An Economic Theory of Censorship

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Broadcast regulation can exploit sunk costs as a means of exerting control over the content of broadcast speech—to compel favored speech and to suppress disfavored speech. One conspicuous FCC policy that manifests rent extraction is the newspaper-television cross-ownership prohibition. A rent-extraction model of broadcast regulation shows how such seemingly "structural" regulation can facilitate the government's influence over broadcast content and, indeed, why it is advantageous for the FCC consciously to embed methods of influencing broadcast content within regulations that are likely to be subjected to lessened degrees of judicial scrutiny.

I. INTRODUCTION

Legal criticism of broadcast regulation typically starts by demonstrating the paradoxically disparate treatment of print media and broadcast media under the First Amendment. In contrast, economic criticism typically starts by demonstrating that the scarcity of the electromagnetic spectrum, to the questionable extent that it exists, does not distinguish broadcasting from any other medium of com-

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munications for which the essential factors of production are privately owned and ordered. Each line of criticism is powerful. And each continues to the current day to appear again and again in court challenges to broadcast regulation.[1] It is more useful, however, to model broadcast regulation in terms of the creation and dissipation of rent.

Rent-seeking connotes that legislation or regulation can artificially reduce competition in a market and permit a firm to earn economic rent—that is, profit exceeding a competitive return. This creation or perpetuation of a monopoly position by means of government intervention comes, of course, at an added cost to those who buy the goods or services of the party earning the rents. Thus, it represents an implicit redistribution of income, as well as a deadweight loss in allocative efficiency, which accrues to no one's benefit. Economists describe rent-seeking behavior as the various activities undertaken to receive these income transfers though the legislative or regulatory process.

Rent-seeking, however, is only part of the story. Broadcast regulation also has important elements of "rent extraction," which connotes the dissipation by government policy of either publicly or privately created rents. Broadcast regulation is a process by which rents are created, perpetuated, and threatened with dissipation (and thus extracted) by means of the coercive power of the state. Content control is one manifestation of such rent extraction. "Content-neutral" regulations imposed on broadcasters can restrict the editorial discretion of broadcasters, though such regulations may not appear to be overt attempts by the government to censor. Such regulations so restrict free speech by making particular kinds of speech exceptionally costly, and other kinds of speech advantageous if not expedient for purposes of currying favor with regulators to preserve existing streams of rent. The license renewal process is the credible threat by which parties, both public and private, have used the power of the state to extract rents from broadcasters.

A controversial example of an FCC policy that facilitates rent extraction is the newspaper-television cross-ownership rule. The FCC

[1] Even Judge Douglas Ginsburg, who years before as a law professor expressed disbelief in the spectrum scarcity rationale, considered himself constrained to write for the D.C. Circuit in 2002 that, with respect to a First Amendment challenge to a particular broadcast regulation, "this court is not in a position to reject the spectrum scarcity rationale *even if it no longer makes sense*." *Fox Television Stations, Inc v FCC*, 280 F3d 1027, 1046 (DC Cir 2002) (emphasis added). For Professor Ginsburg's expression of disbelief, see Douglas H. Ginsburg, *Regulation of Broadcasting* 58-61 (West Publishing, 1979).

prohibits the common ownership of a broadcast station and a daily newspaper in the same locale.[2] More precisely, the rule forbids the grant of a television license to a party who directly or indirectly owns, operates, or controls a daily newspaper if the Grade A contour of the television station in question (a measure of signal field strength) encompasses the entire community in which the newspaper is published.[3] The rule would seem to be the quintessential example of structural regulation of the broadcasting industry, as opposed to content regulation. Thus, even though the rule might be readily criticized as bad economic policy, it would not be considered an unconstitutional restriction on the freedom of broadcast speech, because content-neutral restrictions on broadcasters receive a low level of judicial scrutiny under the First Amendment.[4] A very different conclusion emerges from an economic theory of censorship that recognizes the potential for regulators to subject sunk investment to rent extraction. Indeed, such influence over content is especially efficacious for regulators precisely because courts have traditionally subjected structural regulation of broadcasting to a diminished level of judicial review.

II. CENSORSHIP AND SUNK COSTS

The principal exponent of the rent-extraction theory of regulation, Fred McChesney, writes: "The overriding lesson of the rent-extraction process is that politicians are interested in any stock of immobile capital or wealth from which they can extract a share."[5] McChesney argues that legislators and regulators maximize their personal welfare by extracting from private citizens a portion of the wealth that those government officials forbear from expropriating altogether. Regulation can do more than create rents through an extralegal form of exchange between the state and a private interest group. Regulation can also *extract* rents—either rents created through such government largess or rents created privately (such as through innovation).[6]

Viewed in those terms, a major consequence of broadcast regulation, including the FCC's newspaper-television cross-ownership rule, may be to extract private rents. A broadcast license is thought by many to be a government largess upon which the FCC may freely at-

[2] 47 CFR § 73.3555(d).

[3] See id at § 73.3555(d)(3).

[4] See generally Geoffrey Stone, *Content-Neutral Restrictions*, 54 U Chi L Rev 46 (1987).

[5] Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* 122 (Harvard, 1997).

[6] Id at 23-32.

tach regulatory burdens that extract a share of the economic rents generated by the broadcaster's use of that license—by, in effect, taxing through regulation the discounted expected net cash flow of a licensed station. So viewed, a broadcast license is a classic example of a publicly created rent that is subsequently vulnerable to extraction by factions powerful enough to influence the regulatory prerogatives of the FCC or Congress. That view ignores, however, that any economic rent that a broadcaster enjoys is at least as likely to have been *privately* created. Moreover, given the economies of scale and scope with regard to program production, a broadcaster will have quasi-rents that also are vulnerable to appropriation. If a broadcaster is forced to forfeit his license through revocation or denial of renewal, his ability to salvage specialized investments made in the station will be limited if he is not permitted to own other media of mass communications in the same geographic market. A broadcaster faces the risk that his speech may provoke attempts to expropriate, through the license renewal process, the quasi-rents and privately created economic rents associated with the operation of his station.

It is possible for the FCC to extract programming concessions from broadcasters in return for withdrawing the threat to deny renewal of the broadcaster's license. Denials of renewal and revocations of licenses have been relatively infrequent in the FCC's history. That infrequency comports with a model of regulation in which the FCC seldom expropriates the entire value of a station, but instead, with greater frequency, extracts a portion of the value of numerous stations by directing that certain kinds of programming be aired and other kinds of programming be suppressed.[7] Nonetheless, the annual number of revocations has grown in recent years. Although the FCC does not report statistics on denials of renewal, it does report statistics on revocations. Table 1 lists the 65 revocations of broadcast licenses or construction permits over the 59-year period from 1939 to 1998.[8] It is striking that twenty-one of those revocations occurred in the seven years from 1992 through 1998, the last year for which the FCC reports such statistics. As Figure 1 shows, the 1990s was by a substantial margin the decade having the highest number of revocations.

Typical forms of rent extraction are political threats to reduce

[7] That result dovetails with the recognized principle in takings jurisprudence that small regulatory takings may go uncompensated: "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." See *Pennsylvania Coal Co. v Mahon*, 260 US 393, 413 (1922) (Holmes, J.).

[8] See Federal Communications Commission, 1998 Annual Report, available at http://www.fcc.gov/Reports/ar98.doc (last visited July 7, 2003).

Table 1: FCC Revocations of Broadcast Licenses and Construction Permits, 1939-1998[9]

Station Call Letters	Location	Date
KUMA	Yuma, AZ	02-20-39
WSAL	Salisbury, MD	10-24-39
WWPN	Middlesboro, KY	10-16-47
KGAR, KGAR-FM	Garden City, KS	02-27-48
WPBP	Mayaguez, PR	12-22-48
KCRO	Englewood, CO	10-14-49
KWIK	Burbank, CA	12-14-49
KPAB	Laredo, TX	01-26-50
WXLT	Ely, MN	05-23-50
KFMA	Davenport, IA	06-21-50
KALA	Sitka, AK	05-21-52
WSHA(TV)	Sharon, PA	10-27-54
KOTO	Albuquerque, NM	06-22-55
WGAV	Amsterdam, NY	09-25-57
KHCD	Clifton, AZ	07-23-58
KAJK(TV)	Reno, NV	06-03-59
KBOM	Bismarck-Mandan, ND	11-30-60
KLFT	Golden Meadow, LA	01-19-61
KPSR(FM)	Palm Springs, CA	07-19-61
WLOV(FM)	Cranston, RI	11-01-61
WIOS	Tawas City-East Tawas, MI	12-20-61
KCPA(FM)	Dallas, TX	02-12-62
WGRC	Green Cove Springs, FL	02-20-62
KWK	St. Louis, MO	05-27-63
WBMT	Black Mountain, NC	06-26-63
WELF-FM	Glen Ellyn, IL	03-11-64
WELG-FM	Elgin, IL	03-11-64
WCLM(FM)	Chicago, IL	09-27-64
WHHL	Holly Hill, SC	06-22-66
WPFA	Pensacola, FL	05-11-66
WSRA	Milton, FL	08-01-67
WEKY	Richmond, KY	05-03-68
KDFR(FM)	Tulare, CA	07-03-68
KLSU	White Castle, LA	03-26-73
WFAN-TV	Washington, DC	04-16-74
WMET(TV)	Baltimore, MD	04-16-74
WVGB	Beaufort, SC	06-24-76
WCLY	Columbia, PA	05-19-77
WLLE	Raleigh, NC	07-21-77
KKUZ-AM	Terrance Lake, WA	01-13-89
KRGL-AM	Myrtle Creek, OR	05-05-89
WRPZ-AM	Paris, KY	08-22-90
WBBY(FM)	Westerville, OH	02-21-90
WKSP-AM	Kingstree, SC	08-01-91

continued

[9] Id.

