

national markets by limiting the size of group owners of television stations, but does not affect concentration in the local video delivery market, and thus does not raise competition concerns that were discussed in the local ownership rule sections above. The national cap limits the ability of group owners to purchase television stations in individual local markets. The effect of this ownership restriction on station performance in the video delivery market is discussed elsewhere in this summary.

361. Based on its analysis of the relevant markets, the Commission finds that the current rule is not necessary to maintain competition in the three economic markets it examines. As the record indicates, the media marketplace is undergoing unprecedented change. Broadcast stations are subject to competition from cable and DBS, and they face increased competition for viewers, advertising revenues, station network affiliations, and programming. The Commission concludes that the 35% cap is no longer necessary to protect competition in the media marketplace and unnecessarily constrains the organization of, and investment in, free, over-the-air (*i.e.*, non-subscription) broadcast television.

362. *Broadcast competition framework.* The evolution of non-price competition in television has implications for the economic organization of broadcast television networks. Higher channel capacity cable systems and the growth in the number of cable networks, together with the programming options offered by DBS, have intensified the competitive pressure on broadcast television networks to slow the erosion of viewer market share and to build strong network brand identity reflecting program focus, quality and reputation.

363. Two broadcast television network organizational changes, which are viewed as responses to the growth in viewer options, are noteworthy, namely, (1) the extensive backward integration into program supply, and (2) the desire to increase the extent of forward vertical integration through ownership of additional local television stations. Transaction cost economics suggests that such organizational integration induced by increased rivalry within the media industry may improve economic efficiency.

364. Transaction cost economics adopts a contractual approach in understanding the economic organization of firms. The transaction—the exchange of goods or services for money or other goods between parties—is the focal point of economic analysis.

Determining the governance structure that minimizes the economic cost of effectuating a particular type of transaction is a central objective of a transaction cost analysis. Transaction cost economics identifies three, discrete governance structures, namely, (1) the market; (2) hybrid contracting; and (3) hierarchy, where transactions are placed under unified ownership in a firm subject to administrative controls and management. Whether it is economically efficient (cost minimizing) to effectuate exchange using market contracting or through hierarchy (vertical integration) depends on certain behavioral assumptions, and key attributes of any given transaction.

365. In general, ordinary market contracting is an efficient governance structure for transactions supported by general purpose assets not dedicated to the specific output demand of a given customer. As asset specificity deepens, market contracting as a governance structure gives way to either hybrid structures or hierarchy (vertical integration) as the least costly to organize transactions. The pervasiveness of asset specificity in the program production industry suggests that complex contracts between broadcast television networks and program suppliers may not be the least costly governance structure for effectuating transactions.

366. Broadcast television networks have a single, strategic focus, namely, the maximization of the number of television viewers that are attracted to mass audience and niche audience programming. This strategic focus is crucial to broadcast television networks, since the sale of audiences to national advertisers provides their only stream of revenue from broadcast operations in contrast to cable networks which may receive both advertiser and subscriber revenue. By contrast, local broadcast television stations pursue a more complex business strategy as licensed broadcast facilities. First, the local station seeks to maximize the size of the audience it attracts within its local television market. If the local station is a network affiliate, then the local station will promote the network's program schedule together with syndicated programming the station may acquire to help fill out its daily program schedule. Second, the local station will also promote its own locally-produced programming, such as news and public affairs programming, that it believes is responsive to issues or viewer preferences in the communities served by the station. Station management may vary the allocation of time devoted to any particular type of programming,

including network programming, to respond to emerging preferences or news events in the communities located in its local television market. As the networks have lost viewer market share over the last decade in response to the growth in cable and DBS, the traditional contractual relationship between a television network and a local station affiliate may be a less efficient governance structure. From a transaction cost perspective, television networks view their massive sunk investments in network programming as increasingly risky assets as non-broadcast program options proliferate.

367. With respect to contractual safeguards, the networks have attempted to negotiate substantial penalties for failure to clear a full schedule of network programming. With respect to changes in governance structure, the broadcast television networks have argued for elimination of the national ownership cap, which would permit the networks to substitute hierarchy (vertical integration) for the current contractual relationship with independently-owned station affiliates. Presumably, the networks believe, consistent with transaction cost logic, that conflicts in strategic focus between stations and the network respecting programming decisions can be resolved more efficiently, *i.e.*, at minimal transaction cost, if hierarchy, *i.e.*, forward vertical integration, replaces market contracting as the governance structure.

368. Thus, the Commission's transaction cost analysis suggests that the national ownership cap probably restricts the full transition to the least costly way for organizing transactions between television networks and local television stations, *i.e.*, forward vertical integration, assuming that realization of a network's singular strategic focus on mass or niche audience size is the preferred policy objective. If, however, locally produced programming and ultimate program selection authority are a higher policy priority, then the Commission's transaction cost economic framework identifies the relevant policy trade-off, namely, the incremental social benefit of local programming viewed as a component of the Commission's localism policy goal versus the increased social and private costs of inefficient contracting.

369. *Program Production and Acquisition Market.* Competition in the program production and acquisition market is important because networks and owners of individual television stations compete with each other, as well as with cable television networks, to acquire programming that will