FCC is currently embroiled in several major policy controversies, including the distribution of overseas communications, the regulation of broadcasting and the allocation of the electromagnetic frequency spectrum, and the direction of future competition in the digital communications and cable antenna television fields. The appointment of Chairman Burch is noteworthy since he is "known to have an oft-used pipeline into the White House" (9).

The White House is paying special attention to the problems of the telecommunications industry. In February 1970, President Nixon submitted a reorganization plan to Congress to establish in the Executive Office of the President an Office of Telecommunications Policy "equal in rank with the President's staff panels on the economy, science and environment" (10). A specific objective of the new office was to provide a focus for representing the President's views to the FCC and Congress regarding matters such as cable antenna television, regulation of pay television, assignment of scarce portions of the radio spectrum, "diversification of media ownership . . . and the encouragement of competitive challenges against the Bell Telephone System in specialized communications services" (11).

Nevertheless, Dean Burch is not just on the receiving end of the traffic between the White House and the FCC, and that is the significance of the "pipeline" comment. Industry publications highlight the transfer of policy ideas which is now bringing the FCC out into the open on nationally recognized issues from its previous anonymity in governmental affairs:

> Burch's influence over the votes of the independent FCC is important to another power— the Office of Telecommunications Policy in the White House. Now headed by 31-year-old Clay T. Whitehead, the recently reorganized and strengthened office has broad powers to shape government policy on computers and communications. Part of OTP's mission is to ensure the effective presentation of the Administration's views to Congress and the FCC. In Dean Burch, OTP has a strong voice and sympathetic ear. There's no evidence he functions merely as OTP's chore boy, but he was quick to accept the White House policy on open competition in domestic satellites. And the FCC's recommendations for the U.S. position at the World Administrative Radio Conference strongly reflect those of OTP (12).

Burch favors the concept of a competitive communications industry although he maintains he has "no fixed opinions" regarding the Commission's agenda (13). His views are seen differently, however, depending upon the biases of the observers who pass judgment on his public expressions. Similarly, Burch's most flamboyant Democratic colleague, Commissioner Nicholas Johnson, is a man who must seem inscrutable to some while appearing most open and logical to others. As one who champions the public interest, Johnson has made powerful enemies in the industry. He has struck at the very heart of American Telephone and Telegraph through celebrated decisions regarding the right to add "foreign attachments" to AT&T equipment, the desirability of permitting direct microwave competition with AT&T data transmissions, and with FCC ordered price reductions on certain long-distance traffic (14).

Commissioner Johnson has in fact been instrumental in reordering AT&T's priorities through these decisions. His views regarding AT&T service have been adamant, as can be witnessed in this portion of an interview concerning communications issues:

> JOHNSON: The telephone company has failed to adequately anticipate and prepare for the present and future demand for communications service for computers. The telephone company has failed to anticipate and provide the services now being offered by cable-television companies. It has failed to conceptualize itself as in the "communications" rather than the telephone business" (15).

Johnson, too, is concerned about competition within the industry; he

states: ". . . a fully functioning free private enterprise competitive system, with informed consumers, will best serve the public interest—and will do so better than government regulation" (16). The effect upon the Bell System has been to awaken it to the possibilities in "communications" which Johnson and others have suggested; Bell men now anxiously fear that by resting easy with a currently profitable telephone business they may be following the path of the railroads in becoming shackled to what someday may be an outmoded technological concept (17).

As for the future of FCC appointments and policies, one might best be advised to watch for a continuing emphasis upon competitive markets. Although the *New York Times,* on the occasion of the ill-fated nomination of Sherman Unger to an FCC chair, predicted that there would be an "expansion of cable TV, a relatively permissive view of economic concentration in the mass media, and the discouragement of competitive challengers to the Bell System in the field of specialized phone services and data transmission" (18), at least one of these predictions has failed to materialize.

The FCC announced on May 26, 1971 that it would allow open competition in specialized communications services, such as in the field of microwave transmissions. The only requirement for authorization was that companies be financially and technically qualified. Further, it appears that existing carriers will take advantage of an opportunity to cut rates selectively, increasing competitive atmosphere all the more (19).

If the FCC cannot currently be characterized as having a single mind on these issues, it very possibly might find itself moving in that direction if the issues now pending with regard to public broadcasting heat up much more. The furor over the filming by the Columbia Broadcasting System (CBS) of a documentary called "The Selling of the Pentagon" has involved the FCC, as well as Congress. Several calls to investigate the integrity of editing techniques within the broadcast industry were made but, in seeking to draft a letter from the FCC to the chairman of the House Commerce Committee, the FCC Chairman ran up against the sensitivities of one of his own Republican colleagues, Thomas J. Houser, appointed to a term which expired June 30, 1971. It is noteworthy that Houser was not reappointed. Instead, Republican Congresswoman Charlotte T. Reid of Illinois, who is not an attorney, was appointed.

III

AT LAST! DOMESTIC COMMUNICATIONS SATELLITE SYSTEMS

IN MARCH OF 1970 the Federal Communications Commission finally made

its move in the domestic satellite case. Competition for construction permits was opened to all industrial concerns that are technically and financially qualified, in keeping with the new directions in national telecommunications policy. In taking this action, the Commission also followed the inclinations of some commissioners: namely, to work the FCC out of a job. By choosing to allow industry initiative, the FCC would be relieving itself of the onerous task of limiting entries to the field. At the same time another round of proposals, review and comment would be eliminated, a move which would be sure to please impatient congressional committees.

This decision did not meet the approval of all parties, however. COMSAT was found to be rather disquieted by the news, since the FCC was quite obviously not willing to take the position that COMSAT alone was authorized by Congress to own and operate American space communications systems. At the time it was widely feared that if AT&T were to extend itself into satellite communications, then other entities might find themselves shut out from the market. Certainly COMSAT, which—unlike public utility common carriers—could not generate its own communications traffic, would find itself at an extreme competitive disadvantage should the vast Bell System be allowed liberal entry into satellite operations.

American Telephone and Telegraph, were it allowed to subsidize satellite communications traffic with revenue from its profitable telephone operations, could afford to undercut the satellite rates of any American competitor. The pressures being brought to bear against this alternative are tremendous, not only because of the philosophic interest in competitive satellite systems, but also because of the lucrative nature of the market. As COMSAT President Joseph V. Charyk has observed:

> I think the very success of satellites for international application has complicated the problem of authorization on the domestic scene, because with the international success, it would appear that satellites are a good thing, and so everyone wants to get into the act domestically.
>
> As a result, the FCC has been faced with a large number of interested parties, all contending that they should have some role on the domestic scene, and with the 1962 act not being completely explicit on who should have the authority to develop satellites for domestic applications, a rather confused picture has been created. . . . (20).

Dr. Charyk refers to the ambiguous state of interpretation of the Communications Satellite Act of 1962 which, aside from its designation of COMSAT as the sole United States instrument informing a global satellite communications system, left unclear the position that COMSAT was to have in domestic communications (21). Owing to unforeseen studies

in satellite technology which were made subsequent to the Act, this question has gained importance faster than anyone had believed possible. The misjudgment was compounded by the provision that the existing overseas common carriers be allowed to subscribe to the underwriting of COMSAT stock, giving them a large minority ownership and significant representation on the Board of Directors of their would-be competitor. Ironically, of the $200 million which COMSAT raised through the sale of stock, most is not now needed for the purposes intended as a result of advantageous cost factors and of greater-than-expected international traffic, made possible through the technological gains of the mid 1960s. Because of its overcapitalization, the company now feels all the more incentive to break into the domestic communications field.

With a little help, it may get the chance. One move currently being pursued by friendly forces is to rewrite the legislation to exclude competitors from either owning shares or sitting on the COMSAT Board of Directors. A bill offered by Senator Mike Gravel (D-Alaska) proposes approval by the Congress for cut-off dates of 1973 (for ownership) and 1972 (for representation). His drive for an independent COMSAT is being bolstered by a Justice Department statement advocating not only the Senator's measures, but provisions which would someday allow COMSAT to retail its satellite circuits and own in their entirety the ground stations necessary for the transmission of domestic communications as well. These legislative and executive actions are putting AT&T under increasing pressure to sell out (22).

Meanwhile AT&T and COMSAT continue to battle it out. Whereas COMSAT has capitulated to AT&T on certain occasions, such as the scuttling of its proposal in response to the Ford Foundation satellite proposal of 1966, AT&T has been hurt by the attacks of competitors on the fairness of its ratemaking actions. Traditionally AT&T has argued that any cost savings resulting from new technologies should be passed along to *all* communications users, meaning those who use obsolescent channels as well as the users of the new technology.

Opponents complain, however, that the acceptance of this argument by the FCC has caused undue strain upon competition to meet the rates of a technology which is not strictly competitive, but which is subsidized by other, more profitable lines. In other words, Bell's competitors find it unfair to let terrestrial modes of communication shelter developing satellite systems until economic viability and market domination have been reached, only to see satellites then protect land or sea routes which might otherwise be abandoned to other firms. This way AT&T is able to maintain a complete line of telecommunications services over an indefinite

period while specialized companies must struggle by on the good will of the FCC, which must allow more "favorable" rate regulations (favorable to carriers but not consumers) so that Bell does not control the entire industry.

Since a domestic satellite system is only likely to prove attractive to a narrow market (the broadcasters) in its earlier years, COMSAT would stand to benefit if rates were determined individually according to type of service offered. Such a decision would, in effect, put COMSAT and AT&T on an equal footing since both firms have equal financial and technical capabilities once economic questions have been eliminated. As it is now, COMSAT charges AT&T with skimming the cream off certain profitable services. It could just as easily charge the FCC with harboring biases towards a public utility system of regulating communications markets:

> The FCC's approach to regulation creates a strong bias in favor of technologies requiring heavy capital investment and against capital-saving technologies like satellites; this may reinforce AT&T's conservatism. The FCC lets a carrier set rates at a level that will permit it to earn a "reasonable" return on its capital investment. With any given rate of return on capital, the larger the fixed investment required, the larger the dollar earnings (23).

The significant questions then are what effect satellites will have on domestic communication rates, whether there will be a "social dividend" and if so how it will be applied and to whose benefit. A Rand Corporation study points out that the FCC has had great difficulty regulating AT&T:

> AT&T has enjoyed an extraordinary degree of freedom for a regulated company. It has been able to decide what the structure of its rate should be, and it has been able to use profits from one kind of service to subsidize its expansion into other, sometimes unprofitable, service areas. The principle that savings from new technology should be "passed along to all users" enables the company—not its customers, not the FCC, not the free play of the market—to decide, in effect, what those savings should be and how they should be used (24).

As the FCC moves towards regulating rates of return for *specific* service categories such as broadcasting via satellite, COMSAT and the smaller carriers would stand to benefit and AT&T would come under closer scrutiny.

IV

PENDING APPLICATIONS

BUT THIS REMAINS an open question pending the actual determination by the FCC of who shall actually be allowed to launch a domestic satellite

system. Eight teams or separate firms have applied for the opportunity as provided by the new open competition policy of the FCC. The outcome will be extremely important both in terms of the application of the social dividend and in terms of the future market ground station equipment. In any case, industry observers believe FCC will base its decision on the eight proposals on "three standards: the economics of the proposed system, the novel services that it will make available, and the efficiency with which it utilizes the orbital slots and frequency spectrum" (25).

Two of the proposals are worth specific mention. The first is a cooperative agreement suggested by AT&T and COMSAT, wherein COMSAT would launch two satellites under their ownership and technical control, which would be leased entirely to the Bell System but with AT&T controlling the satellite circuits. This would allow great leeway in the operations of Bell's intricate communications system, and at the same time allow COMSAT to maintain its prominent position in satellite communications. The compromise appears to support previous arrangements between COMSAT and the carriers affected by the FCC (26). Under this "authorized user" concept which has developed the FCC does not permit COMSAT to deal directly with public customers. It may only lease satellite circuits to the other communication carriers.

It might be argued, in fact, that COMSAT has capitulated almost completely to AT&T, since the plan calls for AT&T to own the highly lucrative ground stations. COMSAT has heretofore been authorized to own 50 per cent of ground stations on U.S. soil and territories. Polling satellite experts, the *Wall Street Journal* found a common belief that 'if the AT&T-COMSAT plan is approved, it would pretty much eliminate COMSAT from any subsequent market penetration" (27). It is also evident that "by proposing lease from COMSAT, AT&T has blunted questions raised by FCC as to whether the company, because of its overpowering position, should be permitted entrance to satellite communications" (28). AT&T also makes much of the fact that the approval of its plan would not in any way preclude the competition of other carriers in satellite communications.