Table 1: *continued*

Station Call Letters	Location	Date
WPSC-AM	Pageland, SC	02-07-92
WDAT-AM	Amory, MS	08-03-92
WAST(AM)	Ashtabula, OH	08-19-92
WORI-AM	Oak Ridge, TN	06-24-92
KOKY-AM	Jacksonville, AR	07-13-92
WKU(AM)	Parrish, AL	11-11-92
WFRK(AM)	Coleman, FL	01-07-93
KBRS(AM)	Springdale, AK	08-03-93
WKLO(AM)	Danville, KY	08-26-93
KUCB(FM)	Des Moines, IA	02-02-96
KLEH(AM)	Anamosa, IA	11-05-96
WSJR(AM)	Madawaska, ME	11-05-96
WKZF(FM)	Bayboro, NC	11-14-96
KZOT(AM)	Marianna, AR	11-20-96
WLVC	Fort Kent, ME	12-10-96
KRBG(FM)	Canadian, TX	02-01-97
WAYB(AM)	Waynesboro, VA	02-09-97
KRKE	Aspen, CO	02-24-97
KFCC(AM)	Bay City, TX	04-22-98
KUHD(AM)	Port Neches, TX	05-19-98
WBOW(AM), WBFX(AM), WZZQ(FM)	Terre Haute, IN	06-25-98

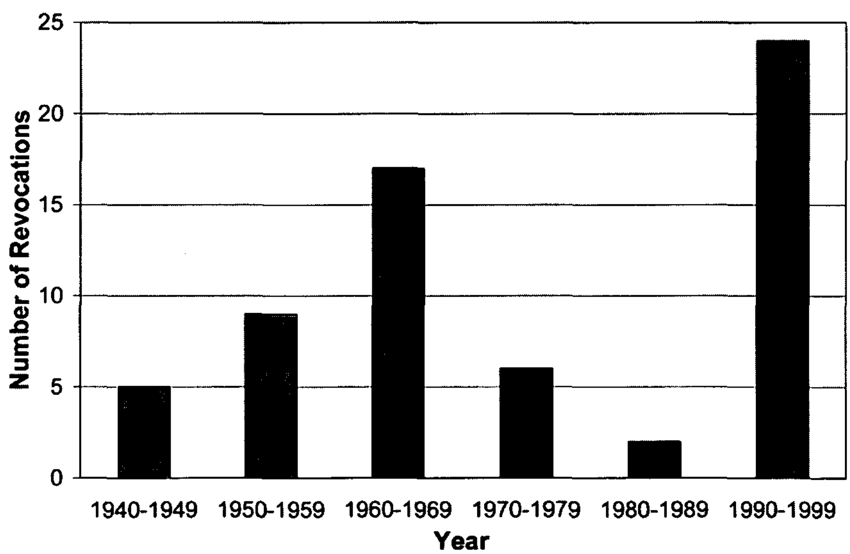

Figure 1: FCC Revocations of Broadcast Licenses and Construction Permits, by Decade, 1940-1998[10]

[10] Id.

prices or raise costs. The private firm that is the target of the threatened rent extraction thus faces an incentive to pay some form of consideration to politicians to prevent the imposition of the new regulatory regime. Political contributions are a principal way in which rents can be extracted, but the FCC would have different methods to extract rents from broadcasters, such as mandatory amounts of children's programming or the coerced contribution of "free" air time to political candidates for national office.[11]

A. Quasi Rent and Economic Rent

Assume that, to provide service, a broadcaster must invest k dollars. Suppose that the investment k is irreversible, so that k represents sunk costs. The broadcaster has operating costs c and expects to earn revenues R. The broadcaster's economic rent is defined as revenues net of operating cost and investment cost, $R - c - k$. The prospect of earning economic rent provides the incentive for entry. The firm's economic quasi rent is defined as net revenue, $R - c$. The quasi rent provides the broadcaster's incentive to stay in the industry after entry costs have been sunk. Having sunk k, the broadcaster decides whether or not to continue operations on the basis of its comparison of R and c only.[12]

Assume for ease of exposition that the broadcaster operates in a competitive market, such that no firm may earn economic rents. In other words, $R - c - k = 0$. Equivalently, $R - c = k$. This second equation says that the broadcaster's economic quasi rent must equal its sunk costs. Because the broadcaster will remain in the industry as long as $R - c > 0$, the FCC may extract concessions worth as much as k dollars before the broadcaster would simply relinquish his license. For example, the FCC could impose up to k dollars of costs on the broadcaster in the form of requirements to air children's programs, sell below-market political advertisements to federal candidates, promote localism, and otherwise meet the "needs and interests" of the community of license. For k to go to zero in equilibrium, c must rise to the level of R, or R must fall to c, or some combination of the two must happen. That is, the FCC can affirmatively alter the broadcaster's selection of content in a manner that raises operating costs or

[11] See Lillian R. BeVier, *Is Free TV for Federal Candidates Constitutional?* (AEI Press, 1998).

[12] This characterization of the problem is influenced by the contribution of my colleague, Daniel F. Spulber, to our analysis of rent extraction in the unbundling of the telecommunications industry. See J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States* 423-25 (Cambridge, 1997).

reduces revenue, or both, as long as revenues still cover operating costs. Revenue would fall, for example, when FCC-required content reduced the broadcaster's number of viewers, and hence its advertising revenues.

Consider now the case in which the broadcaster earns economic rent (also called monopoly rent) because the FCC has parsimoniously licensed an insufficient number of television broadcasters in a particular geographic market. Now the broadcaster's total revenue consists of its competitive level of revenue, R, plus monopoly rent, M. However, the FCC fully extracts the monopoly rent (as well as the quasi rent), such that $M + R - c - k = 0$. In this setting of imperfect competition, the broadcaster's exit decision changes. The broadcaster will remain in the market as long as the sum of his monopoly rents and quasi rents is positive: $M + (R - c) > 0$. The broadcaster will be willing to incur larger sunk costs, for the zero-profit condition under binding entry regulation becomes $M + R - c = k'$. In other words, the broadcaster will tolerate up to k' dollars of FCC rent extraction. By assumption, however, the FCC will not knowingly permit M to fall, such as by hastening the advent of other video platforms like cable television or direct broadcast satellite. Instead, the FCC has greater latitude to induce the broadcaster to carry programming that lowers R (because it appeals to a smaller audience than the programming it displaces) or to incur unnecessary costs that increase c, or some combination of both.

The preceding discussion describes the situation of compelled speech. The same analysis can be used to describe *suppression* of speech. Suppose that a broadcaster in a competitive environment, such as Rupert Murdoch, aired speech that offended a politically powerful person or group that could influence the FCC. How much would the broadcaster stand to lose if the FCC denied renewal of its license? Another way of posing the question is to ask: What costs of the broadcaster in a competitive market cannot be avoided if he is forced to exit the market? The question answers itself. The broadcaster will lose his sunk costs, which by definition are the fixed costs of assets that cannot be redeployed elsewhere and thus have no salvage value.

B. Relative Shares of Sunk Costs and Operating Costs

Use of the threat of nonrenewal as a means to suppress speech would manifest itself in at least three regulatory strategies. Under the first strategy, the FCC would use its policies to distort the broadcaster's production technology. If any tradeoff is possible at all between operating costs and sunk costs in the production of broadcast programs, the FCC would have an incentive to steer broadcasters toward methods that employed greater levels of sunk costs and lesser levels of operating costs. Doing so would increase the amount of investment that would be held hostage by the license renewal process.

Such investments are *asset-specific* because, as Oliver Williamson defines them, they are "durable investments that are undertaken in support of particular transactions, the opportunity cost of which investments is much lower in best alternative uses or by alternative users should the original transactions be prematurely terminated."[13] A mundane example of an asset-specific investment is a tenant repainting his apartment at his own expense on the last day of a one-year lease. The tenant will be able to enjoy the benefits derivable from repainting his apartment only if he and his landlord renew their lease. The tenant's investment in repainting his apartment is specific to another asset—namely, the renewed leasehold for the apartment. That investment has no salvage value to the tenant. Similarly, a broadcaster makes substantial durable, nonsalvageable investments in support of his licensing transaction with the FCC—investments such as advertising for his station, network affiliation agreements, retransmission consent agreements, business relationships with customers (that is, purchasers of advertising time), the development of (or the contractual commitment to buy) long-running programming, and the creation of a good reputation in the community.

Call z the "sunk cost ratio" and let it equal the ratio of the broadcaster's sunk costs to his (variable) operating costs: $z = k/c$. The FCC's power to censor increases as z rises. The FCC has an incentive to force the broadcaster, for any given level of output, to move from an isocost curve having a low z to one having a high z. The two factors of production may be generically described as a sunk-cost asset and a variable-cost asset. (The marginal rate of technical substitution between the two factors is $-z$.)

