

Statement of
James H. Quello, Commissioner
Federal Communications Commission
Before the
Subcommittee on Telecommunications and Finance
June 17, 1987

In 1982, the Commission eliminated its three-year holding rule for broadcast stations that were acquired through the transfer process. While I voted for repeal of the rule, I now believe the Commission erred in striking down this regulation. A bill, H.R. 1187, has been introduced by several members of this subcommittee which proposes to reinstate the three year holding rule. I wholeheartedly endorse this proposal.

On May 28, 1987, I submitted for the record my initial thoughts on the need to reinstitute the three year rule. Today, I am submitting a lengthy supplement to that statement. Because of time considerations I would like to summarize my position.

Without question there has been unprecedented churn in the broadcast industry. In the last two years we have seen a significant number of stations sold and in some cases resold for quick profits. Data recently provided by the Mass Media Bureau suggests that the number of stations transferred in less than three years is increasing. Data recently provided by Paul Kagan

Associates, Inc. shows that in 1986 160 television stations were sold. Of this number, 23 percent were held less than two years. Moreover, review of data from the 1987 Edition of the Television Factbook, and the Commission reveals an increasing trend of short-term station trading. For example, in 1983, 5.1 percent of the stations sold were held less than three years. The number increased steadily to 28.4 percent in 1984 and 31.6 percent in 1985. According to latest available data, in 1986, an astounding 52 percent of the stations sold were held less than three years. Kagan's analysis also shows that the rate of station flipping has increased steadily since 1983.

It is important to remember one historical footnote. The Commission first adopted its three year rule in 1962 as a response to what it believed was accelerated station trading. At that time, the Commission observed that in 1961, 45 percent of the stations traded were held less than 3 years. In 1960, 53 percent of the stations traded were held less than three years. We have now come full circle. The concerns which moved the Commission to act in 1962 apply equally today.

While there may be conflicting data on this subject and various reasons for sales increases, the real issue is that reinstituting the three year rule would undeniably help to reestablish the public interest standard in broadcasting transfers. I believe the conflicting Commission views on takeovers is primarily a matter of honest differences in regulatory philosophy and approach.

I have seen a productive evolution at the FCC over the past thirteen years from overregulation to deregulation, to unregulation to marketplace self regulation to some counterproductive lapses into unregulatory excess.

For example, I'm afraid the Commission erred when we first fostered a climate that made takeovers relatively easy. At one time, the FCC public interest approval required to take over a broadcast property was considered a formidable requirement. Now it is found to be not only possible but relatively easy.

The FCC actions fostering the easy sale, merger or takeover climate encompassed a variety of actions including the following: The trustee concept adopted in 1983 to facilitate and expedite hostile takeovers, elimination of the three year holding rule; the simplification of financial qualification requirements by only requiring a simple personal certification, the extended 12-12-12 limit on station ownership, the new more liberal ownership attribution rules, and the easing of license renewal and license transfer requirements.

I have to admit I supported most of the measures, but I would like to reestablish the antitrafficking and the financial responsibility rules. Also, I vigorously dissented to the trustee concept in hostile takeovers.

Other factors that caused the gold rush of entrepreneurs to stake a claim in broadcast properties were (1) the increased awareness two years ago that broadcast properties were great cash flow vehicles and then relatively underpriced; and, (2) the incentives of an attractive depreciation allowance for new owners.

My general attitude questioning takeovers by professional financial raiders was initially expressed in my byline article in the Los Angeles Time (March 22, 1985). The key last two paragraphs read:

"The financial community should realize that broadcast properties should not be considered just another takeover game. Potential buyers have to meet the requirements of not only the Securities and Exchange Commission and the Justice Department but also the FCC, which is required to make public interest finding before a transfer of control or ownership. The requirement for FCC approval is something that potential raiders should keep in mind. Our broadcasting system requires a degree of stability that is not enhanced by excessive financial manipulation and speculation."

I naturally don't oppose all mergers and sales. Some of the purchases and mergers between communications companies serve the public interest. My main concern is with professional raiders

and financial opportunists with little or no broadcast or communications background or public interest commitment.

I was once quoted and I repeat "I don't think I was appointed by the President and ordained by Congress to accommodate a bunch of fast buck artists trading broadcast properties like commodities."

I don't believe the recent instability serves overall public interest. Broadcasters are licensed to serve the public interest. When a broadcast property is challenged by a takeover or when a licensee is required to service a heavy debt burden as a result of rapid station trading, programming, including the most vital news and public affairs programming, receives less commitment and time from key management.

Also, I have the additional insight of my personal experience in undergoing two different takeovers. Station WXYZ, Detroit was sold to ABC in 1947 causing turmoil. Everyone was scurrying for jobs including the Vice President and General Manager. I was promotion manager at the time and I noticed that program planning and public service were temporarily placed on hold. Years later, when I was Vice President and General Manager at WJR in Detroit, we were taken over by Capital Cities. Now Capital Cities is a fine broadcaster that has served the Detroit community well for many years. In fact, I was fortunate enough to remain at the station for 8 years after the merger regaining my Vice Presidency in the process.

However, the process of selling the station to Capital Cities created uncertainty, turmoil and confusion. People were scrambling for jobs and security. No one was sure how new management would operate. As a result, the station energies for months pending the takeover were focused away from long range program planning or serving the public.

Obviously, this disruption happens whenever any business is sold. However, in a broadcast market with rapid turnover, disruption has extreme adverse consequences. Management's resources, time and energy become focused on the merger or takeover and not on progressive station operations. Special public affairs and programming projects are put on hold in order to see if they "fit" with the new ownership. Program planning and public interest take a hiatus.