A rival proposal offered by Fairchild Hiller Corporation has dared to base its communications system on a 120-transponder satellite which would easily accommodate all current requirements of existing customers within its huge capacity. Concurrently, it would offer on a free basis extensive communications services, such as public broadcasting and Alaskan telephone service, not now economically viable. The only other high-capacity, multi-purpose domestic satellite system is offered by COMSAT, using

derivatives of the Hughes Intelsat 4 series. Apparently this type of system would meet with greater approval under the new emphasis on the forward-looking application of existing but under-utilized satellite technologies. In its brief to the FCC, Fairchild leaned heavily upon this one point, hoping presumably that pressure from Congress or the White House might influence the still somewhat conservative Commission. Unfortunately, the very capacity of the Fairchild system may make it vulnerable since business from AT&T and the broadcasters would be essential if the non-commercial services were to be supported economically. And even if this traffic were assured, it is not certain that capacity alone would spur the public interest uses upon which the company bases much hope for public support. System priorities are as much a factor as system capacities:

> None of the proposals, according to expert space engineers, takes full advantage of the unique opportunities that satellites afford for the mass distribution of signals from a single source, for cheap earth stations that would service remote areas, and for free transmission of public interest and instructional programs. Essentially, all the applications offer systems that are oriented primarily to the big, profitable traffic in point-to-point transmission of commercial messages (29).

Which proposal will be selected? For a variety of economic and political reasons, it would be difficult for the FCC to reject the AT&T-COMSAT plan. Should a second or third system be approved, as may be likely if true competition is to ensue, speculation is that the preferences of the broadcasters will cause the FCC to lean heavily to RCA, Hughes Aircraft, General Telephone, or Western Union. The FCC can select a mix of several proposals.

The danger may be that with the pressures for a decision in the case growing every year, the FCC may simply give in to the best of the contenders, even if the resulting systems are below par and will affect the communications industry for years to come. Given the fears of industry observers that the initially undersized markets would make early competition deadly to economically weak systems, it might pay the nation to again reconsider the proposals or call for a new competition if none of the proposals seems adequate. This was the path followed in deciding the TAT-6 submarine communications cable controversy, and it appears that the eventual system will be better for the delay.

In speaking of pending arrangements for future projects in the field of telecommunications, one should say a word about the United States and the International Telecommunications Satellite Consortium (Intelsat). Final agreement has been reached among the participating nations on a

permanent arrangement under which a global communications satellite system would be assembled and operated. Seventy-nine nations shared ownership in the Intelsat system at the time agreement was reached, and the very size of the organization gives a good indication that future operations are likely to continue to exceed expectations once the new management scheme becomes a reality.

Under the new arrangements, COMSAT would surrender its managerial role to, first, a secretary general of Intelsat and, later, to a director general responsible to the Intelsat Board of Directors. Additionally, the voting power of COMSAT is to be reduced considerably in keeping with a new ruling that no nation is to control more than 40 per cent of the voting power of the Intelsat Board of Governors. The U.S. now has over 50 per cent of the votes. This measure was designed to reduce the dominance of COMSAT over European users, although COMSAT's percentage of satellite traffic has been dropping steadily.

V

CONCLUSION

WITHOUT A DOUBT the FCC and the Nixon Administration are moving ever more surely towards an active policy of competition in what has traditionally been a highly regulated and monopolized field. But due largely to the horizons opened by successful new technologies, more international communications traffic is being generated than ever before. It therefore is suggested that the new direction in telecommunications policy is likely to achieve the seldom-observed feat of benefiting the industry, the companies, the public and the nation all at the same time—*if* the FCC is able to come to the correct decisions in its pending determinations. Few can really say with conviction that the FCC has the capacity to pick out the solution yielding the best opportunities. A lot will depend on the ability of an undermanned, underfinanced staff to wade through the window-dressing of slick corporate applications and develop a clearly understood operational interpretation of broadbrush policy statements.

Competition between the various firms is going to be keen. The private carriers were shunted off the stage in 1961 and 1962 by the new Democratic administration. After they had secured statements from the Eisenhower Administration favorable to exclusive private industry control of communications satellites, the Kennedy Administration proposed COMSAT. Proposing increased competition in communications satellites delivery systems might accomplish the same effect as abolishing COMSAT as a quasi-governmental entity. COMSAT may be about to suffer some

reverses as President Nixon replaces or reappoints members of the FCC whose terms expire. But review of the White House statements clearly shows that the Nixon philosophy is not merely a convenient strategem adopted to satisfy the private communications carriers. That would be gross oversimplification. It is intended as a philosophy supporting greater competition in all fields and, as such, is applicable to other industries such as railroads and aviation as well as communications (30).

The COMSAT case represents a combination of technological, political, and economic changes, the impact of which has social implications as well. If COMSAT has failed to implement socially desirable programs or provide leadership for social uses of communications satellite technology, what can be expected if a totally private carrier is given monopolistic control over satellites? The public interest in the use of communications satellites involves more than just the maintenance of competition in the interests of consumers. It is also important to secure maximum utilization of the system to accomplish social purposes in education and health, as well as in other fields which are commercially unprofitable, but which have great social implications.

As the Karth Subcommittee concluded in early 1970—a point worthy of repetition—the inability of the Government to make decisions is delaying the application of advances in satellite technology. It is ironic that other nations are applying the fruits of American-financed research and development in communications satellites to the creation of regional domestic systems faster than the United States can decide the direction of its own policies.

The basic question is still how the dividend arising out of the efficiencies of new technology developed through government funding should be distributed. In this case it can be spread broadly over the whole field of communications, limited to reducing the broadcasting bill, or applied to reducing long-distance telephone charges. It could also be used as a social dividend. One way or another the decision on a domestic communications satellite system will have far-reaching implications for the public interest. It will also suggest whether the FCC mechanism is appropriate for resolving such momentous questions in the 1970s (31).

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29. Shayon, *op. cit.*, p. 57.

30. See the *Economic Report of the President*, January 1970, p. 109.

31. This paper is based on a 20,000 word study, "The Public Interest and the Fruits of the New Technology: The Communications Satellite Case," with six pages of documentation. For these materials, which are available under the National Auxiliary Publications Service program of the American Society for Information Science, order Document NAPS-01829 from the National Auxiliary Publications Service, c/o CCM Information Corporation, 909 Third Avenue, New York, N.Y. 10022, U.S.A., remitting US$4.00 for microfiche, $9.00 for photocopy.

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Domestic Satellites, the FCC, and Competition in Domestic Telecommunication†

Richard W. Nelson*

The development of satellite communication technology in the 1960s raised the potential for technical change in domestic, long-distance telecommunications.[1] It also raised the potential for change in market structure. The effect on market structure, which was made possible by the emergence of a new group of potential suppliers of long-distance telecommunication services and a changed set of conditions of production, is the subject of this paper. It is shown that the development of satellite technology touched off forces leading to an increase in the number of actual suppliers, the development of more intense rivalry among existing suppliers, and increased significance of the threat of entry as a force in shaping market behavior. All of these changes in market structure herald increased competition.

The potential for increased competition in long-distance telecommunications followed from a change in technology that was essentially exogenous to the industry.[2] Interest in the new technology reflected the evaluation by firms that satellite operations would be profitable and, in the case of new suppliers, that a challenge to existing producers and the development of new markets were warranted. However, in actual practice, change in technology and market structure did not follow automatically from nor solely as a result of the interest of commercial enterprises. Because domestic telecommunication is regulated by the Federal Communications Commission (FCC), the potential forces for change inherent in the commercial interest in satellite communication translated into an actual effect only after the FCC

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[1] Long-distance telecommunications is used in this paper to refer to that part of domestic, point-to-point telecommunications involving transmission between urban areas.

[2] The feasibility of utilizing satellites in domestic telecommunications hinged on developments in rocketry making it possible to place and maintain large payloads in orbit, advances in miniaturization of electronic components, and advances in the durability and reliability of electronic equipment. The latter two advances involved refinements in technology rather than radical changes in the type of technology, since satellite communication systems continue to use the same basic radio technology incorporated in terrestrial communication systems.

The underlying advances in technology were largely exogenous to the communication industry itself, rather being spin-offs of the federal government's space program. Of course, private firms were involved in the federally sponsored research, and once the underlying technology had been developed sufficiently to bring implementation of satellite systems within the grasp of potential telecommunications suppliers, they took interest in the new technology and began to carry on the work for commercial purposes.

ruled that development to be in the public interest, as defined in the Communications Act of 1934.[3]

ESTABLISHED INDUSTRY STRUCTURE

In 1972, prior to the implementation of satellite technology in domestic telecommunications, the supply side of the domestic, long-distance telecommunication market was dominated by a single communication common carrier, the American Telephone and Telegraph Company. That company operated an extensive nationwide system for long-distance transmission as an extension of its local telephone operations. A second, much smaller common carrier, Western Union, and in addition a number of specialized common carriers serving limited geographical areas and providing specialized services also were suppliers in the long-distance telecommunication market. Finally, there were several very small private operators maintaining long-distance facilities solely for their own use. The common carriers involved in domestic, long-distance telecommunications and their revenues from that activity in 1972 are presented in Table 1.

Near monopoly clearly was the major characteristic of the supply side of long-distance telecommunications within the United States. Fully 91 percent of total long-distance revenues of the industry were accounted for by AT&T and its subsidiaries. The long-distance transmission requirements of this demand, plus that of the additional five percent of total industry revenues accounted for by the independent telephone companies, all were served by the long-distance facilities maintained by AT&T.[4] Moreover, these figures, which serve well to demonstrate the overall dominance of AT&T, do not reveal the underlying absolute monopoly existing in major submarkets, owing to effective segmentation of demand. Thus, in long-distance message telephone service, accounting for 86 percent of total industry revenues, AT&T was the only supplier of long-distance transmission services. Western Union had an effective monopoly in meeting the requirements of switched message telegraph service, accounting for three percent of total industry revenues. Only in the market for private line service, accounting for 11 percent of total industry revenues, were there competing long-distance systems in existence offering consumers a choice of supplier.

The market for private line service itself was diverse. It included the demand for program distribution, largely by the major television networks. The long-distance requirements of this demand were served almost entirely by AT&T, though small, specialized common carriers provided some service in areas of low population density. AT&T also was the dominant supplier of private line service in the voice, data, and record area, where it accounted for about 84 percent of total revenues. However, Western Union also was well established in this field of long-distance telecommunications, operating major leased systems for the Department of Defense and the General Services Administration of the fed-

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[3] U.S. Public Law 73-652, Communications Act of 1934, 73rd Congress, June 19, 1934.

[4] Total long-distance revenues include the local service required to connect long-distance systems with their customers as well as actual long-distance transmission. Variance among firms and types of communication service in the amount of local service supporting long-distance transmission makes a breakdown of total revenues by firm or service type an imperfect measure of the distribution of demand for actual long-distance transmission.

TABLE 1

LONG-DISTANCE TELECOMMUNICATIONS COMMON CARRIERS: 1972

	Total Long-Distance Revenues	
	$ Millions	% of Market
By Supplier		
American Telephone & Telegraph Company	9.983	91
Independent Telephone Companies	603	5
Total: Telephone Companies	10,586	96
Western Union Telegraph Company	389	4
Specialized Common Carriers	11	–
Total: All Common Carriers	10,986	100
By Type of Service		
Message Telephone Service	9,463	86
Message Telegraph Service	319	3
Private Line Service	1,204	11
Total: All Categories	10,986	100

Source: Federal Communications Commission, *Statistics of Communications Common Carriers* [1972]; also FCC, *Annual Report to Congress* (Fiscal year 1973).

eral government, as well as systems designed to meet private demand. On individual routes along which demand was highly concentrated, intense competition also had been posed by the emergence of specialized common carriers, following a 1971 decision of the FCC.[5] On one of these routes, linking Chicago and St. Louis, one of the specialized common carriers was reported to have taken 80 percent of the private line market, primarily from AT&T.[6] Despite their success on individual routes, the nationwide impact of the specialized common carriers still was small in 1972. However, these carriers were expanding their operations at a rapid rate and were bound to gain importance over time.[7]

Physical integration with the local telephone system is a second important characteristic of the supply of long-distance telecommunication services. A

[5] First Report and Order, FCC Docket No. 18920, 29 FCC 2d 870 (May 25, 1971).

[6] *Wall Street Journal*, March 5, 1974.

[7] MCI Communications Corp., the first specialized common carrier to challenge the general common carriers in the private line market, projected its revenues upon completion of its initial nationwide system at $55 million. (See First Report and Order, FCC Docket No. 18920, 29 FCC 2d 870.) Data Transmission Co., the second of the two most important of the specialized common carriers, anticipates revenues of $40 million upon completion of its initial nationwide system in 1976. The combined revenues of these firms clearly will be significant, but still their operations will be small relative to the private line operations of AT&T.

very large part of total long-distance demand is generated by customers of the local telephone systems, and the presence of natural monopoly conditions in the provision of local services, on which the long-distance systems are dependent for interconnection with their customers, makes physical integration of the local and long-distance systems mandatory for the achievement of efficient operations. It clearly is uneconomic, for example, for nonintegrated long-distance suppliers to construct custom local facilities providing the capability for switched service to all customers of the local telephone systems, as this would require duplication of the entire switching facilities of the local telephone systems as well as the local loops to the current telephone subscribers. Much demand for nonswitched, private line service, too, is handled most efficiently through the local telephone systems, owing to the undesirability of constructing even duplicate local loops. Thus, a very large block of long-distance demand, in both the message and private line areas, had to utilize the local telephone system for interconnection with the long-distance systems. Only for the very largest customers requiring private line service is it even possibly economic to construct private local links independent of the telephone systems, thus potentially breaking the chain of physical integration.