[13] See Oliver E. Williamson, *The Economic Institutions of Capitalism* 55 (Free Press, 1985); see also Oliver E. Williamson, *Markets and Hierarchies: Analysis and Anti-trust Implications* (Free Press, 1975); Oliver E. Williamson, *The Mechanisms of Governance* (Oxford, 1996). For similar discussions of the importance in regulation of cost recovery for asset-specific investments, see Sidak & Spulber, *Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States* at 102-09 (cited in note 12); Jean-Jacques Laffont & Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 53-127 (MIT Press, 1993); Daniel F. Spulber, *Regulation and Markets* 610 (MIT Press, 1989). The pioneering work on the appropriability of asset-specific investment in unregulated markets is Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process,* 21 JL & Econ 297 (1978); Benjamin Klein & Keith Leffler, *The Role of Market Forces in Assuring Contractual Performance,* 89 J Pol Econ 615 (1981).

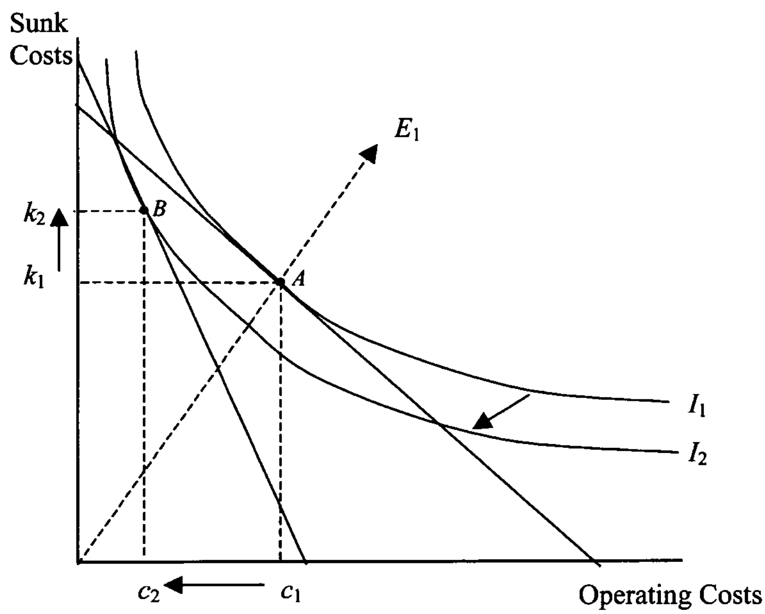

Figure 2.

The FCC has the perverse incentive to force the broadcaster to a *lower* level of output (an inferior isoquant) if doing so is necessary for the broadcaster to shift to an isocost curve manifesting the greater proportion of sunk costs, and thus higher z, that the FCC desires for purposes of influencing the broadcaster's choice of content. Figure 2 depicts this distortion in production choices.

By combining k_1 units of sunk costs and c_1 units of operating costs, the broadcaster can produce a level of output (as measured in audience size or advertising revenue, for example) that is denoted by the isoquant I_1. The sunk cost ratio for this production technology and level of output is $z_1 = k_1/c_1$. The FCC, however, could achieve greater influence over the broadcaster's content choices if his production instead relied on a technology that was tilted toward sunk costs. So the FCC would prefer the broadcaster to employ k_2 units of sunk costs and c_2 units of operating costs, even though to do so would entail the broadcaster's producing a lower level of output, represented by isoquant I_2. From the FCC's perspective, the new sunk cost ratio, $z_2 = k_2/c_2$, exceeds z_1 and thus is unambiguously superior in the sense that it signals a broadcaster who is likely to be more responsive to the programming preferences of the FCC and of those in government and the private sector who influence the agency's tastes.

C. Relative Shares of Sunk Costs and Salvageable Fixed Costs

As a second regulatory strategy, the FCC would use its policies to thwart any attempt by the broadcaster to convert sunk costs into salvageable fixed costs. This incentive is consistent with the FCC's many prohibitions on cross ownership of broadcast licensees and other mass media (both electronic and print). Suppose that the broadcaster also operates a newspaper in the same locale. Again assume zero economic profits. Now, however, some portion of what had been sunk costs is not really sunk after all. Suppose that the broadcaster has invested r dollars in assets that could be redeployed from his television station to his newspaper if the FCC denied renewal of his broadcast license. Although r is a fixed cost, it is not a sunk cost. The amount of the broadcaster's sunk assets that the FCC now holds hostage by its threat of nonrenewal falls from k to $k - r$.

Let s denote the broadcaster's new, reduced level of sunk costs in his station under cross ownership, and define k^* to be the broadcaster's fixed investment in both sunk *and* redeployable assets in the station, such that $k^* = r + s$ and $k > s$. Using the definition by Paul Milgrom and John Roberts, define a to be the asset's degree of product specificity, which equals "the fraction of [the asset's] value that would be lost if it were excluded from its major use,"[14] and express that fraction as $a = s/k^*$. The FCC's power to censor a broadcaster through the threat of nonrenewal of his license increases as a increases. Cross ownership of broadcast and other mass media renders the FCC's threat of censorship less credible because such common ownership transmogrifies the costs characteristics of certain of the broadcaster's current assets so as to cause a to fall.

D. Attainment of Economies of Scope

A third regulatory strategy of FCC censorship closely relates to this second strategy. If the owner of a multiproduct media firm may redeploy a fixed asset used in the broadcasting industry upon his exiting the broadcasting business, then it is very likely the case that he also can use that particular asset *simultaneously* (as opposed to sequentially) for both broadcast purposes and nonbroadcast mass media purposes for as long as he remains a broadcaster (though, of course, not longer than the asset's useful life). To coin a new term, the redeployment (that is, the salvaging) of an asset from one productive activity to

[14] Paul Milgrom & John Roberts, *Economics, Organization and Management* 307 (Prentice Hall, 1992).

another implies the existence of *intertemporal* economies of scope, whereas the *simultaneous* use of an asset across two or more productive activities implies the existence of common costs, which in turn implies the current existence and exploitation of economies of scope.

Loosely speaking, economies of scope exist if the total cost of producing two products, q_1 and q_2, on a stand-alone basis in separate firms exceeds the total cost of producing the same two products jointly within a single firm: $C(q_1) + C(q_2) > C(q_1 + q_2)$.[15] For example, the cost to Rupert Murdoch of jointly producing a daily newspaper in Boston and operating a television station in Boston, $C(q_1 + q_2)$, is less than the sum of the respective stand-alone costs of one firm producing only the daily newspaper in Boston and a second firm operating only the television station in Boston, $C(q_1) + C(q_2)$. Possible sources of economies of scope include a common corporate management, office building, advertising sales staff, editorial staff, and brand name.

It is possible that some economies of scope result from synergies in operating costs, which clearly benefit consumers because they will induce any firm, even a monopolist, to maximize profit by charging lower prices. Our principal concern with respect to censorship of broadcasting, however, arises from common costs that are fixed but no longer product-specific by virtue of the firm's joint production of broadcasting and one or more other mass media activities. Let j denote the ratio of the total cost of joint production to the sum of stand-alone costs, which in the simple two-product case is $j = C(q_1 + q_2)/[C(q_1) + C(q_2)]$. The more that j falls when a broadcaster expands into the cross ownership of other mass media activities, the less leverage the FCC has to censor the broadcaster by threatening nonrenewal of his license and hence extraction of the quasi rents that would provide a recovery of, and a competitive return on, his prior investment in sunk-cost assets. Put another way, the broadcaster's attainment of economies of scope frustrates the FCC's attempt to censor him, for such economies of scope make the salvageability of his common fixed costs instantaneous.

E. Summation

A sunk-cost theory of broadcast censorship predicts that the FCC has the incentive to distort a broadcaster's production choices in at least three respects: (1) the relative shares of sunk costs and operating

[15] See, e.g., William J. Baumol, John C. Panzar & Robert D. Willig, *Contestable Markets and the Theory of Industry Structure* 71 (Dryden Press, Harcourt Brace Jovanovich rev ed 1988).

costs, (2) the relative shares of sunk costs and salvageable fixed costs, and (3) the attainment of economies of scope. All of these regulatory distortions of the broadcaster's production choices may appear to courts on casual observation to be inherently content-neutral. Yet, in actuality, each regulatory distortion serves the insidious purpose of influencing the degree to which a broadcaster is made more or less vulnerable to the FCC's attempts to compel favored speech or suppress disfavored speech. So viewed, these regulatory distortions are not content-neutral in the least.

III. SPECTRUM, PROPERTY, AND RENTS

By its enactment of the Radio Act of 1927, Congress in effect decided to nationalize the spectrum, declare it a public forum, license its use, and assert that the licensee acquires no property interest in his licensed frequency. The D.C. Circuit quickly confirmed that the 1927 legislation created no property right in the licensed frequency, ruling in 1932 in *Trinity Methodist Church, South* v. *FRC*[16] that the Federal Radio Commission's refusal to renew a license could not constitute a taking of property under the Fifth Amendment, because there was no private property to be taken.[17] But that was the beginning, not the end, of the judicial examination of the property interests in broadcast licenses.