Again, I believe broadcasting with its public interest obligation, more than other industries, requires stability and long-range planning capability in order to maximize service to the public.

While elimination of the three-year rule was not the sole cause of the current churn in broadcasting, reimposition of the rule would reduce the potential for station flipping. The rule would force investors to view broadcasting as a long term investment with a public service requirement rather than a vehicle for quick profits.

Reestablishment of the rule would also reduce the potential for broadcasters to be the object of corporate takeovers. Because broadcasting operates under a statutorily imposed public interest standard, it should not be treated like just any other industry. By reinstituting our trafficking rules and revising our hostile takeover policies, broadcasters would be able to devote more resources to programming and meeting the needs of their communities instead of concentrating on fighting takeovers or on financing heavy debt burdens.

In conclusion, I believe the public interest standard and a practical public trustee model should remain as an important part of our regulatory framework and in our transfer of control consideration. The public trustee model is not inconsistent with deregulation. However, it does require close examination of each issue to ensure the Commission remains faithful to the Congressionally mandated public interest standard.

**SUMMARY OF SUBMISSION OF
COMMISSIONER JAMES H. QUELLO
FEDERAL COMMUNICATIONS COMMISSION
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE**

June 17, 1987

The following supplements my statement that was submitted to the Subcommittee on May 28, 1987. I believe the Commission erred when it decided to eliminate the three year holding rule. Unlike other industries, broadcasting is obligated to operate in the public interest.

There is no doubt that trading in broadcast stations has increase in recent years. For example, data prepared by Paul Kagan Associates, Inc. demonstrate that 23 percent of all television station sales in 1986 involved stations that were held less than two years. A review of data from the Television Factbook by the Mass Media bureau reveals that 52 percent of all television station transfers in 1983 involved stations held less than three years.

Rapid and quick turnovers in broadcasting are not consistent with the public interest. Corporate raiders and speculators have little incentive to serve their local communities. Looking for the "fast buck," speculators merely seek quick profits. The three-year rule would help to reintroduce the public interest standard back into the transfer process.

**SUPPLEMENTARY SUBMISSION OF
COMMISSIONER JAMES H. QUELLO
FEDERAL COMMUNICATIONS COMMISSION
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE**

On May 28, 1987, I submitted to the record my initial thoughts on the current trafficking in station licenses. At that time, I expressed my support for H.R. 1187, which seeks to reinstitute the Commission's three-year holding rule. Let me again express my support for this worthy legislative proposal.

The following supplemental statement provides further support for reestablishing the three-year rule. As I have stated on numerous occasions, the Commission erred when it decided to eliminate the three-year rule in 1982. That decision rested on a faulty premise. Specifically, the Commission assumed that speculators or short-term broadcasters would be good for the public interest because they would infuse capital into the industry.

This statement will show, however, that the interests of takeover specialists and corporate speculators do not always coincide with the public interest. I believe that it is not enough to simply examine the so-called economic efficiencies attributed to takeovers and rapid acquisitions. Rather, it must be stressed that broadcasting, unlike any other industry, is obligated by statute to operate consistent with the public interest. Hence, the overall issue in this area is whether the

public interest is best served by reinstating the three-year rule. I believe the answer is yes. Rapid turnovers and trading in broadcast licenses for quick profits is currently undermining efforts to serve the public interest. Therefore, I submit that reestablishing the three-year rule will promote the public interest by providing for greater stability and long-range program planning in the industry.

I. Government Interest

The threshold question that must be addressed is whether the Commission has a legitimate regulatory concern in limiting the number of rapid turnovers occurring in broadcasting. I believe it does. Over the years, stability in broadcasting has been recognized as a legitimate Commission objective.¹ Both the Commission and the courts have expressed concern over rapid restructuring of the industry. The Commission's desire to promote stability in the industry is reflected in its policies concerning renewal and ownership.

For example, in Central Florida Enterprises v. FCC,² the Court of Appeals for the District of Columbia affirmed the Commission's policies underlying the grant of a renewal expectancy. The court acknowledged the legitimacy of promoting investment into broadcasting to ensure quality service.³ Furthermore, the court recognized that a system resulting in the "haphazard restructuring of the industry" is undesirable.⁴

The court stated, "we cannot readily conclude that such a restructuring could serve the public interest."⁵ This position was subsequently affirmed by the Court of Appeals in Victor Broadcasting v. FCC⁶ which stated: "The final justification for the renewal expectancy is the avoidance of haphazard industry restructuring. That is, the public interest is advanced if there is no rapid turnover of licensees (emphasis supplied)."⁷ It is certainly inconsistent for the Commission to focus on stability in the renewal process while at the same time adopting transfer policies which undermine this stability.

Also, the policy of promoting stability in broadcasting is reflected in our rules regarding multiple ownership. Indeed, the Commission's decision establishing a national multiple ownership limit reflects a desire to obtain the benefits of group ownership while avoiding harmful disruption to the industry.⁸ In that decision, the Commission's fear of irreparable harm to the industrial structure justified both an audience reach cap⁹ as well as a numerical limit.¹⁰ The Commission concluded that "...our objective is to permit a reasonable amount of expansion of group ownership immediately but not to create the danger of an abrupt and disruptive restructure of the national broadcasting industry."¹¹ It is important to recognize that the issue in adopting a national multiple ownership cap was the potential for unbridled acquisition of broadcast stations. The policy concerns articulated there are directly before us today.