Although long-distance systems operated by AT&T, Western Union, and many of the specialized common carriers all were linked with the local systems of the telephone companies, such physical integration was not universal. AT&T operated a long-distance system to meet the needs of the television networks for program distribution that was totally independent of the systems serving telephone demand. Some of Western Union's operations similarly did not rely on the local telephone systems for interconnection, and the privately owned systems generally provided end-to-end service. The specialized common carriers took different approaches toward interconnection, some providing independent local loops, owned by either the carrier or the customer, and others relying largely on the local telephone systems for interconnection.

AT&T's position as the dominant supplier of local telephone services and also the largest producer of long-distance services created a very high degree of vertical integration in ownership as well as in physical integration between local and long-distance systems.[8] This fact also made AT&T an essential supplier to firms that competed with it in the long-distance market. As a result, AT&T had considerable potential power vis-a-vis its competitors in determining the division of this demand. By establishing rates for interconnection, as well as rules establishing the conditions on which service would be provided, AT&T could effectively determine its own share of demand dependent on its local facilities for interconnection. Thus, in 1972, the unavailability of interconnection with AT&T's switched local facilities guaranteed AT&T long-distance transmission business of the subscribers of its local, switched telephone service. The total demands of these customers, including local interconnection, amounted in 1972 to an estimated $8.7 billion, or 79 percent of the long-distance revenues of the

[8] Subsidiaries of AT&T operate local telephone systems supplying over 80 percent of the total telephones installed in the United States, and generating almost 95 percent of total local revenues of the telephone industry.

entire industry. This is to be contrasted with the private line area, where interconnection with AT&T's local facilities was permitted and where other suppliers had made significant penetration of the market.

POTENTIAL IMPACT OF SATELLITE TECHNOLOGY ON THE SUPPLY OF TELECOMMUNICATION SERVICES

Satellite technology introduced a new set of cost conditions in long-distance telecommunications which had significant implications for the market structure of the domestic long-distance telecommunication industry. The primary impact of the new technology was to reduce the significance of economies of scale in long-distance transmission. This change was rooted in two cost characteristics of satellite communication. First, with satellite technology, the cost of communication was independent of distance.[9] Second, the ability of a single satellite to serve a wide geographic area, possibly the entire continental United States, meant that demand sufficient to utilize efficient equipment could be pooled nationwide rather than simply along particular routes linking individual local markets. Given indivisibilities in transmission equipment on the same order as those existing in terrestrial systems, the new capabilities of satellite systems clearly implied a reduction in the relevance of economies of scale in the industry since the market that could be served by any individual piece of equipment would be broadened considerably. This effect would be especially relevant along routes having less concentrated demand. Of course, there also was some change in the nature of the transmission equipment utilized in production. However, the two technologies shared to a great extent the same radio technology, and any change in the extent of indivisibilities appeared to be in the direction of lesser rather than greater economies of scale.[10]

A direct implication of a diminution of the significance of economies of scale was that a greater number of suppliers could operate efficiently on a nationwide basis.[11] Any actual increase in the number of suppliers in the market was likely to be affected by the monopsonistic elements on the demand side of long-distance telecommunications. AT&T, General Telephone and Electronics, Western Union, and the television networks each controlled large blocks of demand and were unlikely to divide these respective demands among more than one supplier. This limitation was especially significant in the case of the

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[9] Even with satellite technology, the independence of cost with distance applies only to a point. The nature of the geostationary orbit utilized for communication satellites allows one satellite to serve any two points within 8,000 miles of each other on the face of the earth. Beyond this distance, service would require the use of two satellites, with a corresponding increase in cost. In domestic telecommunication, this situation results only in the case of certain service between Hawaii and the mainland.

[10] Since satellite technology is new, there exist no operating systems on which to base a cost analysis. However, for an analysis of the cost estimates of the firms involved in the FCC's inquiry, see Richard W. Nelson [1971], pp. 85–111.

[11] The applications filed with the FCC by firms interested in domestic satellite communication suggested that nationwide operations could be established for an investment of as little as $50 million and operated profitably with revenues of $15 million annually. The total market for long-distance services that could be served economically by satellite is considerably smaller than the $ 11.0 billion of total long-distance revenues of the common carriers in 1972, since the latter includes local interconnection and also shorter routes on which satellite technology would not be efficient. However, natural monopoly did not appear to be involved.

telephone companies owing to the size of the demand that they controlled, although it was possible that revised practices regarding interconnection would alter the extent of their control considerably. In any case, in light of the near monopolization of the industry prior to satellite communication, the limits thus imposed did not prevent a significant expansion in the number of firms operating in the industry.

Accompanying the potential increase in the number of firms was a potential increase in the rivalry among suppliers of long-distance telecommunication services. The ability of Western Union and the specialized common carriers to expand the scope of their operations, using the new satellite technology, gave them a greatly enhanced ability to challenge the industry leader. Much more vigorous rivalry thus was possible in the private line market. Especially susceptible was the service to the television networks, where AT&T's almost total penetration had previously been accepted passively by the other telecommunication suppliers. Not so obvious but equally susceptible to increased rivalry was the demand for long-distance telephone service, both on a message and private line basis. Long-distance message telephone service was the monopoly of AT&T prior to 1972, and accordingly no rivalry had existed at all. In the private line area, rivalry had previously been restricted to routes having dense demand, and might be extended considerably under satellite technology.

A corollary of the reduced significance of economies of scale was that nationwide operations could be established with a much smaller total investment than was possible previously. The reduced minimum investment, coupled with the diminished dominance of the market by AT&T that was likely to follow from the increase in the number of firms and rivalry among existing firms, would have the effect of reducing the level of barriers to entry into the industry. This effect would be reflected not only in the initial structure of the industry, after the introduction of satellite technology, but also in the years following the establishment of the initial systems. Thus, in the long run, the introduction of satellite technology also was likely to lead to an increased threat of entry into the industry, raising another potential impact on market structure and behavior.

The emergence of new potential suppliers of domestic, long-distance telecommunication services proposing to establish satellite systems, as well as the decision by existing suppliers to convert to the new technology, was to a great extent a reflection of the change in cost conditions initiated with the new technology. The increase in the number of potential suppliers can be viewed as a market response to reduced barriers to entry, and to the opportunity for additional firms to share in the supply of the domestic, long-distance telecommunications market, without sacrificing efficient production. Of course, changes in the regulatory environment, discussed in the following section, also must be considered in interpreting the increase in the number of potential suppliers. However, in this context, it is important to note that the initial commercial interest in domestic satellite communication was expressed in 1965 and 1966, prior to the liberalization of the FCC's standards as regards entry by specialized common carriers in the private line market.

POTENTIAL ROLE OF REGULATION

The fact that domestic telecommunication was regulated meant that change potentially brought about by the development of satellite technology had to be approved by the FCC before it actually could be effected. The FCC's influence encompassed changes in the number of firms, rivalry among suppliers, and the threat of entry, and would result through application of entry control, policy toward interconnection, and rate regulation.[12]

The FCC's statutory authority over the operations of communication common carriers and over use of the radio spectrum by all nongovernment users gave it effective control over whether any firms would establish satellite communication systems and, if so, how many would do so, who they would be, and what segment of the market each would serve. Entry control could have been administered so as to preclude the use of satellite communication technology altogether, or to ensure that it was introduced only by existing suppliers of long-distance telecommunication services. In the former case, even technical change would have been precluded. In the latter case, technical change could have occurred but the impact on the market structure of domestic telecommunication would have been limited to the possibility of increased rivalry among existing suppliers converting to the new technology. Alternatively, by authorizing entry by new domestic telecommunication firms proposing satellite systems as well as conversion to satellite technology by existing producers, the FCC would permit the development of an increased number of firms in the long-distance market and an increase in rivalry among them.

Entry control also would affect the threat of entry into the industry, though this effect would depend not on the number of firms that the FCC permitted to enter but rather on the manner in which it chose to exercise its authority over entry control. Should the Commission simply grant certificates or construction authorizations to a specified number of satellite applicants, including some new entrants, there would result an increase in the number of firms but no change in the threat of entry facing those that became established. Suppliers of long-distance telecommunications would remain protected against competition by the umbrella of the FCC's entry control as long as subsequent new entrants would have to be able to prove to the Commission that their entry was socially desirable.[13] Alternatively, the FCC could allow the number of firms in the industry to increase simply by abandoning or relaxing significantly its use of entry control so as to permit all interested firms to enter the market. In this case, not only would there result an increase in the number of firms, but those

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[12] The FCC also had authority to regulate the location of the satellites. Given that there are a limited number of "orbital slots" available, the method by which they were allocated could have a significant effect on the evolution of the industry. However, at least initially, the number of slots was more than sufficient to accomodate the satellites of all interested suppliers.

[13] This was a traditional practice in the industry. Under the doctrine of "economic exclusivity," a new supplier would not be granted a certificate or construction authorization unless it could prove (1) that it would generate sufficient revenues to make its operations profitable (i.e., that it was economically viable), and (2) that these revenues would not be gained at the expense of an established supplier. The latter condition clearly is very restrictive, but the former also is difficult to prove for a firm proposing new types of service.

firms would operate under an increased threat of entry posed by the existence of potential entrants who were uninterested or unsuccessful in the first round of establishing satellite communication systems.

Regulation of interconnection is seated in the FCC's authority to regulate the service offerings and tariffs of the local telephone carriers. Liberal rules of interconnection would increase the number of firms that could be expected to enter domestic satellite communication, by reducing the control of the telephone carriers over significant blocks of demand. Of course, the threat of entry into these submarkets, that otherwise would be the protected monopolies of the integrated telephone carriers or their chosen suppliers, also would be increased, opening the way for challenges by new entrants as well as existing telecommunication carriers. Such interconnection by the local telephone companies was essential if nonintegrated firms were to tap a very large part of the long-distance market in challenge to the dominant, integrated producer (AT&T). The protected demand included that of customers requiring telephone, record, and data service on a switched-message basis and also that of customers of leased line service too small to warrant construction of private interconnection facilities. AT&T had an obvious incentive to deny or restrict interconnection with its extensive local telephone network so as to force its customers to utilize its own long-distance facilities. Accordingly, policy in this area was a very relevant force in the development of domestic satellite communication.

The FCC's authority to regulate rates extends to all common carriers and thus potentially to all satellite communication firms except those that lease entire systems to single customers. Rate regulation had a very significant potential impact on the direction in which long-distance telecommunications evolved in response to the development of satellite technology. Maintaining rates at existing levels would have discouraged entry, since new entrants would have been unable to attract customers from the established suppliers by offering reduced cost service. In such a case, there would be less incentive for customers to take the risk of changing suppliers.[14] Of course, given the number of firms entering, price regulation also could undermine the potential price rivalry among suppliers, possibly directing whatever rivalry should remain toward service quality. Moreover, should the FCC maintain prices at established levels, thereby effecting a cartel, any new entry that might occur would tend not to increase competition but rather to create excess capacity, as new firms would enter to share existing markets despite sufficient existing supply. Such a development would be discouraged were established suppliers allowed to cut prices so as to forestall uneconomic entry.

ACTUAL REGULATORY POLICY

The FCC's decision in its domestic satellite communication inquiry, adopted in June 1972, set the course of regulatory policy toward the use of the new technology.[15] Summarized very

[14] Because satellite technology was new, there were risks involved in changing from an existing terrestrial supplier to a satellite supplier. This was especially true for those large customers, such as the television networks, which probably would have to contract for service in advance of construction.

[15] Second Report and Order, FCC Docket No. 16495, June 16, 1972.

briefly, that decision established two broad policies. Under a policy of "affording a reasonable opportunity for entry into the domestic satellite field by qualified applicants," in effect all interested firms meeting certain qualifications as to financial and technical expertise were allowed to establish satellite systems, regardless of the impact on other established suppliers.[16] As to the use of those systems, the FCC indicated its willingness to allow entry even in the long-distance message telephone area, which traditionally had been treated as a natural monopoly, though here the FCC envisioned that market segmentation rather than direct competition would develop.[17] Simultaneously with its ruling on entry, the FCC established a second broad policy under which AT&T and other suppliers of local telephone service would be required to provide interconnection for the long-distance systems of satellite suppliers, under reasonable tariffs, so as to allow the development of competitive supply in the private line area to subscribers of the local telephone systems.

The issue of price competition, which also had very important implications for the development of the industry, was not explicitly treated in the FCC's domestic satellite decision. However, the Commission seemed to carry forward the spirit of the specialized common carrier decision, which it quoted repeatedly. In that earlier decision, it was established that the specialized common carriers would not be protected through the imposition of minimum rates from competition by other specialized carriers or general common carriers. This policy apparently would be continued in domestic satellite communication.