A. The Statutory Extent of Public Ownership of the Spectrum

The broadcast licensing provisions of the Communications Act of 1934 begin in section 301 with the statement that their purpose is "to maintain the control of the United States over all the channels of radio transmission; and to provide for the use of such channels, but not the ownership thereof, by persons for limited periods of time, under licenses granted by Federal authority, and no such license shall be construed to create any right, *beyond the terms, conditions, and periods of the license.*"[18] Elsewhere, in section 309(h), the act requires that a "station license shall not vest in the licensee any right to operate the station nor any right in the use of the frequencies designated in the license *beyond the term thereof.*"[19] In addition, section 304 provides: "No station license shall be granted by the Commission until the applicant therefore [*sic*] shall have signed a waiver of any claim

[16] 62 F2d 850, 853 (DC Cir 1932).
[17] Id at 853.
[18] 47 USC § 301 (emphasis added).
[19] Id at § 309(h) (emphasis added).

to the use of any particular frequency or of the electromagnetic spectrum as against the regulatory power of the United States because of the previous use of the same, whether by license or otherwise."[20] Thus, a statutory condition placed on the grant of a license is that the broadcaster relinquishes the right to assert any claim, against the federal government, akin to adverse possession of a particular frequency in a particular geographic area.

By 1940, in its first pronouncement on the Communications Act of 1934, the Supreme Court echoed the D.C. Circuit's brief analysis of the property question in *Trinity Methodist Church*, stating in *FCC v. Sanders Brothers Radio Station*[21]: "The policy of the Act is clear that no person is to have anything in the nature of a property right as a result of the granting of a license."[22] This statement was overblown. By 1948, the D.C. Circuit retreated from its emphatic denial of the existence of any private property right, asserting in *L.B. Wilson, Inc. v. FCC*[23] that under the Communications Act a broadcaster has "a private right or interest in a station licensee while his license is outstanding,"[24] even if that private right was not an ownership interest:

> That private as well as public interests are recognized by the Act is not to be doubted. While a station license does not under the Act confer an unlimited or indefeasible property right—the right is limited in time and quality by the terms of the license and is subject to suspension, modification or revocation in the public interest—nevertheless the right under a license for a definite term to conduct a broadcasting business requiring—as it does—substantial investment is more than a mere privilege or gratuity. A broadcasting license is a thing of value to the person to whom it is issued and a business conducted under it may be the subject of injury . . . . [D]ecisions of the Supreme Court . . . support these statements and . . . provisions of the Communications Act itself . . . recognize that a broadcasting license confers a private right, although a limited and defeasible one.[25]

That reasoning is more cogent than the Supreme Court's oblique sentence quoted earlier from *Sanders Brothers*. Suppose a lessee of office space lawfully assigns his unexpired lease. Simply to recognize that, for a limited period of time, the lessee holds a valuable asset that he

[20] Id at § 304.
[21] 309 US 470 (1940).
[22] Id at 475.
[23] 170 F2d 793, 798 n.5 (DC Cir 1948).
[24] Id at 798 n.5.
[25] Id at 798 (citations omitted).

may convey to another does not imply that he owns the building that he leases, let alone the ground on which it stands. To the extent that the lessee "owns" a property interest, it is something vastly inferior to a fee simple. If the lessee could convey a fee simple rather than an unexpired leasehold, he could obviously fetch a higher price. Similarly, a broadcaster could fetch a higher price for the sale of his station if he could convey a fee simple in the frequency on which it operates rather than merely a defeasible license awarded by the FCC to use that frequency (at a specified level of radiated power, which implies the extent of geographic coverage) for a specified purpose for a specified term of years.

As an elementary matter of property law, *Wilson* is inconsistent with *Sanders Brothers* and *Trinity Methodist Church*. It is contradictory to say in *Sanders Brothers* that the Communications Act does not create "anything in the nature of a property right," and then to say in *Wilson* that the statute "confers a . . . limited and defeasible" private right of some sort. By the plain language of the Communications Act, the Supreme Court misspoke in *Sanders Brothers* to the extent that it intimated that the grant of a license does not create *any* kind of property interest held by the broadcaster. Section 309(h) states only that a licensee shall not confer any rights "*beyond the terms thereof*."[26] Plainly, a statutory provision stating that a station license does not confer any right to use a particular frequency *after* the present license term expires presupposes that, *during* the term of that license, a licensee *does* possess some cognizable property interest. It would be far-fetched to suppose, in the alternative, that section 309(h) manifested Congress' concern that a nonexistent property right during the license term would blossom into a valid property interest after that license term had expired. Because the Communications Act does create, at a minimum, a defeasible property interest in the *private use* of a frequency, the Supreme Court's statement in *Sander Brothers* that a broadcast license lacks "anything in the nature of a property right" is too extravagant. It must follow, therefore, that the D.C. Circuit's initial premise in *Trinity Methodist Church* that a licensee under the Radio Act of 1927 lacks any private property interest protected by the Takings Clause of the Fifth Amendment is incorrect also.

Until the 1990s, it mattered little in practical terms to correct the popular misconception that the Communications Act confers on the licensee during his license term no constitutionally protected property interest, because relatively few actions by the FCC to confiscate a broadcaster's license occurred *during* the term of the license through

[26] 47 USC § 309(h) (emphasis added).

the vehicle of a revocation proceeding under section 312 of the Communications Act.[27] As Table 1 shows, the frequency of revocation rose sharply during the 1990s. Until that time, one could safely generalize that most confiscatory actions occur *after* the expiration of a license term, during the license renewal process, when the FCC and petitioners adverse to the licensee face much lower procedural hurdles to disqualify a renewal applicant than they do a licensee in a revocation hearing. In a revocation proceeding, "both the burden of proceeding with the introduction of evidence and the burden of proof shall be upon the Commission."[28] In a renewal proceeding, however, both evidentiary burdens are on the renewal applicant.[29]

B. Fictional Property Rights Before and After the License Term

Although the FCC has refused to acknowledge the existence of any private property right during the license term, it has dignified two other kinds of private property interests—one before the grant of a license and the other after its expiration—that have far less, if any, statutory basis in the Communications Act. The former fictional property right is known as a license applicant's "*Ashbacker* rights." The latter is a licensee's "renewal expectancy."[30]

1. "Ashbacker Rights"

Section 309(e) of the Communications Act originally required the FCC to conduct a comparative hearing—essentially a multiparty litigation—when the agency for any reason was unable to find that granting an application for a license would serve the public interest, convenience, and necessity.[31] The Supreme Court construed this section in 1945 in *Ashbacker Radio Corp.* v. *FCC*, saying that "where two bona fide applications are mutually exclusive the grant of one without a hearing to both deprives the loser of the opportunity which Congress chose to give him."[32] The Court nominally narrowed *Ash-*

[27] Id at § 312.

[28] Id at § 312(d).

[29] Id at § 309(e).

[30] See Howard A. Shelanski & Peter W. Huber, *Administrative Creation of Property Rights to Radio Spectrum*, 41 JL & Econ 581 (1998).

[31] See 47 USC § 309(e) (formerly 47 USC § 309(a)).

[32] 326 US 327, 333 (1945). In *Ashbacker*, Fetzer Broadcasting Company applied for a new AM station on 1230 kHz at Grand Rapids, Michigan in March 1944. In May 1944, Ashbacker Radio Company filed an application to change the frequency of its existing station at Muskegon, Michigan from 1490 to 1230 kHz. The FCC concluded that simultaneous operation on 1230 kHz at both Grand Rapids and Muskegon would cause intolerable interference to both applicants. After examining the Fetzer applica-

backer in *United States* v. *Storer Broadcasting Co.*,[33] stating that "Congress [never] intended the Commission to waste time on applications that do not state a valid basis for a hearing,"[34] and permitting the FCC to dismiss, without consideration, applications which, if granted, would violate the FCC's multiple ownership rules.[35] By the late 1980s, the D.C. Circuit reasoned that section 309(e) "does not preclude the FCC from establishing threshold standards to identify qualified applicants and excluding those applicants who plainly fail to meet the standards,"[36] and that *Ashbacker* "merely held that the Commission must use the same set of procedures to process the applications of all *similarly situated* persons who come before it seeking the same license."[37]

Nonetheless, the FCC repeatedly fretted about the "*Ashbacker* rights" of an applicant or a licensee in comparative licensing adjudications (both initial licensing cases and license renewals). A "spirit of *Ashbacker*" line of decisions even emerged at the agency that extolled "the public interest benefits of entertaining competing applications in some circumstances,"[38] and the D.C. Circuit noted that "whatever the power of the Commission to set basic qualifications in the public interest and to deny hearings to unqualified applicants," the FCC is not authorized "to deny *qualified* applicants their statutory rights to a *full hearing* on their own merits."[39]

Given the duration and expense of comparative hearings, *Ash-*

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tion and supporting data, the FCC granted it in June 1944 without a hearing and the same day designated Ashbacker's application for hearing. Ashbacker in turn filed a petition for hearing against the FCC's grant of a construction permit to Fetzer. The FCC denied Ashbacker's petition, noting that Ashbacker would have the opportunity to show (in the hearing on its own application) that grant of its application would better serve the public interest than would the grant of Fetzer's application, which the FCC had already authorized in June 1944. Id at 328. The Supreme Court reversed the action of the D.C. Circuit, which had granted without opinion the FCC's motion to dismiss Ashbacker's appeal from the grant of Fetzer's construction permit. Id at 329.

[33] 351 U.S. 192 (1956).

[34] Id at 202.

[35] Id at 193-97; see also *Reuters, Ltd. v FCC*, 781 F2d 946, 951 (DC Cir 1986).

[36] *Hispanic Information & Telecommunications Network, Inc v FCC*, 865 F2d 1289, 1294 (DC Cir 1989).