The discussion above reveals that there is ample precedent among the Commission's deregulatory decisions to support the proposition that the Commission has a legitimate interest in providing for stability in the broadcast industry. Furthermore, our regulatory concern with the industrial structure grows out of the desire to facilitate program service to the public. For example, revisions to the national multiple ownership rules were designed to facilitate the development of new programming alternatives.¹² Our recent inquiries regarding changes to the local ownership rules and cross interest policy are justified similarly on the notion that the Commission has a legitimate interest in shaping the economic incentives of the industry to enhance program service to the public.¹³ Because rapid turnovers in broadcasting affect a licensee's performance, it is appropriate for the Commission to attempt to structure the marketplace to increase incentives for better programming.

Having established the legitimacy of government action, the question becomes whether there is a need to reinstitute the three-year rule. This analysis turns on three distinct questions. First, whether there have been changes in the broadcast industry since we eliminated the three-year rule that call for reestablishment of the regulation. Second, does the current market environment impair or create the potential for harm to the public. Third, whether reimposition of the three-year rule will rectify existing market disincentives.

II. Changes and Restructuring of the Market for Broadcast Stations.

In 1982, the Commission was confident in its assessment of the marketplace for broadcast stations. At that time, the Commission stated the broadcast industry was both "mature" and "successful." In this factual context the Commission determined that the public interest was "usually best served by allowing station sales transactions to be regulated by market forces."¹⁴ Unfortunately, the item contains no economic analysis regarding the market for broadcast stations. The analysis in the decision focuses on the stability and maturity of economic forces as they existed in the business of broadcasting. However, one could argue that the economics of the broadcasting business would appear to be different from the market for station sales. This distinction was never adequately addressed in the 1982 decision. Responding to conclusions that circumstances in the industry did not support repeal of the rule, the Commission stated summarily:¹⁵

We believe the record demonstrates otherwise. Additionally, as the courts have recognized "the Commission's decisions must sometimes rest on judgment and prediction rather than pure factual determination" and "in such cases complete factual support for the Commission's ultimate conclusions is not required since a forecast of the direction in which the future public interest lies necessarily involves deduction based on the expert knowledge of the agency." (citations omitted)

In 1982, the Commission's predictive judgment was based on a marketplace for broadcast stations that had been subject to a three-year holiday rule for 20 years. Thus, it did not have an accurate assessment as to how the market would operate absent the three-year rule. Moreover, it was impossible to foresee the convergence of numerous factors that would ultimately transform and restructure the marketplace for broadcast stations. Lower interest rates, increased awareness by Wall Street of broadcasting's value, emergence of junk bond financing mechanisms and changes in the tax laws worked together to fuel the fire of station sales. In addition, the Commission's deregulatory activities including raising the national multiple ownership cap to twelve stations, raising ownership limits that are cognizable under our attribution rules,¹⁶ adopting procedures to expedite hostile takeovers of broadcast properties,¹⁷ and reducing oversight of a licensee's financial qualifications¹⁸ created greater incentives for station trading. Because of these factors and the impact on the marketplace for broadcast station sales, the rapid churn in the broadcast market in recent years bears no resemblance to the market which existed in 1982.

The intensity of merger and acquisition activity in broadcasting can be seen by measuring by the amount of merger activity when compared with corporate size. Broadcasting is disproportionately represented in merger and acquisition

activity when compared with its relative size in the economy.¹⁹ For example, it has been estimated that broadcasting represents .7% of total corporate market value. However, the industry represents 2.3% of the value of total merger activity, more than three times its corporate value.

In my previous statement, I presented data demonstrating a trend of increasing overall churn in the industry. Unfortunately, the Commission data only records the total number of transfers approved in any one year. As a result, these data included transfer applications that did not involve actual changes of control. As I observed in my previous statement, including pro forma transfers in these data will exaggerate the number of transfers occurring in any one particular year. Nevertheless, these data provide some indication on increases in the turnover rate. Assuming that the proportion of pro forma transfers remains constant, comparison in the number of transfers over time provides insight into the dramatic churn now confronting broadcasting. Data published by Broadcasting magazine on the number of transactions in any given year generally confirmed this conclusion. For example, Broadcasting reports that in 1979 there were 593 transactions involving broadcast stations. By 1985, the number more than doubled to 1,657 transactions.

Studies concerning the number of stations sold within three years reveal that there is an increasing trend towards short-term trading in broadcast stations. Of course, all data have shortcomings and methodological problems. Regardless of the qualifications, however, there can be no doubt that station flipping has become an acceptable investment strategy.

At my request, the Mass Media Bureau last year reviewed data concerning transfers of stations held less than three years. At that time, the Bureau found that only 25% of stations transferred between 1983-1986 were held less than three years. Unfortunately, the data averaged the total number of transfers and did not provide any insight on whether there was a trend towards increased station flipping.

Recently, the Bureau attempted to provide a yearly breakdown of station transfers for the years 1983-1986. According to the review, the number of broadcast stations sold, that were held less than three years, has increased steadily since the three-year holding rule was eliminated. For example, in 1983, 155 of the 971 stations sold, 16% of the total, were held less than three years. In 1985, 27.9% of the stations sold were held less than three years. By 1986, the number of stations sold that were held less than three years increased to 36.5% of all station sales. The trend toward increased station trafficking held less than three years appears across all broadcast service.

For example, in 1986, 39.2% of the AM stations, 35.5% of the FM stations, and 28.8% of the television stations sold were held less than three years.

It should be noted that there are legitimate questions regarding the reliability of these data. Mass Media data are recorded for the purposes of tracking applications, and are not designed for indepth empirical research. As a result, the data base is probably skewed. Nevertheless, these data demonstrate a general increase in station flipping. Moreover, the increase is corroborated by other research in the area.