The FCC's decision to allow new firms to enter the long-distance telecommunication field and all firms to utilize satellite technology, and to establish liberal rules of interconnection so as to discourage extension of the local monopoly of the telephone companies into long-distance telecommunication, in effect released the potential forces of change in domestic telecommunications described in the preceding sections of this paper. These potential changes—increased number of suppliers, increased rivalry, and heightened threat of entry—stimulated by the availability of satellite communication technology, would occur simultaneously with changes in market structure resulting from the independent but related growth of the specialized common carriers, which had already begun to establish domestic systems using the existing, terrestrial technology. The latter movement, generally limited to the shorter routes, represents solely a response to conditions of demand and change in the regulatory environment. However, the two channels of influence on market structure are interrelated. Satellite technology greatly enhanced the potential capability of the specialized common carriers, which as a result were likely to incorporate satellites in their operations.

The FCC's domestic satellite communication decision did not go as far in

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[16] Some conditions were imposed on individual entrants in an attempt to ensure fair competition. Thus, AT&T and other telephone carriers were precluded from using satellites for private line service for a period of three years. Conditions also were placed on Comsat, although these were lifted in the subsequent Memorandum Opinion and Order on December 21, 1972.

[17] The only applicant proposing long-distance message telephone service was General Telephone and Electronics, which would serve the long-distance needs of its own local subscribers rather than directing this demand through AT&T's long-distance facilities, as previously practiced.

the direction of authorizing change in market structure as was possible. It was implicit in the decision that, with the exception of GT&E's system, which involved only market segmentation, interconnection with local telephone systems to tap switched, message demand would not be permitted. This, in effect, would preclude the development of competition in the largest area of the market, maintaining the existing monopoly of AT&T and the other telephone carriers. Though protection of monopoly in this area has traditionally been based on the presence of natural monopoly conditions, those conditions were clearly evident only in local service. Thus, this important area would remain as it was, marked by technical change within existing market structure.

The interest of AT&T and GT&E in satellite communication raised the issue of cross-subsidization of the long-distance operations of these firms from their protected, monopoly operations in local markets. Under traditional ratemaking practices, such cross-subsidization could arise even from a competitive response by AT&T in the long-distance area, which could force it to set long-distance rates at less than required to generate the allowable rate of return on its invested long-distance capital (part of which would be less efficient, terrestrial equipment). In a similar situation, an unregulated supplier facing competitive markets for all of its services would have to accept a diminished profit until it could convert entirely to the new technology. The FCC treated this issue implicitly by imposing conditions on the operations of AT&T and GT&E designed to ensure a fair opportunity for new entrants to compete for private line demand. Further, the philosophy behind the Commission's decision implied an unwillingness to allow cross subsidization to occur. However, an explicit settlement of the issue of cross-subsidization awaited future decisions of the FCC.

EVOLVING STRUCTURE OF DOMESTIC SATELLITE COMMUNICATION

The initial structure of domestic satellite communication, representing the initial reaction of commercial firms to the FCC's 1972 decision, had only begun to emerge as of October 1974, since there is a lag of several years in implementing satellite systems owing to the use of custom-built equipment. Two companies, RCA and Western Union, had begun offering satellite services within the domestic market.[18] Both offered private line service, meeting voice, data, and video demands. Western Union also used its system to support its operations in the area of record communications. Although Western Union's operations represented technical change within its already established domestic telecommunication system, RCA's position in satellite operations reflected the addition of a new competitor in the market.

Several other firms still were in the planning or construction stages of establishing satellite communication systems as of October 1974. One of the proposed systems would be jointly owned by AT&T, GT&E, and Comsat, and would

[18] RCA was the first company to begin offering satellite services in the domestic market, in January 1974. RCA used its own earth terminals but rented satellite circuits on the Canadian domestic satellite, planning to replace the latter after launching its own satellite, which was under construction. Western Union was the first firm to offer satellite service utilizing its own satellites, beginning in July 1974.

be used solely by AT&T and GT&E to support the long-distance message demand of the local telephone systems as well as to provide private line service for those companies' customers. Comsat and IBM had agreed on a joint venture in domestic satellite communication. Finally, Hughes Aircraft (through a subsidiary, National Satellite Corp.) and Fairchild Industries and Western Union International (through a joint venture, American Satellite Corp.) also had satellite systems under review.[19]

The initial structure of domestic satellite communication thus would have at least two and possibly up to seven firms selling satellite communication services. The impact of satellite technology on the submarket for long-distance, message telephone demand would be to give GT&E a role in that area but not to increase competition. Similarly, switched record communication would still be served by Western Union. However, all of the satellite communication firms would be represented in the private line market, offering voice, data, and television transmission, and in this area there would definitely result an increase in the number of suppliers in addition to technical change.

Arrangements for interconnection with the local telephone systems had not been settled as of October 1974. AT&T protested having to supply interconnection giving long-distance private line customers of other firms access to switched, local service, as required in a FCC ruling in 1974. This action of the Commission had been appealed to the courts, where it was pending, and served to highlight the importance of government action in the area of interconnection.

The extent of vertical integration in ownership of the satellite systems in operation or under construction was varied. Thus, the proposal of AT&T, GT&E, and Comsat involved dividing ownership of the satellite and earth terminal segments of the satellite system between independent firms, but integrating ownership of the terminal segment with the local telephone systems. RCA's interim use of the Canadian domestic satellite for satellite circuits and AT&T for interconnection produced a case where three independent entities were involved in providing end-to-end service. Finally, Western Union provided some integrated end-to-end services using solely its own equipment.

Though the structural impact of satellite technology was just beginning to unfold in 1974, some competitive effects had already appeared. Western Union and RCA filed tariffs for coast-to-coast, private line circuits that cut AT&T's charges by about one-half. AT&T, responding to the increased rivalry from specialized common carriers, including satellite firms, filed a revised tariff structure for its entire private line service. Departing from the historical nationwide rate averaging, AT&T proposed to set its rates more in line with costs by lowering its charges to customers along high-density routes, raising those on all others. This response by AT&T also raised the question of cross-subsidization

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[19] The status of these systems varied as of October 1974. AT&T and GT&E had received authorizations for independent systems in September 1973, but their joint venture had not received FCC approval by October 1974. The system proposed by Comsat and IBM also had not received approval, and additionally had been challenged on antitrust grounds by the FTC. The status of the systems proposed by National Satellite and American Satellite was unclear, although both had received approval by the Commission. National Satellite, which originally had agreed to provide satellite circuits to GT&E as part of its system, had been adversely affected by GT&E's decision to merge its satellite operations with AT&T.

as a practical issue. It remains to be settled by the Commission.

The impending change in market structure following the introduction of satellite technology also has had an effect on the program distribution segment of private line demand. No change of supplier had resulted as of October 1974, but negotiations between the networks, their existing supplier (AT&T) and potential suppliers among the satellite applicants had been underway for several years. A new tariff by AT&T, in 1974, lowered significantly the cost of program distribution to the three networks, again apparently the direct result of the new competition that followed the introduction of satellite technology in the domestic market.

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Competition between Cable Television and Direct Broadcast Satellite – It's More Complicated than You Think

By Andrew S. Wise and Kiran Duwadi

January 2005

Competition between Cable Television and Direct Broadcast Satellite – It's More Complicated than You Think

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FEDERAL COMMUNICATIONS COMMISSON

Abstract

Direct Broadcast Satellite ("DBS") is often considered a substitute for basic cable service, but current cable subscribers may face substantial switching costs to move from cable to DBS services. We use aggregate firm-level price data and other related demographic variables to examine the cost of switching from cable to DBS and vice versa. We find some firm-specific attributes and demographic variables that influence consumer choice and switching costs that appear to affect consumers' desire to switch from one service to another. We then use observation-specific dummy variables that stratify cable price based on changes in the level of cable prices between two periods to examine whether consumer behavior varies depending on the size of price change. We find that when quality-adjusted prices for basic cable services increase substantially, subscribers will switch from cable to DBS, presumably at the point at which the price change is larger than the cost of switching.

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I. Introduction

In this paper, we study substitution between cable television and Direct Broadcast Satellite ("DBS") multichannel services, particularly for the basic cable services to which the vast majority of cable customers subscribe, and any industry characteristics that may affect substitution. Previous examinations of whether cable television prices are constrained by competition have produced inconsistent results. Using different methods and different data sets, economists have examined whether the presence of different competitors can restrain incumbent cable operators from charging supracompetitive prices. This issue is highlighted by persistent increases in inflation-adjusted cable prices, even in the face of what appears to be expanding competition from DBS, and obscured by simultaneous quality increases and new service offerings. Difficulties in acquiring comparable data between cable and its competitors, particularly DBS, have made rigorous examination of substitution between cable and its alternatives even more complicated. We have access to comparable data at the local level, which assists our examination of cable-DBS substitution.

Both cable operators and DBS operators offer a variety of service packages. Cable operators offer a basic package, or *tier*, which by law must include local broadcast channels but often does not include much else.[1] Usually, cable operators offer one or more additional packages of satellite channels in addition to the basic tier, sometimes called "Cable Programming Service Tiers" ("CPSTs"). We follow FCC (2003) in combining the first two packages (i.e., the basic tier and first CPST) of cable service as the "most popular" service. "Most popular" is an apt term, because more than 90% of cable subscribers take these two tiers together before adding any additional services. Together, these two tiers of service form the basis for the cable rates we study, including any per channel rates. Cable operators may also offer other CPSTs and packages of channels transmitted digitally, but these packages tend to have much lower penetration rates. Additionally, cable operators generally offer for an additional charge premium movie channels (termed "premium services" below), such as HBO and Showtime, either a la carte or in packages, and some cable operators offer pay-per-view movies and events, high-speed Internet access, and local telephone service. DBS operators offer various large packages of satellite channels, roughly comparable to cable operator CPSTs, but, due to demand conditions and satellite capacity, can only offer local broadcast stations in some communities, generally in a package by themselves for a few dollars a month. DBS operators, like cable operators, offer premium services for an additional fee.

One study (Goolsbee and Petrin, 2004) found that premium cable is a closer substitute for DBS than the equivalent of cable's most popular services. In this paper, we focus on the question of whether DBS competition constrains cable pricing for the most popular service and how the presence of switching costs affects substitution between non-premium cable and DBS services.[2] We hypothesize that cable's most popular service is a substitute for similar DBS service, and vice versa, but that the presence of switching costs limits substitution for small quality-adjusted price changes.

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[1] Cable operators are allowed to offer all of their channels on one large package, but almost never do this. At a minimum, premium movie services are generally offered separately. Cable operators rarely will, however, offer a large number of satellite channels on the lowest tier of service. Cable operators typically offer a small basic tier with little more than local broadcast signals (required to be carried on the basic tier by law) and any channels required by the franchise agreement, plus one or more large packages of channels (CPSTs) consisting exclusively or principally of satellite channels. In many cases, operators bundle niche and broad-appeal channels together. Combining these two types of channels allows operators to differentiate their content from that offered by the local over-the-air broadcasters. Such a strategy also allows cable and satellite operators to price discriminate among consumers, since certain groups of consumers will buy additional bundles of programming and other groups of consumers will not. See Owen and Wildman (1992) for a discussion on the economics of bundling.

[2] In 2002, the FCC analyzed the proposed merger of DBS providers DirecTV and EchoStar and concluded that the two firms' products were closer substitutes for each other than either product was for cable service. Like Goolsby and Petrin (2004), our data does not distinguish between the two DBS providers, and consequently cannot provide any evidence of cross-price elasticities of demand between the two DBS products.

This paper investigates the substitutability between DBS and cable; identifies proxies that affect consumers' decisions to switch from one service to another; and comments on the policy implications of the results. Using data from the FCC's 2003 survey of cable industry prices, including DBS penetration, we examine whether the cost of switching from cable to DBS plays an important role in substitution between DBS service and the most popular cable service. In other words, we study whether the presence of real or perceived costs discourages consumers from switching between cable and DBS in response to price changes. We find evidence of switching costs, and that switching will occur with sufficient changes in quality-adjusted cable price.