[37] *Maxcell Telecom Plus, Inc v FCC*, 815 F2d 1551, 1555 (DC Cir 1987) (emphasis added).

[38] Amendment to the Television Table of Assignments to Change Noncommercial Educational Reservations (Report and Order), MM Dkt No. 85-41, 59 Rad Reg 2d (P & F) 1455, 1463 n.13 (1986) (citing *New South Media Corp v FCC*, 685 F2d 708, 714-15 (DC Cir 1982); *Rhode Island Television Corp v FCC*, 320 F2d 762, 766 (DC Cir 1963); *Community Telecasting Co. v FCC*, 255 F2d 891, 893 (DC Cir 1958)).

[39] *Citizens Communications Center v FCC*, 447 F2d 1201, 1212 n.34 (DC Cir 1971) (emphasis in original).

backer helped to perpetuate the regulatory rents of existing broadcast licensees in the sense that it virtually guaranteed that every potential competitor would have to overcome great costs and delay to enter any lucrative broadcasting market. In turn, some portion of those governmentally created rents became available for extraction by the FCC through its myriad public interest obligations for broadcasters. This rent-creation and rent-extraction function served by *Ashbacker* evidently escaped the comprehension and commentary of the courts and the FCC, which instead viewed *Ashbacker* exclusively from the perspective of procedural fairness. There can be little doubt, however, that the ability to force the Commission into a lengthy hearing has been a valuable right, even if it has been characterized as a mere procedural right and not a "property" right. Essentially, *Ashbacker* rights became the right to force all competing applicants for a particular radio or television frequency into a self-destructive process of mutual rent dissipation. It should not be surprising, therefore, that the optimal strategy that emerged in comparative hearings before the FCC was to induce competing applicants to settle (thus, relinquishing their *Ashbacker* rights) before the entire expected value of the license had been dissipated.

2. The Renewal Expectancy

The renewal expectancy is a presumption in favor of license renewal for an incumbent broadcaster. How much weight the FCC should accord this presumption, however, proved to be a thorny question. In *Central Florida Enterprises, Inc. v. FCC*,[40] the D.C. Circuit in 1982 said that the "renewal expectancy is to be a factor weighed with all the other factors" when the FCC compares the relative benefits of renewing an incumbent station's license against those of granting the license to a challenger.[41] Essentially, "the better the [incumbent's] past record, the greater the renewal expectancy 'weight'" in favor of license renewal.[42] The renewal expectancy, added the court, was to be "factored in for the benefit of the public, not for incumbent broadcasters."[43]

Although the renewal expectancy is not a true property right, the FCC has offered three reliance-based rationales for granting a renewal expectancy to an incumbent broadcaster. First, the uncertainty that a challenger's proposals will match the past performance of the incumbent raises the possibility that "replacing an incumbent [will not

[40] 683 F2d 503 (DC Cir 1982).
[41] Id at 506.
[42] Id.
[43] Id at 507.

only] be entirely gratuitous, but . . . might even deprive the community of an acceptable service and replace it with an inferior one."[44] Second, the increased likelihood of license renewal provides an incentive to licensees to invest in improved service.[45] Finally, "[c]omparing incumbents and challengers as if they were both new applicants could lead to a haphazard restructuring of the broadcast industry" that would be unlikely to serve the public interest.[46]

Determining whether an incumbent broadcaster is entitled to a renewal expectancy is a backward-looking inquiry, as the FCC attempts "to predict a broadcaster's likely future performance based on its past programming."[47] Confident that a broadcaster who has performed well in the past will likely continue to perform well in the future, the FCC has held that "a licensee 'runs on its record,' and when past performance is in conflict with the public interest, a very heavy burden rests on the renewal applicant to show how a renewal can be reconciled with the public interest."[48] Incumbents' past performance should be "'substantial,' meaning 'sound, favorable and substantially above a level of mediocre service which might just minimally warrant renewal.'"[49] Furthermore, in determining whether to grant a renewal expectancy, the FCC has considered the broadcaster's nonentertainment programming[50] and whether the broadcaster adequately ascertained and responded to community needs.[51]

Caught between its unwillingness to recognize a true property right and its reluctance to deny renewal of a broadcast license, the FCC attempted to predict a broadcaster's future performance from factors lacking predictive power. Judge Laurence Silberman of the D.C. Circuit wrote in 1983 "that virtually *all* the factors upon which the FCC relies in . . . renewing broadcast licenses are in a sense fictitious; they are not really predictive of programming substance."[52] He

[44] Id (citing *In re Applications of Cowles Broadcasting*, Inc, 86 FCC 2d 993, 1013 (1981)).

[45] Id.

[46] Id.

[47] *Monroe Communication Corp v FCC*, 900 F2d 351, 356 (DC Cir 1990).

[48] *In re Applications of Simon Geller*, 90 FCC 2d 250, 270 (1982) (citing *Cowles Broadcasting*, 86 FCC 2d at 1012-14).

[49] Id at 353 (citing *Cowles Broadcasting*, 86 FCC 2d at 955-56).

[50] Id. Examples of "nonentertainment" included news, public affairs, and public service announcements. Id. The FCC also found high school football games, religious programs, and occasional special musical events to qualify as "nonentertainment" programming. See *Victor Broadcasting, Inc v FCC*, 722 F2d 756, 774 (DC Cir 1983) (Wilkey, J., dissenting).

[51] Id.

[52] Id at 351 (Silberman, J., concurring) (emphasis in original).

questioned whether "it is possible to articulate a public interest in any particular type of programming (such as 'nonentertainment')."[53] "When I sit on these cases," he wrote, "I feel somewhat like Alice in Wonderland."[54]

C. Economic Rents in Broadcasting

Apart from the express provisions of the Communications Act granting the licensee an interest in the *use* of a frequency during the license term, broadcast regulation embodies a system of investment-backed expectations that resemble de facto property rights upon which both broadcasters and the FCC rely. Those de facto property rights arise from a broadcaster's specialized investment in his station and his economic expectation that he will be able to convey to others the income stream associated with his license and the investments made pursuant to it. In this respect, an implicit recognition has arisen that private investment incident to the FCC's grant of a broadcast license can produce a stream of quasi rents, which cannot be said to flow from government largesse.

A commercial broadcaster sells audiences to advertisers.[55] He profits by the amount that his advertising revenue exceeds the cost of assembling and transmitting programs free of charge to those audiences. The market price of an advertising slot depends on how many "impressions" it imparts on listeners or viewers—the broadcast analogue to newspaper circulation. There are fixed costs to secure the rights to finished programming, costs analogous to "first negative" costs in the motion picture business or "first copy" costs in the newspaper business. For a given amount of radiated power, the marginal cost of providing a program to one additional viewer or listener is essentially zero because, on the demand side, one person's consumption of a broadcast does not preclude or diminish another person's ability also to consume the broadcast, unlike the rival consumption that attends most consumer goods, such as cars or hamburgers.[56] Thus, there are significant economies of scale in both consumption and program production.

There is, however, a problem of rival use of the essential input for distributing broadcast programming, because one station's use of a specific frequency within a geographic area precludes that fre-

[53] Id.

[54] Id.

[55] I do not address noncommercial broadcasting or subscription-based broadcasting.

[56] See, e.g., Bruce M. Owen, *Economics and Freedom of Expression: Media Structure and the First Amendment* 16-18 (Ballinger Publishing, 1975).

quency's use by another station, lest both stations end up with garbled signals. A station can increase its audience size by increasing its power, assuming that the physical properties of its service contour permit. But at some scale of signal coverage a broadcaster can expand his audience size only by reducing the audience size of another broadcaster on the same frequency in a different locale. Thus, because the distribution of broadcasts is mutually exclusive on any given frequency, and because a profit-maximizing broadcaster has the incentive to encroach on the contour of a neighboring broadcaster if the marginal benefit from doing so exceeds the marginal cost, it is necessary (and, economists would argue, sufficient) for the government to oversee an initial allocation of private rights to use the spectrum and thereafter provide a forum for private parties to enforce claims for electromagnetic trespass and contracts for the mutually beneficial resolution of interference.

As noted earlier, FCC regulation can create and perpetuate monopoly rents (and hence preserve the agency's opportunity to extract some portion of those rents) by preventing or delaying entry into a lucrative broadcast market. There are obvious examples, such as the various cross-ownership rules and the now-defunct *Carroll* doctrine.[57] A less obvious way in which entry can occur is for an existing licensee in an outlying area to move his transmitter to a new site from which he can reach audiences in the larger, more lucrative market. The transmitter move, however, requires regulatory approval. Consider, for example, the experience of aptly named Elba Development Corporation. In 1982, Elba applied to modify its transmitter for a television station in St. Joseph, Missouri in a way that would permit it to broadcast over nearby Kansas City. Predictably, four Kansas City television stations—owned by Great American Broadcasting Company (formerly Taft Broadcasting Company), Meredith Corporation, Scripps Howard Broadcasting Company, and the Hearst Corporation—opposed the move. The FCC's Review Board denied Elba's application because the proposed transmitter move, despite its service to a far larger total audience, would create a "white area" of no over-the-air television reception for 9,936 persons.[58] After years of administrative litigation, Elba's successor in interest mysteriously requested the FCC to dismiss the application with prejudice, which the FCC did in

[57] See *Carroll Broadcasting Co v FCC*, 258 F2d 440 (DC Cir 1958).