Data recently provided by Paul Kagan Associates Inc. further demonstrate that there has been an increase in station flipping. Kagan shows that 160 commercial television stations were sold in 1986, representing 16% of the industry. This number has increased steadily since elimination of the three-year rule. In 1982, the last year with the three-year rule in effect, 35 television stations were sold representing 4% of the industry. Kagan also reports that the number of quick sales, i.e., stations held 0-2 years has also increased. In 1983, the number of television stations sold in this category represented only 3% of the sales. By 1986, this number increased to 26% of the total television sales. A copy of these data are attached to this statement.

Finally, the Mass Media Bureau reviewed television station sales reported in the 1987 Television Factbook. Again, these data reveal a trend towards increased station trafficking. According to the Bureau's analysis, 52.1% of the television stations sold in 1986 were held less than three years. This number has increased steadily in the last few years, 5.1% in 1983, 28.1% in 1984, and 31.6% in 1985.

Regardless of the source, these data show that there has been a demonstrable increase in the number of stations traded in less than three years. Of course, not all of these short-term transfers would be eliminated if a three-year rule were adopted. In fact, the Bureau estimates that approximately one half of the television transfers in this category would have still been allowed under the three-year rule. However, it should be noted that the Commission's decision to adopt the three-year rule in 1962 was based on data demonstrating that 45% of all transfers were held less than three years.

These data are consistent with the theory articulated in my previous statement that short-term station trading is becoming an increasingly popular investment strategy for all broadcast services. As a result, one would expect station flipping to increase, not decrease, in the future.

Some have argued that the recent turnover in broadcasting is a one time phenomenon and that the market has found a new equilibrium. Assuming, arguendo, that the overall rate of station trading will level off, a more fundamental question must be addressed. Without a three-year rule there is no guarantee that future economic circumstances will not converge to rekindle the fires of acquisition. Sound public policy dictates that the Commission adopt a transfer policy that promotes stability and long-term planning in the industry. The peaks and valleys of the business cycle offer no such assurance.

Furthermore, there is every reason to believe that, in an otherwise healthy economy, rapid station trading will continue. Indeed, the ability to sell corporate assets is an integral part of the acquisition process.²⁰ There is some evidence to suggest that the marketplace does not ensure stability to firms acquired by mergers or takeovers. For example, one study examining acquisitions in the general economy found that, on average, corporations divested more than 50% of their acquisitions in new industries and more than 60% of their acquisitions in new fields.²¹ Furthermore, the average divestment rate increases in situations where the acquisition involves a business unrelated to the acquiring firm. In these cases the divestiture rate is a startling 74% of all acquisitions.²² The need to sell corporate assets is a natural and essential part of the acquisition

process and applies equally to broadcasting.²³ It would appear that long-term stability is not guaranteed by a greater number of acquisitions. On the contrary, the acquisition process seems to create additional churn.

It should be obvious to even the casual observer that trading in stations has increased in recent years. This churn is the result of a convergence of several factors, including elimination of the three-year rule. There is every reason to believe that the rapid turnover in broadcasting will continue.

III. Current Incentives in the Marketplace for Broadcast Stations are not Consistent with the Public Interest.

Supporters of current market oriented policies continually argue that there are benefits to be gained from mergers, acquisitions and takeovers.²⁴ Purported benefits include greater efficiency, competitiveness and superior management. For the most part, supporters of this argument use stock market prices as a barometer of societal gain and, hence, public interest.²⁵ Even if this analysis is correct relative to the economy as a whole, it is not necessarily applicable to broadcasting. Unlike other sectors of the economy, broadcasting has an obligation to serve the public interest. Therefore, any cost-benefit analysis of the effects of rapid turnover in the broadcast industry must be analyzed in terms of its impact on the public interest not merely stock values.

Our 1982 decision applied the above mentioned general economic theory to broadcasting. In sum, the Order stated that the three-year rule was detrimental to broadcasting in that it prevented a station from going to its "higher valued use."²⁶ The Commission argued that a "buyer who was willing and able to pay the market price for a station will be more likely to deliver the service audience's want than the owner unwilling or unable to continue station operation."²⁷ As for the possibility of rapid station sales fueled by speculators, the Commission stated: "[T]he speculator may be a 'station doctor' who infuses new capital and/or ideas into a failing station, making it more responsive to the audience."²⁸ The Commission stated further: "Even if the speculator does not cure the ailing station it provides caretaker service until a more permanent licensee is ready willing, or able to buy it."²⁹

It is worth noting that the Commission performed no empirical analysis in arriving at these conclusions. Rather, elimination of the rule was predicated solely on application of general economic theory to the broadcast industry.³⁰ Breaking the Commission's purported logic down to its constituent parts reveals error both in theory and practice and a disregard for underlying public interest concerns.

A. Myth of "Higher Value Use"

The Commission's reliance on the concept of "higher value use" reveals its unequivocal intention that service to the

public is not of primary concern. According to the theory, where broadcast corporate assets become more valuable than engaging in the business activity itself, then it is a proper and socially desirable business strategy to simply sell the assets.³¹ In this environment, however, service to the public becomes merely a by-product of marketplace decisions. As applied to broadcasting, the theory of higher value use turns the statutory obligation to serve the public interest on its head, relegating it to secondary status.

The situation here is unlike other deregulatory actions taken by the Commission. Generally, the Commission relies on marketplace incentives in the broadcasting business as a means of regulating industrial performance consistent with the public interest. The question before us, however, concerns the functioning of marketplace incentives relative to the market for broadcast stations. While related, the marketplace for broadcast stations, as opposed to the business of broadcasting, may give rise to different economic incentives. This is especially true because the station itself is reduced to a commodity, becoming the primary focus of an entrepreneurs business strategy rather than providing service to a community.