We examine substitution between DBS and cable services using a two-stage process. First, we examine the cross-price elasticity for cable's most popular service for the entire industry by regressing the DBS penetration variable against quality-adjusted cable price, firm-specific cable variables, and demographic variables. The resulting cross-price elasticity is less than unity, suggesting that there is only a limited amount of substitution based on price. Additionally, the coefficient of quality-adjusted cable price is not significant. Other measures of cable quality, such as the number of premium movie channels offered (consistent with Goolsbee and Petrin, 2004), and demographic variables that affect the availability of DBS, however, appear to have an effect on DBS penetration. An inelastic cross-price elasticity can mean that significant switching costs exist for homogenous products or that the two products are differentiated. Second, we examine the reactions of consumers facing different levels of cable price changes. This reveals that consumers faced with large changes in quality-adjusted cable prices for the most popular service will substitute between cable and DBS services, depending upon the magnitude and direction of the price change. Economic theory dealing with consumer switching costs predicts this type of behavior where consumers are reluctant to switch to a competing product due to explicit or implicit switching costs.[3]

II. Background and Previous Research

For the purposes of this paper, multichannel video service consists of multiple channels or packages of channels of video networks sold to consumers for a subscription fee. Cable's "most popular service" is defined as the basic tier plus the first CPST. Cable service is sold under a system of local franchises, whereby the local government grants a franchise to a cable company to provide service in its area, and regulation is bifurcated between local and federal governments. Cable service can and does vary widely in terms of quality and price even between bordering communities. DBS service, in contrast, is provided to the entire country with very few differences from community to community in terms of quality and price.[4] Access to DBS service is limited to those who can view the satellite by placing a satellite dish facing south without obstruction, so some at more northerly latitudes, or those living in multiple dwelling units not facing south, may be unable to receive DBS service.

Other video providers compete with cable operators, such as overbuilders, wireless video systems, and telephone-provided video services, but these services are provided only in a few areas and

[3] See Klemperer (1995) for a survey of the literature on switching cost theory. For further detail, see Klemperer (1987a), (1987b), (1992), Beggs and Klemperer (1992), and Klemperer and Padilla (1997).

[4] In general, prices are the same for DBS service, although some short-term promotions may change this temporarily for some consumers or communities. In terms of quality, DBS service is the same for most communities, although DBS offers local broadcast channels in some communities and not others, and more northern latitudes (and the non-continental states and territories) have more difficulty acquiring signals from the satellites, and may not be able to purchase all services.

also vary from community to community.[5] All studies have shown clearly that cable prices are lower and cable quality higher for the most popular cable service in a local service area where an overbuilder is present.[6] Whereas cable prices for the most popular service drop in the presence of an overbuilder, nationwide cable prices continue to rise at a rate much higher than general inflation, notwithstanding the presence of DBS service which is generally equal or superior in quality to the video services offered by cable companies.

Cable television service, or, more broadly, multichannel video service, began in the United States in various small rural communities as a means of bringing broadcast signals from distant urban locations to rural communities that had none. For years, cable television systems only offered this type of "antenna" service. In the 1970's, however, programmers, beginning with Home Box Office, a premium movie service, began transmitting content via satellite to cable systems for distribution to consumers. A proliferation of satellite-transmitted networks followed, and the modern multichannel video industry was born. During the 1970's, 1980's, and early 1990's, cable systems faced competition only from overbuilders, which existed in only a few communities and almost always went out of business; from wireless video systems in a few more places; and from "C-Band" satellite.[7] C-Band satellite was limited, however, by the multiple thousands of dollars cost of the eight-foot diameter dish that was required and by its inability to provide local broadcast signals. It was, therefore, mainly a luxury item (C-Band generally provided more channels than cable systems) or found in rural areas where cable was not available.

DBS service was launched in 1993, and has grown rapidly ever since.[8] DBS service consists of one or more small satellite dishes placed on the outside of a residence, which receives signals from geostationary satellites. Originally, DBS was technically superior, offering more channels with digital video and CD-quality sound, and perhaps appealed mainly to wealthier multichannel video consumers. DBS had certain limitations, however, such as high set-up costs ($1000 for equipment and professional installation in 1994 (FCC 2004)) and long-term contracts. DBS was also prohibited from offering local broadcast stations. Over time, the differences in terms of capacity and quality between cable and DBS have narrowed, however, with cable upgrading the number of channels and the quality of its service, DBS set-up costs dropping, and changing laws and regulations that allowed DBS to provide local broadcast stations.[9]

Prior to 1996, little research on the effects of DBS on the cable industry existed. Since then, however, several researchers have attempted to analyze the competitive effects of DBS on cable. For example, Hausman (1999), in comments on the relationship between cable prices and DBS, concluded that DBS is not a substitute for cable, because cable prices only respond in the presence of another cable

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[5] For instance, less than one percent of the more than 33,000 cable local service areas in the country have been certified by the FCC as having "effective competition" from an overbuilder (*i.e.*, 50 percent of subscribers having access to an overbuilder and 15 percent subscribing to service from the overbuilder). (FCC, 2004.)

[6] See, *e.g.*, FCC, 1999-2003.

[7] C-Band satellite was a predecessor to today's DBS service. It was delivered by satellite to consumers who owned an 8-foot diameter satellite dish. Setup costs limited its effectiveness as a competitor to cable, and today subscribership has fallen to less than one percent of MVPD subscribers (FCC, 2004), with many former C-Band subscribers switching to DBS service.

[8] An earlier attempt at launching DBS service in the late 1980's by a subsidiary of COMSAT failed. The provider that launched in 1993, Primestar, used a slightly different technology than current providers, and Primestar has since been absorbed by current providers. The first provider using current technology, DirectTV, launched in 1994.

[9] See http://www.fcc.gov/mb/shva/ for a summary of the change that allowed DBS carriage of local broadcast signals.

competitor, not to the universal presence of DBS. Hausman attributed this fact to product differences between cable and DBS, such as the inability to provide local broadcast signals, and high DBS start-up costs. Recent work by the FCC and General Accounting Office found significant cable price decreases and cable quality increases where cable overbuild competition exists, but cable price increases everywhere else (GAO, 1999; FCC, 1999-2003). Goolsbee and Petrin (2004) found that premium cable is a closer substitute for DBS than the equivalent of cable's most popular services, but also that all cable subscribers enjoy substantial welfare gains from the entry of DBS from lower cable prices and higher cable quality. Savage and Wirth (2005) found that overbuild entry is more likely in monopoly cable markets with high population density, income, and household growth, and that cable operators in these markets offered more channels with a lower price per channel for basic service, but without examining the effects of DBS competition. GAO (2002) found that the ability of DBS operators to offer local broadcast channels to a local community raised penetration in that community, but did not affect cable prices.

We also follow previous research concerning the cable industry and issues relating to its own-price elasticity, such as Rubinovitz (1993) and Ford and Jackson (1997), both of which employed models similar to the one we specify below.[10] Crawford (2000) studied the consumer welfare effects of the 1992 Cable Act, finding that cable operators responded strategically to rate regulation, moving services and changing product offerings, and that there was no net consumer welfare gain from the 1992 Cable Act. Crawford's finding is relevant to the conclusions we reach below.

The review above indicates a paucity of studies that examine cable and its possible substitutes, especially the effect of DBS service on demand for and pricing of cable's most popular service. In particular, we know of no study that examines the effects of switching costs on consumer choice in this industry. Due to improvements in FCC data collection and a new method of examining this problem, we are able to provide some insight on cable-DBS competition.

III. Switching Cost Theory

In many markets, consumers face costs of switching between different services large enough to change consumer behavior and limit substitution. Klemperer (1987) identified three types of switching costs: transaction costs, learning costs, and artificial or contractual costs.[11] Transaction costs are incurred to begin service with a provider and/or to terminate service with a previous provider. Learning costs are those required to become comfortable with a new product or service. Firms create artificial switching costs though marketing or contractual terms, such as long-term contracts, to "lock in" a consumer to the firm's product. In addition to explicit costs, implicit switching costs also exist, particularly based on a lack on knowledge about a substitute service.

We anticipate that all three types of explicit switching costs exist in the MVPD industry. Both cable and DBS charge installation fees, and DBS charges for equipment in some cases: these are transaction costs.[12] Additionally, there is the time and inconvenience required to research alternative

[10] Other important studies of the cable industry include Mayo and Otsuka (1991), Chipty (1994, 1995, and 2001), Beil, et al. (1993), Otsuka (1993), and Emmons and Prager (1997). Older research on substitution between cable and other products does exist, but it is of limited value, because the industry has changed so drastically in the interim. (See, *e.g.*, Webbink, 1986; Bykowski and Sloan, 1990).

[11] We follow Chen and Hitt (2002) in this discussion.

[12] Cable almost always charges an installation fee, although sometimes consumers can self-install. DBS subscribers can also self-install, but will still have to pay any equipment fee. Given the nature of installing DBS equipment (climbing on the roof, aiming the satellite dish at a satellite, running wiring to televisions), we expect most consumers would rather pay a fee than self-install. With some limited-time offers, consumers can

services and to have one installed. Learning costs may be substantial, particularly for a consumer switching from an older, less-advanced cable service to DBS service. DBS, in particular, uses long-term contracts in exchange for reduced installation or equipment fees.

Knittel (1997) offers the following model in his application of switching costs to long distance telephone service, which we adapt to this study. A consumer pays c to sign up with a cable company, A, and must pay c to change to another MVPD, such as a DBS provider. If c equaled zero, then a consumer would switch between MVPDs whenever the price of another firm fell below that of the current provider. With the presence of a positive switching cost, however, the consumer will not switch providers unless the price of another firm is more than c below cable company A's price. Hence, even if other providers charge below the price for cable, cable company A can earn positive profits at a higher price.

An obvious implication of switching costs is that purchase of a service in the current period depends positively on the purchase of the same service in the previous period. Additionally, consumers will switch in a second period when their switching cost is overcome through a change in price charged in the first period that is larger than the switching cost. We exploit these two implications to search for evidence of switching costs in the MVPD industry.

We hypothesize that switching costs exist in the MVPD industry and affect consumer substitution between cable's most popular service and comparable DBS service. Thus, each provider has some ability to raise prices within a range without losing subscribers, but, if price rises by more than the switching cost, consumers will switch between services. We model these factors below. We use quality-adjusted price to account for differences in packaging between otherwise homogeneous services. We also use differences in price changes faced by consumers in different communities to observe whether sufficiently large price changes can induce switching.

III. Conceptual framework

Our analysis is based on an examination of consumer behavior in a multi-product market. According to economic theory, individuals select goods and services that provide the maximum level of utility or satisfaction subject to an income restraint. An individual's decision to consume is influenced by consumer preferences, the product's characteristics, price, prior consumption or use of the product, and socio-economic factors. Switching costs may also affect consumer choice.

The switching cost associated with consumer choice may be measured by using direct or indirect methods. The direct method uses consumer-level data that represent revealed or stated preferences of the consumers regarding particular goods or services. Individual consumption patterns and histories may be collected by various methods, including consumer surveys (Office of Fair Trading, 2003). The direct method for measuring switching costs is based on the random utility framework pioneered by McFadden (1974), and yields the best information regarding switching costs, but we are prevented from using it here by the lack of consumer level data.

The indirect method uses aggregate firm data rather than individual consumer data to estimate switching costs. Since demand elasticities are related to consumer choice, the indirect method estimates the cross-price elasticity to identify the existence of switching costs. More specifically, a low cross-price elasticity of demand for products that are functionally homogeneous usually indicates the existence of a

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avoid installation and/or equipment costs for DBS, but this often is for limited service (all televisions must watch the same program) or requires long-term contracts, which constitutes a contractual switching cost.

high level of switching costs between products. Simply stated, when consumers are faced with products that are homogeneous, a low cross-price elasticity of demand would mean that a seller could raise its price without significant loss of its current customers. Of course, a low cross-price elasticity of demand could also mean that the products are not functionally homogeneous, but we examine this possibility more thoroughly with the second specification we estimate. Additionally, although price is the key identifier of switching costs, consumer choice is also influenced by product- and firm-specific characteristics, including quality, breadth of product variety, and ease of use. These product- and firm-specific characteristics may increase or decrease switching costs.

In the present analysis, in order to simplify estimation, we first assume that cable and DBS provide "most popular" services that are functionally equivalent when examined using quality-adjusted cable prices. While differences between cable and DBS services still exist, the services have become increasingly similar over time. Since DBS operators now are allowed to distribute local broadcast channels, and since many cable operators have upgraded their systems to offer more channels and digital services, DBS and cable provide similar services. We realize that this is a simplification that may not be accurate in all local multichannel video markets, but we believe that it is a reasonable simplification.[13] Further research using different econometric methods can more fully examine whether this simplification fully captures the nuances of the multichannel video market. Under this assumption, we estimate firm-level demand functions for DBS using cable prices and firm-specific information. We expect that the estimated cross-price elasticity from the DBS demand function will indicate the presence or absence of switching costs between cable and DBS. The presence of switching costs for functionally equivalent goods would be revealed by a positive cross-price elasticity of demand of less than one (Office of Fair Trading, 2003).[14] We specify this DBS demand function as follows:

$$DBSP = f(P^S, P^o, Q^C, Y) + \varepsilon \quad (1)$$

where DBSP is DBS penetration; P^S is the price of substitutes; P^o is DBS price; Q^C is a vector of firm-specific cable attributes that affect consumer choices and reasons to switch from one product to another; Y is a vector of exogenous factors that can shift demand; and ε represents random fluctuations in demand. Since DBS service generally is offered for the same price everywhere, our estimated specifications include only cable prices.[15]

We realize that the assumption of functional equality of cable and DBS services may not hold in all markets, so that the finding of a cross-price elasticity of demand below one does not, by itself, provide strong evidence for the existence of switching costs sufficient to discourage substitution. As noted above, however, in the presence of switching costs, current consumption depends positively upon previous

[13] One piece of evidence supporting this idea is a recent Beta Research study showing that DBS and cable subscribers have very similar viewing preferences (Horeb, 2004). This implies that consumers do not feel they must turn to one service or another for particular programming or services.