[58] *In re Application of Elba Development Corp*, 96 FCC 2d 376 (Rev Bd 1984), *modified*, 1 FCC Rcd 773 (Rev Bd 1986). A white area is defined to be an area that does not receive any Grade B television service, which in turn is defined as service of a quality acceptable to the median observer at least 90 percent of the time at 50 percent of locations at the outer limits of the service.

January 1991.[59] Nine years of administrative process before the FCC had reaffirmed the status quo.

That existing stations in the metropolitan market oppose the transmitter move is consistent with a concern about preventing degradation of their signals because of adjacent-channel interference. But it is also consistent with the expectation that moving the transmitter closer to the city would have a beneficial effect on competition there in the market for video programming and the market for advertising. Indeed, the threat of entry certainly gives the existing metropolitan stations a strong incentive to try to prove that an outsider's proposal will cause impermissibly large white areas in outlying areas. The FCC, however, stacks the deck against increasing competition and enhancing consumer welfare in metropolitan markets because it saddles the potential entrant with the burden of proof. Thus, a relatively arcane FCC policy on evidentiary burdens has helped to insulate broadcasters in large cities from a form of competition.

D. Licensure, Expectation, and Asset Specificity

While emphasizing that the airwaves belong to the public, the FCC has nonetheless given broadcast licensees many accoutrements of ownership. The relevant question, however, is not whether there exists a private ownership right of some sort in the electromagnetic spectrum. As shown in the previous section, the short answer to that question is that, as a matter of law, a limited private right of *use* does exist. But the value of a broadcast station depends less on that limited private right of use than on the expectation that the station's license will continue to be renewed in perpetuity, regardless of who holds it during its current license term. In what might be regarded as the inverse of the Coase Theorem, the greater the transactions costs for terminating one's use of a licensed frequency, the more that person's use merges with an absolute property right akin to a fee simple.[60]

Although the Communications Act precludes the private ownership of broadcast frequencies, it does not preclude the FCC from permitting a licensee to keep, by assigning his license, all or part of the capitalized value of the expected net cash flows associated with the

[59] *In re Application of Elba Development Corp,* 6 FCC Rcd 1564 (1991). The procedural history of the case is summarized in *In re Application of Elba Development Corp,* 5 FCC Rcd 6767 (1990).

[60] For an explication of the "inverse Coase Theorem" in connection with the separation of powers in constitutional law, see J. Gregory Sidak, *The Inverse Coase Theorem and Declarations of War,* 41 Duke LJ 325 (1991); J. Gregory Sidak, *The Line-Item Veto Amendment,* 80 Cornell L Rev 1498 (1995).

license. Section 310(d) deprives the FCC of the discretion to withhold approval for a license assignment to a qualified licensee on the grounds that someone else would give better service.[61] It is only the *initial* license award for an allotted channel—and in the extraordinary event of revocation or nonrenewal—that the FCC had occasion to restrain the alienability of a broadcast frequency and allocate previously assigned licenses by comparative selection.[62] In license transfer proceedings, section 310(d) precludes the FCC from considering the comparative qualifications of assignees, and the FCC routinely approves assignments by licensees in good standing to qualified persons without restricting the consideration given in exchange. Thus, the FCC has permitted a licensee in good standing, by selling his station, to capture the capitalized value of the expected net cash flow of its present license term—as well as any capitalized value that the marketplace attributes to the expected net cash flow from future license terms.

There has been, in other words, a regulatory presumption even before 1997 that, after the initial grant of a license, a broadcast station should be freely alienable in the marketplace.[63] There is a commercial expectation, reflected in the prices that broadcasters pay to acquire licensed stations and in the amounts that they subsequently invest in those stations, that one who acquires a license will keep it until he sees fit to dispose of it by sale. The expectation of an unbroken succession of license renewals has great economic value. The fair market value of an FCC license depends not only on the expected net cash flow that it will generate for its owner during the existing term, but also on whether the licensee is free to transfer the license to another qualified person. Although a license exists as a legal thing only for a term of years, denial of renewal has the effect of denying the licensee the value of an expected net cash flow of unlimited duration. Included in that amount would be the broadcaster's return of, and on, the cost of any undepreciated and nonsalvageable investments made in his station in expectation of renewal.

The distinction between ownership and the alienability of expected

[61] 47 USC § 310(d). In 1989, the FCC repudiated its "*Wichita-Hutchinson* doctrine," which had precluded the assignment of a broadcast license to a transferee who would not offer service equal or superior to that provided by the transferor. See MMM Holdings, Inc, 4 FCC Rcd 8243, 8243-44 ¶¶ 6-10 (1989).

[62] In 1997, Congress mandated that the FCC select among competing applications for commercial broadcast stations filed after July 1, 1997, through competitive bidding, rather than comparative hearings. 47 USC § 309(j). Of course, the best frequencies in the largest cities were long gone by then.

[63] Two exceptions to this general rule are discussed below.

net cash flows generated by the right to use a resource was presaged by Oliver Wendell Holmes, who wrote more than a century ago of the confusion concerning ownership, possession, and conveyancing:

> [W]hat are the rights of ownership? They are substantially the same as those incident to possession. Within the limits prescribed by policy, the owner is allowed to exercise his natural powers over the subject-matter uninterfered with, and is more or less protected in excluding other people from such interference. The owner is allowed to exclude all, and is accountable to no one. The possessor is allowed to exclude all but one, and is accountable to no one but him. The subject of property so large and important are questions of conveyancing, not necessarily or generally dependent on ownership as distinguished from possession.[64]

A broadcaster can have an economic expectation without the security of ownership, and indeed *ownership is irrelevant as long as the broadcaster can transfer to another the value of his economic expectation.* The FCC's creation of a renewal expectancy can be regarded as an explicit recognition of that proposition.[65] What matters more than whether a broadcaster has a right of ownership in a frequency is whether he has the right to convey to a third party the expectation of receiving in perpetuity the benefits derivable from the use of that particular frequency.

The expected net cash flow that his station will generate over successive license terms is an asset that can be valued and sold to others who qualify under FCC policies to be licensees. If near the end of a license term a broadcast station sells for considerably more than the salvage value of its physical assets, one can infer the value that the marketplace imputes to that station's discounted expected net cash flow computed into the indefinite future. In a large city, the value of that expectation can be hundreds of millions of dollars.[66] The loss of a broadcast license through revocation or nonrenewal reduces the value (wealth) of a broadcasting company by an equivalent amount (less the salvage value of the station's physical assets, such as its real

[64] Oliver Wendell Holmes, *The Common Law* 193-94 (1881) (Dover Publications, M. Howe ed 1963).

[65] Judge Silberman has observed: "The Commission appears to act as if incumbency and the renewal expectancy were a property interest—which it is [*sic*] not." *Monroe Communications Corp v FCC*, 900 F2d 351, 359 (DC Cir 1990) (Silberman, J., concurring).

[66] See, e.g., *In re Applications of RKO General, Inc*, 3 FCC Rcd 5057at 5057 ¶ 2 (1988) (either the cite or the name of the case is wrong) (assignment in 1988, after expiration of license term, of independent VHF television station in Los Angeles for $314 million).

property and equipment that can be redeployed elsewhere or in an alternative use).

Because the FCC only infrequently revokes a broadcast license or denies renewal of a license,[67] there has arisen the commercial expectation that, in the absence of wrongdoing and so long as a licensee provides good service in the FCC's estimation, the licensee may continue to hold his license until he chooses to dispose of it. An equilibrium exists in which it is commercially reasonable to buy and sell broadcast stations for prices equivalent to their expected net cash flow extending into the indefinite future, even though the Communications Act clearly grants only a defeasible right to use a frequency during the term of the license. Ownership in fee simple absolute is unnecessary for the broadcaster to convey that expected net cash flow.[68] If it were not commercially reasonable for a broadcast licensee to expect to be granted renewal and to be permitted freely to transfer his license to a third party, it would be very risky for the licensee to make investments in his station that (1) had a useful life extending beyond the term of the license and (2) could not be readily salvaged or redeployed by the licensee (as could a personal computer, for example) if the licensee were abruptly forced to exit the broadcasting industry. Naturally, a licensee's propensity to make asset-specific investments in his station increases with the expected duration of the license.[69]

One can trace to the Radio Act of 1927, and to the following years leading to enactment of the Communications Act of 1934, an awareness by Congress and the courts of the public benefits from encouraging broadcasters to make asset-specific investment in their stations. In 1926, when discussing the appropriate duration of a radio station license under the proposed Radio Act, Representative Davis thought that "perhaps it was not fair to expect anybody to expend a large amount of money to operate the station for a short period."[70]

[67] See text accompanying note 8.

[68] See Ginsburg, *Regulation of Broadcasting* at 60 (cited in note 1); Arthur S. De Vany, et al, *A Property System for Market Allocation of the Electromagnetic Spectrum: A Legal-Economic-Engineering Study*, 21 Stan L Rev 1499, 1531-34 (1969).

[69] For empirical evidence of the link between contract duration and the incentive to make asset-specific investment, see Paul Joskow's research on long-term contracts by which coal mines supply electric utilities with coal. See Paul L. Joskow, *Vertical Integration and Long-Term Contracts: The Case of Coal-Burning Electric Generating Plants*, 1 JL Econ & Org 33 (1980); Paul L. Joskow, *Contract Duration and Durable Transaction-Specific Investments: The Case of Coal*, 77 Am Econ Rev 168 (1987); Paul L. Joskow, *Asset Specificity and the Structure of Vertical Relationships: Empirical Evidence*, 4 JL Econ & Org 95 (1988).