Furthermore, the theory of trading a business to its "higher value use" would appear to be most applicable where the corporations and their assets are part of markets characterized

by potentially unlimited product and ease of entry. In these industries, policies based on highest and best use may be the most efficient and, hence, socially desirable. Broadcasting, however, is inherently limited by the number of stations licensed by the government. Because the marketplace for stations is artificially limited, the process of government authorization makes "higher value use" analysis less applicable to broadcasting.

B. Proper Measure of Value

Supporters of the "highest valued use" theory generally look towards increases in stock prices as the primary measure of societal gain. An increase in the price of stock, however, is not necessarily the most appropriate measure of value. In fact, stock only measures one aspect of value, focusing primarily on short-term gain.³² Moreover, the ability of a corporate raider to manipulate stock values through various "green mail" activities may, in some cases, make stock prices an inaccurate barometer of corporate value. Focusing on short-term stock prices does not measure accurately the benefits of long-term corporate strategy.³³ Given our policies of promoting long-term stability in broadcasting, the public interest should not be measured solely by such short-term indicia. Rather, the commitment to developing a long-term relationship with the community must be considered in the calculus. An environment promoting short-term ownership detracts from this goal.

C. Because of High Debt Burdens and Short Term Goals, Rapid Turnover in Broadcast Stations Creates Disincentives to Serve the Public Interest.

Elimination of the three-year rule is inconsistent with the public interest. The current policy creates economic incentives that necessarily conflict with the Commission's fundamental regulatory objectives.³⁴ According to the 1982 decision, the speculator's desire to increase the value of a station would provide a sufficient incentive to ensure that the wants of the audience would be met. Moreover, it was argued that elimination of the three-year rule would infuse capital into the industry. The following two sections will uncover these inconsistencies of the Commission's decision.

1. The Problem of Debt Servicing

The manner in which capital has been infused into broadcasting is creating economic incentives that conflict with the Commission's public interest goals. Rather than stimulating equity investments into the industry, existing policies have served merely to increase the debt of broadcasting. Current debt for the entire industry has been estimated to be 21 billion dollars. Over five billion dollars of this amount was incurred in 1986, nearly 9 times the amount raised for the industry just four years earlier.³⁵ The size of this debt should be of concern given that financial viability has a most significant impact on performance.³⁶

The creation of large debt burden reduces the role of managerial discretion in making corporate decisions. Unlike equity, that allows a business the flexibility to declare dividends, debt must be serviced. By issuing debt in exchange for stock, managers bond their promise to pay out of future cash flows.³⁷ Investments into future projects must guarantee immediate return and there is no room for projects that are only marginally profitable or yield return only in the long run.³⁸

As a result, there is a disincentive to engage in program development. Program acquisitions must now be viewed solely in terms of their immediate audience appeal and advertising "saleability." There is very little room for experimentation or program flexibility. Stations can no longer wait for a program to "find" an audience.

Most importantly, our existing policy creates absolutely no incentive to provide programming that is not market based. In this regard, the Commission must weigh the current policy's impact on the provision of issue-responsive programming. According to the Commission's own analysis in its deregulation orders, issue-responsive programming is not completely market based.³⁹ Indeed, this concern served as justification for imposition of the issue-responsive programming obligation. The Commission must ask itself whether it should foster an industrial structure which creates a disincentive to provide the

type of programming that it believes to be the bedrock of a licensee's public interest responsibility.

In the long run, debt resulting from rapid turnovers in broadcasting will lead to more than reductions in program service. Indeed, the continued drain of equity from broadcasters to debt holders threatens the quality of the entire industry. Mr. Gene Jankowski, President of the CBS/Broadcast Group, in testimony before this very Subcommittee stated:⁴⁰

The long-term result of such highly leveraged takeovers would be (at least in some cases) diminished service, as programming costs are cut and necessary investments curtailed in order to meet substantial debt payments. In any event, it is clear that such deals do nothing to bring new resources into the industry and do not contribute in any other way to the ability of broadcasters to serve the public interest.

Mr. Jankowski stated further that highly leveraged deals have the immediate effect of draining "capital and credit resources away from the broadcast industry and into the pocket of bankers, financiers, and other parties who made possible the financing of the takeover transaction."⁴¹

Adverse ramifications of a liberal trafficking policy affect the entire broadcast industry, not simply the targets of hostile takeovers and acquisitions. It has become increasingly apparent

that any publicly traded broadcaster may be the subject of a takeover, merger or acquisition. Because of this market environment, non-targeted publicly traded broadcast companies may be forced into taking defensive actions in order to preempt the possibility of future takeovers.⁴² Such a possibility may lead to private leveraged buy outs by existing management or other defensive actions to prevent the firm from becoming a target or being subject to "green mail." In any event, the firms resources are diverted towards protecting the corporation and away from concerns with meeting the needs of the community.

2. Need For Long-Term Planning

Apart from the issue of debt burden, the rapid turnover of stations serves to isolate station owners from their communities. Broadcast licensees cannot develop a relationship with their respective communities overnight. On the contrary, it takes time and effort for a broadcast licensee to learn about the problems facing its community. Even a perfectly functioning market does not make a new broadcaster an instant expert of the needs of the community. Our comparative renewal policies explicitly recognize the importance of this "learning curve function."⁴³ In fact, the incentive to serve their local market coupled with the fact that broadcasters are presumed to know something about their communities were reasons for eliminating our formal ascertainment requirements.⁴⁴

It does not follow that short-term investment objectives will be consistent with the public interest goals of meeting a

community's needs. The object of the speculator is to develop an audience quickly, while at the same time, reducing the costs of operating the station.⁴⁵ There is a very strong incentive to broadcast only those programs that will increase the audience share and "saleability" immediately. There is no incentive to present programming -- be it entertainment or issue-responsive -- that does not show an immediate profit.