[14] With perfectly homogeneous goods, any price elasticity less than infinity would indicate the presence of switching costs. Since there is some differentiation between the goods examined in this case, we would not expect that result. Given that some differences remain between the cable and DBS goods examined, a positive price elasticity less than one indicates the presence of switching costs, or significant differentiation.

[15] DBS providers do offer promotions under which, for example, installation is offered free, a limited amount of equipment is subsidized (i.e., for one television), or monthly rates are discounted for a few months, but these are all short-term offers. Otherwise, DBS subscribers to a particular provider pay essentially the same rates for the same package of service everywhere in the country. The discounts and promotions may lower the existence or perception of switching costs mentioned elsewhere in the paper. Differences in local taxes may also affect relative prices and the effect of switching costs.

demand, and consumers will switch products with switching costs, but only when the price exceeds the switching cost. We, therefore, estimate a second specification that stratifies communities based on the change in quality-adjusted cable price between 2002 and 2001. If the estimation results show that consumers facing different levels of price change reacted differently, *e.g.*, substituted to a greater extent in the face of larger price changes, the case for the presence of significant switching costs is strengthened. This second function is the same as equation (1) above but cable price (P^S) is divided into three separate variables based on cable price changes between 2001 and 2002. Therefore, the reactions of consumers facing particularly large cable price increases or decreases are captured separately from those facing small cable price increases or decreases. This specification will reveal whether consumers facing large quality-adjusted price changes react differently, thus implying that switching costs exist and can be overcome by large price changes.

III. Empirical Model

As mentioned above, we estimate two specifications. Our aim in estimating these specifications is to examine the factors that affect consumer's decision to subscribe to DBS and to reveal the relative importance of costs of switching from cable to DBS. We include several cable specific variables in the specification to examine the effect of cable characteristics on a consumer's decision to switch from cable to DBS, such as the number and/or presence of premium, regional sports, foreign language, and high definition channels locality-by-locality. The first specification is a fairly straightforward measure of the effect of various cable system characteristics and demographic variables on DBS penetration. This specification has been used previously to study the MVPD industry, such as in Rubinovitz (1993) and Ford and Jackson (1997). Using the demand function in Equation (1), we assume constant elasticities, so that the estimated demand equation takes the form:

$$DBSP = e^{B_0} P^{S B_1} Q^{c B_2} Y^{B_3} e^{\varepsilon} \quad (2)$$

Taking the natural log of each side yields:

$$\ln DBSP = B_0 + B_1 \ln P^S + B_2 \ln Q^c + B_3 \ln Y + \varepsilon \quad (3)$$

Note that the coefficients represent elasticities in this model specification. Specifically, the first specification we estimate is as follows:

$$\begin{aligned} LDBSP_l = {} & B_0 + B_1{*}LCABPERSAT_l + B_2{*}LPREM_l + B_3{*}CABINT_l + B_4{*}CABREGSPORT_l + \\ & B_5{*}CABFOREIGN_l + B_6{*}CABHIDEF_l + B_7{*}LNOVERAIR_l + B_8{*}LNLAT_l + \\ & B_9{*}LPOVERTY_l + B_{10}{*}LMULTDWELL_l + B_{11}{*}DBSOVERAIR_l + \varepsilon l_l \end{aligned} \quad (4)$$

Where:

LDBSP is the log of DBS penetration, or the percentage of television households taking DBS, in a local community also served by cable;

LCABPERSAT is log of the monthly charge per cable satellite channel for the basic tier plus the next additional package of channels, a quality-adjusted price for cable;[16]

[16] "Satellite channels" are channels such as CNN and ESPN that cannot be received locally via over-the-air antennas. A "per satellite channel" charge represents a quality-adjusted price, because it represents the per unit charge for channels that cannot be received without cable or DBS service. Determining a "per unit" price is complicated for the multichannel video industry. Cable channels are sold in packages for a monthly

LPREM is the log of the number of premium movie channels offered by the cable system;

CABINT is a dummy variable for whether the cable system offers high-speed Internet access;

CABREGSPORT is a dummy variable for whether the cable system offers one or more regional sports channels;

CABFOREIGN is a dummy variable for whether the cable system offers one or more foreign language channels;

CABHIDEF is a dummy variable for whether the cable system offers one or more channels in high definition format;

LNOVERAIR is the log of the number of local broadcast channels in the community;

LNLAT is the log of the latitude of the community;

LPOVERTY is the log of the percentage of households under the poverty limit in each community;

LMULTDWELL is the log of the percentage of households within multiple dwelling units ("MDUs");[17]

DBSOVERAIR is a dummy variable for whether one or both DBS operators offers local broadcast signals in the community;

and ε is the random error term. Subscript i denotes cross-section observations 1 through 525.

The second specification is an extension of the first, but it uses observation-specific dummy variables to divide communities according to the change in price per satellite channel each community faced between July, 2001 and July, 2002. The method can reveal differing consumer behavior in choosing between DBS and cable in reaction to different quality-adjusted cable price changes. The second specification we estimate is as follows:[18]

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fee, but few consumers watch all of the channels in the package. Therefore, individual consumers perceive some channels as worthless and some channels as highly valuable (sufficiently valuable to cause them to purchase the package even though they do not value all of the channels in the package), and, of course, the value of individual channels varies from consumer to consumer. "Quality adjusted" price is also complicated, in that various measures of quality (ratings, Emmy awards, license fees, etc.) could be used. In our model, for simplicity, we use the monthly rate divided by number of channels for the first two packages of channels. We chose to use the first two packages because these together represent the most popular cable service received by more than 90% of subscribers, and we believe that it is reasonable to assume that the quality-adjusted price of these services plays a pivotal role in consumer choice between cable and DBS services.

[17] We define a multiple dwelling unit as one that contains two or more housing units in one building.

[18] We thank Kit Baum, Greg Crawford, George Ford, and Tracy Waldon for assistance in improving this specification from an earlier version.

$$LDBSP_i = C_0 + C_1*PLUSTENDROP_i + C_2*NEG10TO10_i + C_3*PLUS10RISE_i + C_4*LPREM_i + C_5*CABINT_i + C_6*CABREGSPORT_i + C_7*CABFOREIGN_i + C_8*CABHIDEF_i + C_9*LNOVERAIR_i + C_{10}*LNLAT_i + C_{11}*LPOVERTY_i + C_{12}*LMULTDWELL_i + C_{13}*DBSOVERAIR_i + \varepsilon 2_i \quad (5)$$

Where all the variables are as above, except:

> PLUSTENDROP is an interactive dummy variable that equals the log of the 2002 cable monthly charge per satellite channel for the basic tier plus the next additional package of channels if the local community experienced a 10 percent or larger drop in that price between 2002 and 2001, or zero if not;
>
> NEG10TO10 is an interactive dummy variable that equals the log of the 2002 cable monthly charge per satellite channel for the basic tier plus the next additional package of channels if the change in the local community price was between a ten percent drop and a ten percent rise between 2002 and 2001, or zero if not;[19]
>
> PLUS10RISE is an interactive dummy variable that equals log of the 2002 cable monthly charge per satellite channel for the basic tier plus the next additional package of channels if the local community experienced a 10 percent or greater rise in that price between 2002 and 2001, or zero if not;
>
> and ε is the random error term. Subscript i denotes cross-section observations 1 through 525.

See the Appendix for details on the number of localities that fell within each of these categories. We believe this method will reveal points, if they exist, at which consumers switch from cable to DBS services or vice versa.

We recognize that the functional forms of these specifications do not constitute demand functions in the classic sense, in which the quantity demanded (*i.e.*, a number of units; in this case, subscriptions) is modeled as a function of its own price and characteristics; the price and characteristics of substitutes; and demographic variables. In this case, we use DBS penetration instead of number of subscriptions. We follow other studies that use cable penetration instead of number of subscriptions, such as Mayo and Otsuka (1991) and Chipty (2001).[20] Since very few households purchase more than one subscription, both penetration and number of subscriptions are relevant measures of demand.[21] Additionally, we use no measure of DBS price, but this is appropriate since DBS price does not vary from locality to locality.

In the second specification, we examine current period price for cable, but stratified into three groups according to the change in quality-adjusted price since the previous period, between 2002 and 2001. We believe this specification will capture both the current period cross-elasticity for each group,

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[19] Admittedly, this is a wide middle range, and it would be preferable to have additional price change strata. Difficulties in instrumenting for more variables, however, prevent us from looking for more break points.

[20] Another possible approach is a discrete choice demand specification, following Goolsbee and Petrin (2004).

[21] A limited number of households purchase both cable and DBS, presumably because those consumers want features from both services. The Federal Communications Commission does not have a current estimate for the current number of households that subscribe to more than one service, but characterize it as "low" and ignore the effect of these subscribers when estimating total MVPD subscribers in the industry (FCC, 2004).

and the cross-period nature of switching costs, i.e., that in the presence of switching costs, current consumption depends on previous consumption and on whether changes in price overcome switching costs. Thus, if the second specification shows that consumers faced with large changes in quality-adjusted cable price switch between cable and DBS, and the first specification shows a positive but less than unitary cross-price elasticity, we would hypothesize that this indicates that switching costs hinder switching in the presence of small changes in price.

One concern with estimating these specifications is that consistent estimation of the parameters is precluded if there exists a simultaneous relationship between LDBSP and LCABPERSAT, PLUSTENDROP, NEG10TO10, and PLUS10RISE. A C-Statistic test reveals the existence of this problem, so that OLS estimators will not be consistent.[22] Simply put, LDBSP may partially determine these variables, which may in turn partially determine LDBSP. To handle this problem, we employ an instrumental variable least squares regression technique. The variables we use as instruments in the first specification are **OVERBUILD, CABVERTINT, LCABSUBSYS,** where:

> OVERBUILD is a dummy variable, which equals one if the cable system faces an overbuild competitor and zero if not;
>
> CABVERTINT is a dummy variable, which equals one if the cable system is vertically integrated with a provider of programming, and zero if not; and
>
> LCABSUBSYS is the log of number of subscribers to the cable system that serves the local community.

The second equation required additional instrumental variables. We used the above variables as instruments and added **LNATIONALSUBS, LOWPENETRATION, LDENSITY**, where:

> LNATIONAL SUBS is the log of the number of total subscribers served in the U.S. by the owner of the local cable system;
>
> LOWPENETRATION is a dummy variable, which equals one if the cable system meets the FCC effective competition test for low penetration, and zero if not;[23] and
>
> LDENSITY is the log of the population density for each community.

We follow Crawford (2000) in using instruments that affect the marginal cost of providing cable service. CABVERTINT captures the ability of cable operators to lower costs by purchasing programming from their affiliates at true marginal cost (Chipty, 2001). LCABSUBSYS and LNATIONALSUBS reflect increased bargaining power and cost savings gained from horizontal size (Chipty, 1995). Population density affects system maintenance costs. Neither OVERBUILD nor LOWPENETRATION are related to marginal cost, but cable systems in both of these situations price differently than other systems (FCC, 2003), and correlation tests reveal no relationship between these variables and LDBSP.

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[22] See Baum, Schaeffer, and Stillman (2003) for a discussion of the C-statistic, or "difference-in-Sargan" test.

[23] The "low penetration" test of effective competition specifies that cable operators with less than 30 percent penetration are exempt from rate regulation.

A second concern when estimating both specifications is the existence of heteroskedasticity, given the form of the specifications and the cross-sectional data set. In this case, the variance of $\varepsilon 1_i$ and $\varepsilon 2_i$, denoted $\sigma 1_i^2$ and $\sigma 2_i^2$, respectively, may not be fixed. Heteroskedasticity is a common problem in cross-section studies where observations may not be perfectly homogeneous. Because the data set employed considers communities with widely differing characteristics, the possibility of non-constant variance raises the issue of the efficiency of the estimator. To account for this problem, we report robust coefficient estimates; these are efficient in the presence of arbitrary heteroskedasticity. Multicollinearity is also a potential problem, but a variance inflation factors test shows no evidence of it.

We note that we have excluded digital cable service tiers from the model, although we do include cable systems that offer digital tiers. We choose to focus on the per-satellite channel price of the first two packages of service. Taken together, these two tiers are by far the most popular services on cable systems, with penetration rates typically above 90% of cable subscribers. These two tiers almost always are transmitted in analog format. Additional CPSTs and digital packages tend to have much lower penetration rates. Obviously, digital cable services are valuable to some consumers, and play a role in the decision to choose between cable and DBS. We believe our contribution, however, is to illustrate the effect that the presence of DBS has on the basic services that almost every cable subscriber receives and that some, especially low income subscribers, receive exclusively. This complements Goolsbee and Petrin (2004), which showed that premium cable is the closest substitute for DBS service. Additionally, given the high penetration rates, we believe that it is reasonable to assume that the quality-adjusted price of the first two packages of service play a pivotal role in consumer choice between cable and DBS services.