[70] *To Regulate Radio Communication: Hearings on H.R. 5589 Before the House Comm. on the Merchant Marine and Fisheries*, 69th Cong, 1st Sess 25 (1926) (remarks of Rep. Davis).

Similarly, in 1931, the D.C. Circuit observed: "The installation and maintenance of broadcasting stations involve a very considerable expense. Where a broadcasting station has been constructed and maintained in good faith, it is in the interests of the public and common justice to the owner of the station that its status should not be injuriously affected, except for compelling reasons."[71] In 1947 and again in 1964, the D.C. Circuit emphasized that "valuable rights and investments made in reliance on a license of the Federal Communications Commission should not be destroyed except for the most compelling reasons."[72] In 1982, the conclusion that asset-specific investment by broadcasters serves the public interest was one rationale on which the D.C. Circuit upheld the FCC's establishment of a renewal expectancy for broadcast licensees.[73] In 1988, the FCC again noted, in a controversial renewal proceeding, the significance of the distinction between asset-specific investment and more readily salvageable or shorter-lived investment.[74]

E. The Prerogative to Deny Alienability of Expected Net Cash Flows

The FCC has asserted the prerogative in two situations to deny a broadcaster alienability of his expected net cash flows calculated in perpetuity. The first such departure from the general rule of capital mobility is the agency's prohibition against "trafficking" in broadcast stations.[75] The allusion to drug dealing or smuggling conveys the intellectual orientation of this policy: To protect the public from a broadcaster who would buy a station and "hype" its ratings with shallow programming, the FCC has deemed that it must restrict a licensee's ability to transfer his license for a minimum number of years. The practical significance of the anti-trafficking rule is to expose the acquirer of a broadcast station to at least one license renewal proceeding before he may sell the station to another party. Thus, the

[71] *Journal Co v FCC*, 48 F2d 461, 463 (DC Cir 1931).

[72] *Jefferson Radio Co v FCC*, 340 F2d 781, 783 n.4 (DC Cir 1964) (quoting *Churchill Tabernacle v FCC*, 160 F2d 244, 247 (DC Cir 1947)).

[73] See *Central Fla Enterprises, Inc v FCC*, 683 F2d 503, 507 (DC Cir 1982).

[74] See *In re Applications of RKO General, Inc*, 3 FCC Rcd 5057, 5059-60 ¶ 19 (1988).

[75] See *In re Applications of Powel Crosley, Jr.*, 11 FCC 3, 23 (1945) (defining trafficking as transfer of broadcast license or permit "for the purpose of reselling it at a profit rather than for the purpose of rendering a public service"); see also Amendment of Section 73.3597 of the Commission's Rules, *Applications for Voluntary Assignments or Transfers of Control*, 55 Rad Reg 2d (P & F) 1081 (1982); *Office of Communication of United Church of Christ v FCC*, 911 F2d 813 (DC Cir 1990).

owner of a station must endure at least one round of potential rent extraction by the FCC before the agency will permit him to sell his station to another.

The second basis for the FCC to deny capital mobility is that the broadcaster lacks good character. To receive government permission to speak to a mass audience through over-the-air broadcasting, a person must do more than specify to the FCC his proposed frequency, service contour, antenna location, and so forth. That is, he must do more than merely announce the technical specifications of his proposed broadcast speech that would be analogous to "time, place, and manner" regulation of speech in public places. Section 308(b) of the Communications Act provides that any applicant for a station license, or for the modification or renewal of a license, "shall set forth such facts as the Commission by regulation may prescribe as to the citizenship, *character*, and financial, technical, and other qualifications of the applicant to operate the station."[76] Thus, to secure a license, and to have that license renewed periodically, a broadcaster must first prove to the FCC that he is "basically qualified"—which requires, among other things, a determination that the broadcaster is of good character to be a licensee and will operate the station in the public interest. To define this requirement after decades of ad hoc adjudication, the FCC in 1986 issued the *Character Policy Statement*,[77] which explicates the nuances of good and evil for forty-eight pages in the *FCC Reports*.

Two years later, however, the FCC tied itself in intellectual knots over the prospect of actually making good on its threat to confiscate a license when it happened to be held by a television station having substantial value. Until its approval in 1988 of a settlement permitting the transfer of RKO's Los Angeles VHF station to the Walt Disney Company,[78] the FCC had been unwilling to grant renewal to facilitate the assignment of a license to a third party except upon a determination that the incumbent was fully qualified to *remain* a licensee. The FCC emphasized that its approval of the RKO-Disney settlement was justified by the unique facts of the case, even though the FCC had yet to accept or reject an ALJ's finding that RKO was *unqualified* to be renewed as a licensee.[79] Although the FCC's assertion

[76] 47 USC § 308(b) (emphasis added). Analogous language appears at 47 U.S.C. § 319(a), which specifies the requirements for an applicant for an FCC construction permit (which is a prerequisite to the issuance of a license).

[77] *In the Matter of Policy Regarding Character Qualifications in Broadcast Licensing*, 102 FCC 2d 1179 (1986) [hereinafter *Character Policy Statement*].

[78] See *RKO General, Inc*, 3 FCC Rcd at 5057.

[79] See id at 5062 ¶¶ 40, 45.

of uniqueness in the RKO-Disney settlement was debatable,[80] it remains the Commission's policy, expressed and approved by the D.C. Circuit in *Jefferson Radio Co.* v. *FCC*,[81] that a licensee who has applied for renewal may not transfer his station while an unresolved issue is pending against him concerning his qualifications to be a licensee in the first place.

According to the D.C. Circuit and the FCC, *Jefferson Radio* rests on the premise that "permitting the suspected wrongdoer to evade sanction by transferring his interest or assigning the license . . . will diminish the deterrent effect which revocation or renewal proceedings should have on broadcast licensees."[82] Put differently, it is the FCC's policy to deny renewal and forbid license assignments for broadcasters who fail at renewal time to refute charges of misconduct. The FCC may renew a broadcast license if it determines that such action would serve the public interest.[83] A renewal applicant cannot avoid that public interest determination by assigning his license *after* the expiration of its regular term, while his renewal application is pending. During that period, the licensee has no assignable interest in the license,[84] but merely the right, under section 307(c) of the Communications Act[85] and section 558(c) of the Administrative Procedure Act,[86] to continue to transmit on that frequency pending final disposition of his renewal application. The FCC similarly said in an earlier case that a "licensee cannot act improperly in the broadcast field and then, when challenged, simply sell his station at a profit or without a loss; if this were permitted, such a licensee would have little reason to obey the Act, the Commission rules or policies, or serve the public interest, since the worst that would hap-

[80] The FCC's proclivity to limit a holding to the specific facts of the case exemplifies the seemingly arbitrary manner of adjudication for which the agency has gained notoriety. Judge Henry Friendly wrote in 1962 that the FCC's opinion writers "remain free to pull [prior authorities] out of the drawer whenever the agency wishes to reach a result supportable by the old rule but not the new." Henry J. Friendly, *The Federal Administrative Agencies* 63 (Harvard University Press, 1962). See also Matthew L. Spitzer, *Multicriteria Choice Processes: An Application of Public Choice Theory* to Bakke, *the FCC, and the Courts*, 88 Yale LJ 717, 746 (1979); *Doubleday Broadcasting Co. v FCC*, 655 F2d 417, 423 (DC Cir 1981).

[81] 340 F2d 781, 783 (DC Cir 1964).

[82] *Stereo Broadcasters, Inc v FCC*, 652 F2d 1026, 1027 (DC Cir 1981) (quoting *Northland Television, Inc*, 42 Rad Reg 2d (P & F) 1107, 1110 ¶ 6 (1978)).

[83] 47 USC §§ 307(c), 309(a).

[84] See *National Broadcasting Co*, 21 Rad Reg (P & F) 524, 527 ¶ 3 (1961); cf *WDUL Television Corp*, 2 Rad Reg 2d (P & F) 131, 140 ¶ 14 (1964).

[85] 47 USC § 307(c).

[86] 5 USC § 558(c).

pen to him is that he might have to sell his station."[87] These passages show that both the D.C. Circuit and the FCC recognize that the Commission loses its leverage over a licensee when his exit is costless. The licensee must face the prospect of leaving something on the table. Denial of renewal must entail an opportunity cost. But that cannot happen unless either (1) the FCC can credibly signal that it can give the broadcaster the opportunity upon renewal to earn monopoly rent, or (2) the broadcaster stands to lose a stream of quasi rent, which can only occur if the broadcaster has made sunk investments, some portion of which remains undepreciated when the FCC denies renewal and effectively shuts down the station.

The FCC has carved multiple exceptions to *Jefferson Radio*'s principle of capital immobility. It has permitted the transfer of a station when the licensee is seriously ill or disabled[88] or bankrupt.[89] It has permitted "distress sales" of stations to minority purchasers at 75 percent of fair market value.[90] And, as in the 1988 RKO-Disney settlement, the FCC has made ad hoc exceptions that rely on repeated references to the "unique" facts of the case—as if not every case is factually unique.[91] In short, the degree to which the FCC actually finds *Jefferson Radio* to restrict the alienability of licenses appears to be negotiable—a result more consistent with a regulatory goal of rent extraction than of total confiscation or destruction of rent.