When we examine the broadcast industry as it stands today, many of the corporations that spent years building their companies on the fundamental principle of public service have been sold, taken in private leveraged buy outs, taken over, or forced to defend themselves in long and costly proxy contests. Among the major group owners undergoing rapid change were: ABC (sold); CBS (forced to fight a takeover battle); Cox (went private); Harte-Hanks (went private); Multimedia (paid green mail and recapitalized); RCA (sold); Storer (sold); and Viacom (taken over). After a long takeover battle, John Blair had to seek refuge with a white knight. More recently, Taft Broadcasting under a takeover threat agreed to merge and will become a smaller subsidiary of a Cincinnati based limited partnership.

This is not to say that all mergers and acquisitions are per se inconsistent with the public interest. Rather, the rapid turnover of these and numerous other stations evinces a new

economic environment for broadcasters. The corporate raider has little or no incentive to develop long-term relationships with a community. Broadcasting requires long-term planning to develop an audience and serve a community. The current market environment provides a disincentive to the development of this process.

D. Station Prices and Minorities Ownership

In 1982, the Commission observed that increased station trading would enhance opportunities for minorities to acquire broadcast facilities. It was believed that financial institutions would be more willing to invest in broadcasting if there were no restraints on alienation of the station. This policy was supposed to make it easier for minorities to secure financing for station acquisition. The increase in station prices resulting from such a policy may work, however, to price minorities out of the market for broadcast stations. Given the Commission's recognition that financing is the leading obstacle to minority employment, then it is appropriate for the Commission and the Congress to be concerned where the secondary impact of its transfer policies affect its ownership policies.

I agree it would be inappropriate for the Congress to reestablish the three-year rule for the sole purpose of depressing station prices. However, where there are overarching public interest concerns, such as our minority ownership

policies and issue-responsive programming obligation, the potential for increases or decreases in station prices should be considered. In fact, the only legitimate consideration of station prices should be where it directly conflicts with other FCC policies. Increasing the price of a station in and of itself does not necessarily comport with the public interest.

There is little evidence to suggest that eliminating the three-year rule has stimulated investment in minority ownership of broadcast stations. Of course, if a three-year holding period makes it more difficult for minorities to acquire broadcast stations, then Congress or the Commission could create an exemption to the rule for minority owners. Such a policy is certainly consistent with the Commission's other minority ownership policies.

The fundamental question is whether the three-year rule affects the price of a broadcast station. The average price of a station has increased dramatically in recent years. To date, however, there is no clear evidence that reintroduction of the three-year rule would dramatically decrease the value of a station. While some have estimated a 10% decline in station value, more recent evidence by Paul Kagen suggests that other factors may be more significant in determining station prices. Thus, the three-year rule will not destroy station values or lead to an overall devaluation of the broadcast industry.

IV. Three-Year Rule Will Prevent Speculation in Broadcast Licenses.

Obviously, reestablishing the three-year rule will not prevent all mergers and acquisitions. Indeed, there is no need to completely insulate broadcasting from all of these activities. The issue before us is whether we should take steps to eliminate incentives to speculate in broadcast properties. The three-year rule, therefore, is an effective tool for accomplishing this purpose.

Rather than eliminating all mergers, the three-year rule goes directly to the incentive to traffic in a license.⁴⁶ With a three-year rule, entities seeking to acquire broadcast facilities will know that they will be in the business on a long-term basis. Return on their investment, hence profitability, will be based on a long-term commitment to the community, rather than short-term, quick-fix policies. In other words, the three-year rule would recreate the economic incentives to engage in the business of broadcasting and not the business of station trading. Those corporate raiders whose sole intent is not to operate a station, but to extract green mail, would also be deterred. In this regard, the raider would have to weigh the possibility that if control were ultimately acquired, then it would be required to hold the station for three years.

Of course, the Commission retains the ability, indeed the obligation, to oversee transfers of control without a three-year rule. Supporters who favor the status quo argue that such oversight is sufficient to police applicants whose sole desire is to traffic in a license. However, our review of transfer applications is necessarily limited by the types of public interest issues designated for a hearing. Because the Commission has no policy against trafficking, trafficking issues cannot be designated as hearing issues. As presently constituted, our enforcement posture would require the Commission to find that an applicant misrepresented its intentions to operate the station. However, misrepresentation is often difficult to prove and does not provide an effective means of policing trafficking.

In addition, reestablishing the three-year rule will enable the Commission to provide greater review of a licensee's performance. Under the present regulatory scheme, a station can have numerous owners during the license period. Many owners can now escape the more exacting standards of renewal by merely transferring the station. Because television stations are licensed for a period of five years, reestablishing the three-year rule would, in effect, allow one transfer during the license period. With regard to radio, the three-year rule would potentially allow for two transfers within one license period. Accordingly, reestablishing the three-year rule would give the

Commission greater oversight capability by reducing the number of potential transfer between renewals.