A positive coefficient for LCABPERSAT would indicate that DBS penetration increases with the quality-adjusted price of cable, and supports our assumption that consumers view cable and DBS as substitute goods. A coefficient below one would indicate that DBSP is relatively unresponsive to changes in cable price and thus would be consistent with the presence of significant switching costs. A negative sign for the coefficients of LPREM, CABREGSPORT, and CABHIDEF would indicate that DBS penetration is lower where cable systems offer more high-value channels, perhaps indicating that the addition of these services reduces the benefit from switching to DBS. Similarly, negative coefficients on the CABINT variable would indicate that DBS penetration is suppressed in communities where cable operators offer Internet access. In other words, it would indicate that consumers value receiving this service from their cable provider, and thus attach a lower benefit to switching from more advanced cable systems to DBS. Additionally, negative and significant coefficients for CABFOREIGN and LNOVERAIR would indicate that subscribers view foreign language cable networks and local broadcast channels as significant factors when deciding between DBS and cable services.

Another factor affecting consumer choice of multichannel video distributor is the latitude, represented in our specifications as LNLAT.[24] Latitude increases moving from south to north. In the United States, DBS satellites are in the southern sky. The quality of DBS reception may deteriorate with a move to the northern latitudes, because the angle of the dish points closer to the horizon with higher latitude, and creates a greater chance that an obstruction will prevent a household from receiving DBS service. A negative and significant coefficient for LNLAT would indicate that DBSP is suppressed at higher latitudes because of the dish angle. Similarly, a negative coefficient for LMULTDWELL would indicate that DBSP is suppressed where a higher percentage of households are multiple dwelling units (MDUs), because a certain percentage of those living in MDUs do not have access to the southern sky.

[24] Goolsbee and Petrin (2004) alerted us to the importance of this variable, and Keith Brown and Noel Uri suggested it to us independently, and gave us the necessary data.

We expect the sign of the coefficient of LPOVERTY to be negative, indicating consumers below the poverty line are less able to afford DBS service due to an inability to afford setup costs and monthly fees.[25] Consumers unable to afford DBS service may instead choose cable, or may not be able to afford any kind of MVPD service.

Finally, we expect the coefficient of DBSOVERAIR to be positive, showing that DBS provision of local broadcast signals increases penetration in that area. Since cable operators are required to provide these signals, DBS provision reduces differences between the services. DBS operators have consistently maintained that the ability to provide local broadcast signals increases DBS penetration in those areas (FCC, 2004).

Assuming that switching costs are shown in the first specification, as evinced by a low cross-price elasticity, our second specification is designed to show additional evidence for switching costs, even if cable and DBS services are differentiated products in some markets. As noted above, a low cross-price elasticity may indicate switching costs, or that DBS and cable are differentiated products. If consumers facing small changes in price do not substitute, but those facing large changes in price do substitute, this provides additional evidence that something is interfering with substitution. Under this scenario, consumers facing small price changes will show little substitution between DBS and cable: the coefficient for NEG10TO10 could be either positive or negative, but we would expect that the coefficient will not be statistically significant in the presence of switching costs, because we would not expect a relationship between DBS penetration and small changes in cable price. Consumers facing significant changes in quality-adjusted cable price, however, will overcome their switching costs (*i.e.*, the gain in welfare from switching between services will be greater than the switching cost), and substitution between DBS and cable service will increase or decrease DBS penetration. The coefficient of PLUSTENDROP should be negative, indicating a lower DBS penetration in areas where the quality-adjusted cable price recently has dropped significantly. Conversely, the coefficient of PLUS10RISE should be positive, indicating a higher DBS penetration in areas in which the quality-adjusted cable price recently has risen significantly.

IV. Data

In the past few years, new sources of data have become available that make possible the direct comparison of local cable characteristics with DBS penetration. This study uses data on DBS collected by the FCC in recent years as part of its *Annual Survey of Cable Industry Prices* ("*Price Survey*"). The survey collects cable operator-reported data on cable systems, and also asks operators to estimate how many consumers subscribe to DBS within the local area. The sample is intended to be representative of U.S. cable systems. All of the data come from July 2002, unless otherwise noted below. Demographic data come from the Census Bureau. The data from the Census Bureau are two years older (as of 2000) than the other data, with the exception of the MDU data, which are from 1999. For descriptive statistics for all the variables, see the Appendix.

One objection to this data set is that the sample for the *Price Survey* was chosen to be representative of the cable industry nationwide, rather than representative of the DBS industry. The cable survey data set, however, is very large, and was chosen to be representative of a nationwide industry serving almost every community in the nation. It should, therefore, also be representative of communities served by DBS nationwide. Once matched up with the DBS data, the total number of observations is 525. A second possible objection is that the DBS data are cable-operator reported, so that the data on DBS for

[25] Additionally, a consumer must have a credit card in order to receive DBS service. Those below the poverty line are less able to gain approval to receive a credit card.

some communities may be inaccurate. Many cable operators purchase actual DBS subscriber numbers by zip code from *SkyReport*, but others do not. Unfortunately, we are unable to quantify the extent of this potential measurement error, but we believe that it is reasonable to assume that cable operators are knowledgeable about the extent of DBS competition in the areas they serve.

Finally, the potential bias of this sample should be noted. The sample was chosen to be representative of cable service received by the average cable subscriber, and most cable subscribers receive their cable service from large systems. As a result, the communities that appear in the sample tend to be served by cable systems with a large number of subscribers. These are systems that, on average, offer a higher number of channels at higher prices, and thus communities served by smaller cable systems may be underrepresented. This potential bias, however, may make it less likely that DBS and cable are differentiated products for the markets in the sample, since DBS operators offer packages that are equivalent or superior to the offerings of large cable systems. Therefore, our approach for treating cable and DBS as homogeneous services would be appropriate for this sample.

V. Results

The results from the estimations using equations (4) and (5) are summarized in Tables 1 and 2. In general, these specifications measure the sensitivity of DBS penetration to various factors. These specifications may be viewed as demand equations. The second specification is considerably less robust than the first, probably due to difficulties in instrumenting for three variables, but still is statistically significant and provides interesting insights into the question of whether switching costs affect consumer behavior in this market. The main difficulty in interpretation concerns coefficients of cable characteristics; these can represent either, or both, substitution behaviors (i.e., reasons why people shift between cable and DBS), and/or consumer demand for those characteristics. We attempt to interpret the results in light of this duality.

TABLE 1

FIRST SPECIFICATION: DBS PENETRATION AND FULL INDUSTRY QUALITY-ADJUSTED CABLE PRICE

THE FULL MODEL REGRESSION COEFFICIENTS AND GOODNESS OF FIT STATISTICS

(t-statistics in parentheses)

First Stage Variable	Estimated Coefficient	t Statistic
LPREM	-0.08***	(4.91)
CABINT	-0.15***	(4.98)
CABREGSPORT	-0.09**	(3.02)
CABFOREIGN	-0.04	(1.30)
CABHIDEF	0.00	(0.05)
LNOVERAIR	0.06*	(1.78)
LNLAT	0.25***	(3.19)
LPOVERTY	0.01	(0.83)
LMULTDWELL	-0.00	(0.01)
DBSOVERAIR	-0.04	(1.56)
OVERBUILD	-0.06	(1.09)
CABVERTINT[26]	0.09***	(4.33)
LCABSUBSYS	-0.01	(1.25)
Constant	-0.68	(2.07)
Observations	525	
Centered R-Squared	0.38	
Shea Partial R-Squared	0.04[27]	
F-Statistic Test of Excluded Instruments	7.67***	
F-Statistic	14.35***	

Second Stage Variable	Estimated Coefficient	t Statistic
LCABPERSAT	0.82	(0.80)
LPREM	-0.13	(1.30)
CABINT	0.11	(0.58)
CABREGSPORT	-0.13	(0.97)
CABFOREIGN	0.27**	(2.19)
CABHIDEF	-0.06	(0.41)
LNOVERAIR	-0.20	(1.31)
LNLAT	-1.15***	(2.66)
LPOVERTY	-0.12**	(2.00)
LMULTDWELL	-0.16**	(2.26)
DBSOVERAIR	0.13	(0.99)
Constant	3.03**	(2.32)
Observations	525	
R-Squared	0.12	
F-Statistic	4.36***	
Hansen J Statistic	8.40**	

*** - *significant at 99% confidence level*, ** - *significant at 95% confidence level*, * - *significant at 90% confidence level*

[26] Similar to Crawford (2000), CABVERTINT has the greatest explanatory power.

[27] For this specification, the Shea partial R-Squared equals the standard partial R-Squared, because the estimation includes only one endogenous variable. See Baum, Schaeffer, and Stillman (2003).

TABLE 2

SECOND SPECIFICATION: DBS PENETRATION AND STRATIFIED QUALITY-ADJUSTED CABLE PRICE

THE FULL MODEL REGRESSION COEFFICIENTS AND GOODNESS OF FIT STATISTICS

(t-statistics in parentheses)

Variable	Estimated Coefficient	t Statistic
PLUSTENDROP	-1.12	(0.32)
NEG10TO10	0.91	(0.58)
PLUS10RISE	14.21**	(2.10)
LPREM	0.06	(0.30)
CABINT	0.15	(0.51)
CABREGSPORT	-0.36	(1.37)
CABFOREIGN	0.19	(0.75)
CABHIDEF	-0.51*	(1.82)
LNOVERAIR	-0.19	(0.83)
LNLAT	-1.54**	(2.29)
LPOVERTY	-0.22**	(2.15)
LMULTDWELL	-0.15	(1.30)
DBSOVERAIR	0.41*	(1.74)
Constant	4.89*	(1.88)
Observations	525	
F-Statistic	2.05**	
Hansen J Statistic	6.97*	

*** - significant at 95% confidence level, * - significant at 90% confidence level*

First Stage Diagnostics

	F-Statistic	Centered R2	Partial R2	Shea Partial R2	F-Statistic of Excluded Instruments
PLUSTENDROP	2.05***	0.11	0.06	0.04	3.21**
NEG10TO10	10.87***	0.32	0.05	0.03	3.87***
PLUS10RISE	1.91**	0.06	0.02	0.01	2.03*

*** - significant at 99% confidence level, ** - significant at 95% confidence level, * - significant at 90% confidence level*

The F-statistic and partial R-squared for the first stage indicate that the first stage regression has a reasonably high explanatory power for the endogenous variable.[28] The Hansen J statistic, an overidentification test of all instruments, indicates that the model is correctly specified, and that the instruments meet orthogonality conditions.[29] Results from the diagnostics tests of the second specification are somewhat less encouraging, perhaps due to the inclusion of three endogenous variables in the specification.[30] Given the diagnostic test results reported above, we are very confident in the

[28] Bound, Jaeger, and Baker (1995) recommend using first stage statistical tests as a means of examining whether the endogenous variable is correctly identified.

[29] See Baum, Schaeffer, and Stillman (2003).

[30] We omit reporting the first stage results for all three endogenous variables for the second specification due to space concerns. The reported diagnostics should allow the reader to assess the validity of the specification.

identification of PLUSTENDROP and NEG10TO10. We are less confident in PLUSTENRISE, which may suffer from weak instrumentation, and thus its coefficient should be interpreted with caution.

In the first specification, the coefficient of LCABPERSAT is positive but not statistically significant. There are two possible interpretations. The first interpretation is that switching costs are sufficiently high to discourage substitution between cable and DBS services. A second, alternative interpretation is that the low and insignificant cross-price elasticity indicates that cable and DBS are differentiated products. This is a testable hypothesis requiring additional work beyond the scope of this paper. Switching cost, where the products are differentiated, would require estimation of cross-price elasticity of demand over time (Office of Fair Trading, 2003). Additionally, the magnitude of the coefficient indicates that DBS penetration is relatively unresponsive to changes in the monthly charge per cable satellite channel. For the purposes of this paper, we assume we have accounted for differences between cable's most popular tier and DBS through the specification of our model, particularly through the use of quality-adjusted cable price. We examine this assumption further in the second specification, which we interpret as showing evidence of significant switching costs for consumers choosing between cable and DBS services.

In the second specification, the observation-specific dummy variables for cable price, PLUSTENDROP, 10TO10RISE, and PLUS10RISE, indicate the presence of significant switching costs. The coefficient of PLUSTENDROP is negative, showing lower DBS penetration in areas with a large drop in cable per-satellite channel price, perhaps through substitution to cable, or simply through a lack of substitution to DBS. The coefficient of PLUSTENDROP is not statistically significant, however, creating doubts about strong interpretations of this variable. One possible explanation of the low statistical significance of the coefficient is that DBS subscribers are less able or willing to switch back to cable even when cable prices drop significantly, perhaps due to long-term contracts signed with DBS providers. Long-term contracts represent an artificial switching cost, as discussed above. The coefficient of PLUS10RISE, representing communities with large quality-adjusted cable price increases, is positive and has a large magnitude, showing higher DBS penetration in these areas, perhaps through substitution from cable to DBS. The coefficient of NEG10TO10 has a positive sign, but, as expected, no statistical significance, showing that in communities with little cable price change, cable price has little or no relationship to DBS penetration. We believe it is reasonable to conclude that there is no relationship between cable price and DBS penetration in these communities, at least partially because of the presence of switching costs.