Reestablishing the antitrafficking rule would provide the necessary oversight authority to prevent erosion of the public interest. In this regard, it is important to recognize that the Commission granted numerous waivers under our old rules. However, a liberal waiver policy is not necessarily inconsistent with the objectives of the proposed statute. There will be instances where it is in the public interest to transfer a station within a three-year period. Reestablishing a three-year rule would provide the Commission with the necessary oversight authority to "weed" out those who have a history of speculating in broadcast licenses. To the extent flexibility is needed in this area, I would ask that Congress expressly recognize the Commission's ability to waive the rule in circumstances where the policies underlying the rule are not implicated.

V. Conclusion

As previously stated, I do not believe that repeal of the three-year rule was the sole cause of the rapid turnover in broadcast stations. Several factors worked together to create the churn in the broadcast industry. However, reinstatement of the three-year rule will solve most of the more dangerous problems related to rapid station transfers. Reestablishing the three-year rule will eliminate those entrepreneurs who seek to

merely "turnover" broadcast stations for quick profit. Once again, investors would be required to consider long-term investments in service to the community in order to increase cash-flow and profits. Simply stated, reimposition of the three-year rule would change the investment strategy of those entering broadcasting. The rule would help to reintroduce the public interest standard back into the transfer process.

FOOTNOTES

- 1 See Federal Communications Commission v. National Citizens Committee for Broadcasting, 436 U.S. 775, 809 (1978).
- 2 Central Florida Enterprises v. FCC, 683 F.C.C.2d 503 (D.C. Cir. 1982).
- 3 Id. at 507.
- 4 Id.
- 5 Id.
- 6 Victor Broadcasting v. FCC, 722 F.2d 756, (D.C. Cir. 1983).
- 7 Id. at 764.
- 8 See Report and Order in MM Docket No. 83-1009, 100 F.C.C.2d 17 (1984) recon. granted 100 F.C.C.2d 74 (1984), Appeal pending sub nom. National Association of Black Owned Broadcasters v. FCC, No. _____ (D.C. Cir. 1985).

- 9 On reconsideration the Commission stated:

[W]e have become increasingly aware of the limitations of proceeding solely with a numerical multiple ownership limit in the event that there is rapid expansion of group ownership in the wake of our relaxing of the national multiple ownership rules.... [a] numerical approach may not give appropriate consideration to wide discrepancies in population coverage because a station in the largest market is deemed equivalent to a station in the smallest market.... A numerical cap does not affect this type of restructuring. While there is no evidence in the record that would lead us to believe that such an eventuality would necessarily have an adverse result, we now believe that the potential for this type of restructuring warrants a more cautious approach. To this extent, we now believe it advisable to adopt an additional ownership limit based on audience reach.

Memorandum, Opinion and Order in MM Docket No. 83-1009, 100 F.C.C.2d at 89.

- 10 Regarding the need for a numerical cap, the Commission noted:

We do not believe, however, that we should replace the numerical cap with one based solely on audience reach. Standing alone on audience reach limit may not prevent the acquisition of a tremendous number of stations in

the smaller markets. In this respect, retention of a numerical limit may be appropriate...in order to reduce the possibility of disruptive restructuring in small markets where opportunities for new entrants principally exist.... Retaining the numerical limit will provide us with an opportunity to gain experience with this type of regulation without risking an entire regulatory system should we find that the audience reach approach proves unworkable.

Id. at 89-90 (citation omitted).

- 11 Id. at 97.
- 12 Memorandum, Opinion and Order in MM Docket No. 83-1009, 100 F.C.C.2d 74, 84 (1984).
- 13 See Notice of Proposed Rulemaking in MM Docket No. 87-7, 2 FCC Recd 1138 (1987); Notice of Inquiry in MM Docket No. 87-154 (adopted May 14, 1987).
- 14 Report and Order in BC Docket No. 81-897, 52 R.R.2d 1081, 1086-87 (1982).
- 15 Id. at 1088 n.20.
- 16 Report and Order in Docket 20521, F.C.C. 84-115, released April 30, 1984, recon granted in part F.C.C. 85-252 (released June 24, 1985) recon granted in part F.C.C. 86-410, ___ F.C.C. Recd. ___ (1986).
- 17 Policy Statement, MM Docket No. 85-218, 59 R.R.2d 1536 (1986).
- 18 Financial Qualifications Standards, 72 F.C.C.2d 784 (1979); Revisions to Form 301, 50 R.R.2d 381 (1981).
- 19 Jensen, "The Takeover Controversy: Analysis and Evidence," Working Paper No. MERC 86-01, Revised July 10, 1986, Table 1, p. 7.
- 20 Michael Jensen, who generally agrees that takeovers and mergers are good for the economy, recognized the need for asset dissolution as a means of facilitating mergers or takeovers. He argues:

If assets are to move to their most highly valued use, acquirers must be able to sell off assets to those who can use them more productively. Therefore, divestitures are a critical element in the functioning of the corporate control market and it is important to avoid inhibiting them. Indeed, over 12,000 divestitures occurred in 1985, a record level.

Jensen, "The Takeover Controversy: Analysis and Evidence," (citing Grimm, W.T. Mergerstat Review (1985)).

21 Porter, Michael, "From Competitive Advantage to Corporate Strategy," Harvard Business Review, May/June 1987 at p. 45.

22 Id.

23 For example, in 1984, Metromedia was the subject of a private leverage buy out that left the company with an enormous debt. As a result, Metromedia's controlling stockholder, John Kluge, sold some of the properties to satisfy the debt burden. Time magazine, May 20, 1985; p. 57.

24 For example, the Economic Report of the President states:

The available evidence, however, is that mergers and acquisitions increase national wealth. They improve efficiency, transfer scarce resources to higher valued uses and stimulate effective corporate management. They also help recapitalize firms so that their financial structures are more in line with prevailing market conditions. In addition, there is no evidence that mergers and acquisitions have on any systematic basis caused anti-competitive price increases.

Economic Report of the President, 1985 at 196.

25 Id. at 96-97.

26 Report and Order in BC Docket No. 81-897, 52 R.R.2d 1081, 1082 (1982).

27 Id. at 1087.

28 Id. at 1088 (emphasis added).

29 Id.

30 As noted previously, the decision rests largely on the Commission's "judgment and prediction rather than a pure factual determination." See supra note 15 and accompanying text.

31 For example, a retail chain store may possess real estate that is more valuable as office sites than retail outlets. Although the retail chain is well managed, if the company announces that it will not sell its real estate or put it to any use other than retailing, then the market has little incentive to value the firm's real estate at its current market price. See Economic Report of the President 1985 at 198.

32 Shareholder wealth maximization is not identical to social wealth maximization. For example, a takeover can redistribute wealth in favor of shareholders without increasing economic output. See Coffee, "Shareholders Versus Managers: The Strain in the Corporate Web," 85 Mich L. Rev. 1, 104 (1986).

33 As Professor Michael Porter of the Harvard Business School observed:

Most studies have approached the question [corporate acquisition strategies] by measuring the stock market valuation of mergers, captured in the movement of stock prices of acquiring companies immediately before and after mergers are announced.

These studies show that the market values mergers as neutral or slightly negative, hardly cause for serious concern. Yet the short term market reaction is a highly imperfect measure of long term success of diversification, and no self respecting executive would judge corporate strategy the way.

Porter, Michael, "From Competitive Advantage to Corporate Strategy," Harvard Business Review, May/June 1987, pp. 43-45.

34 The Commission's criticism of the three-year rule was premised in part on its belief that the rule created disincentives to serve the public interest. At that time, we stated: "Certainly the public is ill served by forcing a licensee who is unwilling or unable to continue operation of the station to struggle along until three years has elapsed." Report and Order in BC Docket No. 81-897, 52 R.R. 1081, 1088 (1982).

This argument lacks merit. First, the Commission never prevented licensees who were experiencing economic hardship from selling their stations under the old rule. Second, for those "unwilling" to remain in broadcasting, there is an obvious incentive to maintain or even increase the station's value. Certainly, the incentive to maintain the value of the station in these circumstances is the same as those who would purchase a station solely for the purposes of reselling.

35 Channels, April 1987, p. 47.

36 Anthony Hoffman, President and Director of Corporate Finance for Cralin and Company, New York, in testimony before the House Subcommittee on Telecommunications, Consumer Protection and Finance, 99th Cong., 1st Sess. 90 (1985) stated:

[T]he single factor which can exert the most leverage on the other elements of the public interest is financial viability. The best intentions in terms of enhanced program quality and diversity can evaporate if the financial structure of the resulting company forces cuts in the budget for program production and acquisition.

- 37 Jensen, Michael, "The Takeover Controversy: Analysis and Evidence," July 1986 (Working Paper) p. 18.
- 38 Moreover, stations may find future cash flows insufficient to service the debt due to flat advertising revenues, thereby, increasing the risk of bankruptcy.
- 39 See Office of Communications of United Church of Christ v. FCC, 707 F.2d 1413, 1425-1426 (D.C. Cir. 1983).
- 40 Testimony of Gene Jankowski, President of CBS/Broadcast Group before the House Subcommittee on Telecommunications, Consumer Protection and Finance, 99th Cong., 1st Sess. 153 (1985).
- 41 Id.
- 42 Most attempts at empirical evaluation of the takeover phenomenon have sought to study either targets or bidders, typically through stock prices or follow-up studies of their post acquisition performance. This seems to be the wrong focus, or at least an overly narrow one, because the more important impact of the takeover may well be on those firm's managers who are not taken over, but who change their behavior as a result of the general deterrent threat of a takeover.

See Coffee, "Shareholders v. Managers: The Strain in the Corporate Web," 86 Mich. L. Rev. 1, 40 (1986).
- 43 See Federal Communications Commission v. NCCB, 436 U.S. 775, 807 (1978). Discussing the problems associated with divestiture, the court affirmed the Commission's conclusion that new owners "would lack the long knowledge of the community and would begin raw." The court stated further "owner's knowledge of their local communities would be lost if replaced with outside interest." Id. at 808.
- 44 UCC v. FCC, 707 F.2d at 1437.
- 45 In testimony before the House Subcommittee on Telecommunications, Consumer Protection and Finance, 99th Cong., 1st Sess. 78 (1985), Thorton Bradshaw, former Chairman of the Board of RCA noted that corporate income is used "to satisfy the appetites of raiders whose only focus is the here-and-now." As a result, debts are not incurred to increase the industrial capacity of the broadcasting business. Mr. Bradshaw states: "In other words, corporations are following a forced policy of 'Pay now, regret later.'" Id.

- 46 As Robert Faust, Vice President and Comptroller at the Westinghouse Broadcasting Company, Inc. stated:

The rule would get rid of speculators. When a trader gets involved, you get a turnover, a lack of public interest and a turning up of operating profits for the purpose of selling

Gordon King, Vice President of Post/Newsweek Co., Stations Division stated that the current market, absent a three-year rule, facilitates a merger frenzy characterized by raiders who think of nothing but profit. Without the three-year rule, raiders can avoid the renewal process, an important check on a radio or television's performance in the community. See MultiChannel News, May 4, 1987.

- 47 Data supplied by Paul Kagan Associates Inc. suggests that factors other than the three-year rule are the primary determinants of station value.