In the first specification, the coefficient for LPREM is negative but not significant, indicating perhaps that the number of high-value video services offered by the cable operator plays a role in the penetration of DBS, as would be expected. This result is consistent with the findings of Goolsbee and Petrin (2004) that premium cable is a closer substitute for DBS than the most popular service. Thus, the quality of cable service available as measured by the number of premium services offered may affect acceptance of DBS. This result, in combination with the low t-statistic for LCABPERSAT, may mean that cable and DBS compete in terms of quality instead of price, consistent with the findings of GAO (2003). In the second specification, the coefficient is positive, but very close to zero, and of almost no statistical significance, perhaps reflecting difficulties in instrumentation. A similar interpretation for the negative coefficient of the CABHIDEF variable in both specifications is reasonable, that cable provision of high-value video services lowers DBS penetration. We note that very few cable systems in the sample offered high-definition channels, and that consumer ability to receive high-definition signals on an appropriate television was quite low at the date of the survey.[31]

[31] Again, in the second specification, the statistical significance drops, perhaps reflecting difficulties in instrumentation.

The positive signs for the coefficients of CABINT and CABFOREIGN may represent consumer demand for advanced services, and parallel demand for DBS as an advanced service. Because DBS offers foreign language channels at a level at or above most cable systems, this is particularly true for CABFOREIGN in the first specification, which is significant at a 95% confidence level. CABINT is not statistically significant in either specification, however, indicating that Internet access service is not an important factor in choosing between cable and DBS.[32]

The negative sign for the coefficient of CABREGSPORT in both specifications, although with low statistical significance, indicates that DBS penetration is suppressed in areas where cable operators offer regional sports channels. This result is interesting due to a peculiarity in regulation of cable operator-owned cable networks. The FCC's "program access" rules require programming networks that are affiliated with cable operators to offer their service to cable competitors such as DBS operators, with one Congressionally-mandated exemption. Vertically integrated networks can deny access to their program networks if the networks are delivered terrestrially, instead of via satellite. (Wireless microwave transmission is also used, and is not covered by program access rules.) Additionally, there is no requirement that non-vertically integrated networks offer their services to competitors to cable, so it is possible for cable incumbents to negotiate exclusive carriage agreements with non-vertically integrated networks. Terrestrial delivery is impractical for national networks, because no cable operator owns a sufficiently broad terrestrial distribution network to deliver a programming network to the entire country. In some areas, however, cable operators' distribution networks are broad enough to transport regional networks terrestrially, and thus the networks could be exempt from program access regulations. Some cable operators have bought or developed regional sports networks and, in some cases, cable operators have also bought the sports franchises that are carried on these regional sports networks.

We, therefore, can think of three circumstances that may be contributing to reduced DBS penetration where cable operators carry regional sports networks. First, cable operators may be reducing DBS penetration by making unavailable to DBS providers affiliated regional sports networks transmitted terrestrially.[33] Second, cable operators may be able to make unavailable to DBS providers non-vertically integrated regional sports networks, which are not covered by FCC program access rules, by signing exclusive carriage agreements. Third, the terms of the carriage agreements for some regional sports networks, either affiliated or unaffiliated with cable operators, may make them uneconomical for DBS providers to carry. In other words, the revenue gained through carriage of regional sports networks may not exceed the cost of carrying them, even if not carrying the networks reduces subscribership in some areas.[34] The low statistical significance of the variable, however, cautions against giving strong weight to these interpretations. Additionally, it is unlikely that the result can be explained exclusively based on vertically integrated regional sports networks, since, as far as we know, only Comcast SportsNet in

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[32] We note that almost all consumers who can subscribe to cable Internet access service can do so without subscribing to the cable operator's video service, although sometimes at a higher cost. Frequently, consumers also have the choice of DSL high-speed Internet access service. Therefore, it is perhaps not surprising that cable provision of high-speed Internet access service is not a significant factor for consumers in deciding which *video service* to subscribe to.

[33] See FCC (2004), pp. 80-81 for a discussion of this issue. Firms that compete with incumbent cable operators indicate that circumvention of program access rules through regional terrestrial delivery is a significant problem, but cable operators dispute this assertion.

[34] For instance, EchoStar has declined to carry the Yankees Entertainment and Sports Network (YES Network), a regional sports network that is unaffiliated with cable operators and is made available to all MVPDs. DirecTV carries YES Network, and claims that it has increased subscribership. (See http://www.skyreport.com/skyreport/apr2002/ 041002.htm.) Another factor in the calculation for DBS operators is channel capacity: in some cases, it may not be worth using a nationwide slot for a regional channel that will appeal mainly to viewers in one region.

Philadelphia is both delivered terrestrially and denied to DBS operators. Therefore, to the extent that this result is valid, it is likely due to a combination of the factors listed above.

In both specifications, the negative signs for the coefficients of LNOVERAIR, LNLAT, LPOVERTY, and LMULTDWELL are all as expected. Broadcast channels are a substitute for subscription video services for some consumers, such that areas with more broadcast channels have lower DBS penetration. As explained above, consumers at higher latitudes are less likely to be able to receive DBS service, and the estimation reflects this negative relationship. Similarly, consumers living in MDUs potentially have more difficulty pointing a satellite dish in the necessary southern direction. Finally, consumers below the poverty line are less able to afford DBS service, probably due to set-up costs and a requirement for a subscriber to have a credit card to initiate service. Each of these variables represents non-cable characteristics of local markets that affects DBS penetration.

Finally, both specifications show a positive coefficient for DBSOVERAIR, as expected. Apparently, the ability to provide local broadcast signals does increase DBSP in a local area. One way to think of this result in the context of this model is that the provision of local broadcast signals lowers the cost to consumers of switching to DBS, in that they do not have to install or pay for installation of a broadcast antenna in addition to the cost of DBS equipment.

VI. Conclusion

Overall, this paper generates interesting results that point to areas for further investigation, and complements and extends previous work on cable-DBS substitution by Goolsbee and Petrin (2004). Given the current debate over cable rate increases, the results presented above, particularly from the second estimated specification, have important policy implications. These results indicate that, as previously shown by Goolsbee and Petrin, consumers view DBS as a substitute for cable in terms of higher quality services offered, such as premium movie and high-definition channels. Additionally, even for basic cable services, consumers appear to turn to DBS as a substitute for cable when facing large quality-adjusted cable price increases, but may turn to cable as a substitute for DBS to a lesser extent when presented with large quality-adjusted cable price decreases. The latter result may be due to long-term contracts for DBS service that increase the cost to consumers of switching from DBS to cable. The presence of switching costs, however, limits substitution between cable and DBS services when quality-adjusted price changes are small.[35] These findings are consistent with the hypothesis that DBS providers are a constraining factor on quality-adjusted price increases for basic cable services by cable firms. Previous studies that examine per channel cable prices indeed show that, on average, per channel cable prices change very little from year to year, for an average of 0.9% per year between 1998 and 2002. (See, *e.g.*, FCC, 2003, and Table 3, below.) Taken in concert with rapidly rising total cable subscription rates (an average of 7.1% for programming and equipment between 1998 and 2002), this implies that most cable operators are adding satellite channels nearly as fast, or faster, than they are raising their total package prices.

[35] Obviously, other factors may also limit switching between cable and DBS, such as cable offering bundles of services, or offering advanced services such as video-on-demand. Our model only addresses the effects of price changes on the switching decision.

TABLE 3

CABLE PER CHANNEL RATE VERSUS CONSUMER PRICE INDEX

	July 1995	July 1996	July 1997	July 1998	July 1999	July 2000	July 2001	July 2002	Average '98-'02
Rate per channel *percent change year-to-year*	$0.604	$0.618 *2.3%*	$0.635 *2.8%*	$0.645 *1.6%*	$0.642 *-0.5%*	$0.645 *0.5%*	$0.656 *1.7%*	$0.664 *1.2%*	0.9%
Consumer Price Index	152.5	157.0 *3.0%*	160.5 *2.2%*	163.2 *1.7%*	166.7 *2.1%*	172.8 *3.7%*	177.5 *2.7%*	180.1 *1.5%*	2.3%
Cable CPI	201.1	214.9 *6.9%*	231.1 *7.5%*	246.5 *6.7%*	255.4 *3.6%*	267.3 *4.7%*	279.7 *4.6%*	297.3 *6.3%*	5.2%

Source: FCC (2003).

One possible way of looking at the multichannel video market, supported by the results in this paper, is in the context of the theory of switching costs. In the multichannel video market, the incumbent cable operator commands a large market share, and cable subscribers may consider switching from cable to DBS as implying a perceived or real switching cost. In a situation where price discrimination between new customers and repeat customers is not possible, and where the consumer switching cost is high, the incumbent would charge supra-competitive rates to existing subscribers and not compete for new subscribers. The new entrant would compete only on the fringe of the market and serve new subscribers. The incumbent may also provide a whole array of services (e.g., cable operators providing high speed Internet services), thus making the cost of switching to other multichannel services higher than before for its current subscribers. Our results point to this possibility, since it appears that consumers switch multichannel video providers only in response to relatively large price changes, not small ones. In other words, consumers are reluctant to change due to real or perceived switching costs, but can be pushed over that hurdle by price increases that exceed their perceived switching cost.

We also find that DBS penetration is lower where cable operators carry regional sports channels. This is likely due to a combination of factors discussed above. Two of the factors may involve cable operators limiting DBS operator access to regional sports networks. If this is true, cable operators may be able to offset competitive pressures from DBS, and thus may be able to impose larger price increases without losing subscribers to DBS where they are able to transmit vertically-integrated regional sports networks terrestrially, or are able to reach exclusive carriage agreements with non-vertically-integrated regional sports networks. There may be, however, benefits from the program access exception for terrestrial delivery (such as providing incentives for cable operators to develop regional programming) that outweigh the harms from reduced competition.

As noted above, it appears that DBS can act as a constraint on cable prices even for basic services, because sufficiently large quality-adjusted price increases result in increased DBS penetration. Thus, large quality-adjusted price increases for the most popular or basic cable service may not be sustainable for cable operators. Additionally, if DBS has driven quality improvements in the market, the lack of consumer substitution in response to small cable price changes may be less important for consumer welfare (i.e., consumer welfare gain from quality improvements may outweigh welfare loss from higher prices). The restraining effects of competition appear discontinuous or "lumpy," although ultimately effective in restraining the market power of cable operators. Analyses of market competition that fail to take into account switching costs may conclude that competition with DBS will not constrain cable prices, or even be used to justify cable rate regulation. The results of this paper do not support such conclusions. Additionally, Crawford (2000) found no net consumer welfare benefit from cable rate regulation, even in the absence of competition, due to evasion of the regulation. Moreover, over time, the

two products have become more similar, and with reduced setup costs for DBS, perhaps consumers will substitute more readily between cable and DBS in the future.

The findings in this paper point to areas for additional research, such as estimation of a differentiated products model to examine further the role of switching costs in this market, and the addition of digital cable service to this type of study. Moreover, monitoring the presence and effect of switching costs in this market will support an economically efficient government policy by revealing with more precision the interaction between competitors in the market.

APPENDIX

TABLE 4

DESCRIPTIVE STATISTICS*

Variable	N**	Mean	Standard Deviation
DBSPC	525	0.16	0.13
PERSAT02	525	0.83	0.31
PLUSTENDROP	55	0.76	0.31
NEG10TO10	410	0.84	0.32
PLUS10RISE	60	0.86	0.26
PREM	525	76.1	44.5
CABINT	374	N/A	N/A
CABREGSPORT	408	N/A	N/A
CABFOREIGN	374	N/A	N/A
CABHIDEF	30	N/A	N/A
OVERAIR	525	11.3	4.36
LAT	525	38.5	4.85
POVERTY	525	0.09	0.07
MULTDWELL	525	0.30	0.17
DBSOVERAIR	307	N/A	N/A
OBDUM	24	N/A	N/A
VERTINT	265	N/A	N/A
SUBSYS	525	90,311.0	135,908.7
NATSUB	525	333.9	121.6
LOWPENETRATION	52	N/A	N/A
DENSITY	525	2,748.5	5,338.1

* In this table, we report the true numerical value of these variables, not the log of that number, so some of the variables no longer carry an "L" or an "LN" prefix.

** For dummy variables, N reflects the total that equaled one. For the interactive dummy variables, N reflects the total that fell within the range of price change reflected in that variable, described above. The mean and standard deviation for interactive dummy variables reflects the per cable satellite channel charges for communities within the range.

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