Still, to maintain a credible threat, the FCC must deny renewal of a broadcaster's license on occasion, which it does most often in cases of broadcasters in very small markets who are likely to have limited resources to litigate successfully up to the D.C. Circuit.[92] A broadcast licensee in renewal bears the burden of proof to establish his qualifi-

[87] *Tidewater Teleradio, Inc,* 24 Rad Reg (P & F) 643, 657 ¶ 7 (1962), cited in *Jefferson Radio,* 340 F2d at 781-83 n.1.

[88] See *In re Application of Cathryn C. Murphy,* 42 FCC 2d 346 (1973).

[89] See *In re Application of Second Thursday Corp,* 22 FCC 2d 515 (1970); *In re Application of Oyate, Inc,* 3 FCC Rcd 6759 (1988).

[90] See *Statement of Policy on Minority Ownership of Broadcasting Facilities,* 68 FCC 2d 979, *clarified,* 44 Rad Reg (P & F) 2d 479 (1978).

[91] See *RKO General, Inc* 3 FCC Rcd At 5043 ¶¶ 3, 33, 40, 45, 49 (1988); see also *Spanish Intl Communications Corp,* 2 FCC Rcd 3336 (1987); *George E. Cameron, Jr. Communications,* 56 Rad Reg 2d (P & F) 825 (1984).

[92] For example, the licensee in *Catoctin Broadcasting Corp of New York,* 2 FCC Rcd 2126 (Rev Bd 1987), was represented by three apparently unrelated sets of attorneys between the time of the ALJ's initial decision and the licensee's filing of exceptions to that decision (that is, the filing of an appeal before the FCC's Review Board). Id at 2138 n.1. The Review Board affirmed the ALJ's determination that the licensee was unqualified to be renewed, Id at 2137-38 ¶ 85, as did the full Commission, 4 FCC Rcd 2553, *recon. denied,* 4 FCC Rcd 6312 (1989).

cation to be renewed. If accused of having discriminated in hiring on the basis of race, for example, he must prove that he did not do so—by a preponderance of the evidence, even if that requires him to prove the negative, such as the absence of an intent to discriminate. Private parties might directly intervene in the process of rent extraction, as in the strategic use of the renewal process by persons seeking monetary or political gain.[93]

IV. THE EVOLUTION OF REGULATORY METHODS TO INFLUENCE BROADCAST CONTENT

Rent extraction is consistent with the experience of content control in American broadcast regulation. Censorship has been evident in the licensing of broadcasters since the days of the Federal Radio Commission (FRC), the predecessor to the FCC. Half a century later, the FCC was using a more refined form of "structural" regulation in conjunction with the licensing process to punish disfavored speech.

A. Censorship by the Federal Radio Commission and Early FCC

In *Near* v. *Minnesota,*[94] the Supreme Court in 1931 invalidated a Minnesota law that permitted the state's courts to suppress the publication of any "malicious, scandalous or defamatory newspaper."[95] *Near* expanded the definition of "prior restraint" to include cases enjoining an individual from future speech on the basis of past speech. *Near* stands in stark contrast to the *KFKB*[96] and *Trinity Methodist Church*[97] cases of the same era. In *KFKB,* the FRC denied renewal

[93] In *Catoctin,* for example, the broadcaster was a sole proprietor. He was found to be unqualified to be renewed, largely on the basis of evidence provided by a local faction with whom the broadcaster (who was also a landlord) had a dispute over a proposal to build public housing in his small town. The case became intensely controversial because the broadcaster also was accused by his adversaries of racial discrimination in hiring. The broadcaster had worked for thirty years at stations within a narrow strip along the Lake Erie shore, and the chairman of the FCC's Review Board observed that the broadcaster would salvage little value from his station, "which he labored several decades to acquire." *Catoctin,* 2 FCC Rcd at 2139 (separate statement of Review Board Chairman Marino). The full Commission denied renewal without commenting on the First Amendment implications of the case. *Catoctin Broadcasting Corp of New York,* 4 FCC Rcd 2553 (1989).

[94] 283 US 697 (1931).

[95] Id at 706, 722-23 (1931).

[96] *KFKB Broadcasting v FRC,* 47 F2d 670 (DC Cir 1931).

[97] *Trinity Methodist Church, South v FRC,* 62 F2d 850 (DC Cir 1932). The definitive analysis of these cases is Thomas G. Krattenmaker & Lucas A. Powe, Jr., *Regulat-*

of the license of an individual who regularly broadcast radio programs discussing medical problems that listeners described to him by letter. The FRC found the program "inimical to the public health and safety" and thus "not in the public interest."[98] The D.C. Circuit upheld the FRC's action and stated that the agency "is necessarily called upon to consider the character and quality of the service to be rendered" and that it thus had an undoubted right to examine past performance.[99]

The result in *KFKB* comports with *Trinity Methodist Church*, in which the FRC ordered a radio station off the air because its owner, an evangelical preacher, had broadcast editorials attacking the decadence of Los Angeles city government. The FRC found the preacher's broadcasts "sensational rather than instructive."[100] The same might have been said for the newspaper that the Supreme Court the year before had protected from prior restraint in *Near*, yet the state was forbidden to enjoin the publication of even a single issue—no one even contemplated shutting down the newspaper. The D.C. Circuit upheld the FRC's action in *Trinity Methodist Church*, granting the agency broad discretion to consider the character and quality of programming. The court saw no denial of free speech, "merely the application of the regulatory power of Congress in a field within the scope of its legislative power."[101]

The FRC became the FCC when the Communications Act became law on June 19, 1934.[102] From its inception, the FCC used its license-renewal powers to suppress speech that it disfavored and to promote speech that it deemed, euphemistically, to be "meritorious." In section 326 of the new act, Congress provided in part: "Nothing in this Act shall be understood or construed to give the Commission the power of censorship over the radio communications or signals transmitted by any radio station, and no regulation or condition shall be promulgated or fixed by the Commission which shall interfere with the right of free speech by means of radio communication."[103] Yet the FCC's first reported decisions are remarkable for the extent to which the agency explicitly used the content of broadcast speech to decide whether to renew a broadcast license.

The FCC's first reported license renewal proceeding concerned sta-

ing Broadcast Programming 24-28 (MIT Press, 1994), and Lucas A. Powe, Jr., *American Broadcasting and the First Amendment* 13-27 (California, 1987).

[98] *KFKB*, 47 F2d at 671.

[99] Id at 672.

[100] *Trinity Methodist Church*, 62 F2d at 851.

[101] Id.

[102] Pub L No 73-416, 48 Stat 1064 (1934).

[103] 47 USC § 326.

tion WSBT in South Bend, Indiana.[104] Discussion of broadcast content in the FCC's decision of July 13, 1934, was brief and relatively innocuous compared with the decisions that would shortly follow. The station's service was found to be "meritorious and well designed to satisfy the needs and interests of the South Bend area."[105] One statement suggests what the FCC understood to be "meritorious" programming: "A liberal policy is followed by the applicant in its cooperation with local civic and philanthropic activities and considerable time over the stations is devoted to such matters."[106] That statement comports with the view that broadcast regulation has had the effect, by inducing the broadcaster to include certain kinds of programming, of directing a licensee to subsidize certain favored interest groups or government initiatives.

The renewal process enabled the FCC not only to encourage the broadcast of some kinds of programs and messages, but also to discourage the broadcast of others. In March 1935, the FCC ruled on the renewal application of station WHOM in Jersey City, New Jersey, in *New Jersey Broadcasting Corporation.*[107] The renewal application had been designated for hearing to determine "[t]he nature and character of the service rendered and the programs broadcast by Station WHOM."[108] The hearing examiner recommended renewal, "although certain programs did not serve or at least were of doubtful public interest."[109] Reviewing the hearing examiner's findings, the FCC recounted that "[a] careful examination of this log reveals that programs of a community, civic, charitable, religious, and educational nature constituted a substantial portion of the station's time."[110] The FCC discussed at length the meritorious programs about the Society for the Prevention of Cruelty to Animals, about history, about birds, about opera. Then, however, the FCC stated:

> The Commission received certain complaints concerning programs broadcast over Station WHOM by the Hill Medical Office, Modern Medical Associates, Medicated Air Institute, the Tri-Boro Racing Guide, and Barbara Toy. The Commission

[104] *In re application of John L. Hopkins*, 1 FCC 117, 125-27 (1934). A Chicago station also was addressed in the renewal proceeding.

[105] Id at 128. The phrase "needs and interests" became an FCC mantra. When discussing broadcasting, the agency still rarely speaks simply of "consumer demand."

[106] Id.

[107] 1 FCC 224 (1935).

[108] Id at 224.

[109] Id at 225.

[110] Id.

> has made a careful review of these programs, as a result of which it is impelled to the belief that the programs broadcast by the Hill Medical Office, Modern Medical Associates, and the Medicated Air Institute were of doubtful public interest; that the programs broadcast over Station WHOM by the Tri-Boro Racing Guide and Barbara Toy did not serve public interest, convenience, and necessity. However, the large majority of programs broadcast by the station were generally meritorious and did serve public interest, convenience, and necessity, and that the programs of the Hill Medical Office, Modern Medical Associates, Medicated Air Institute, Tri-Boro Racing Guide, and Barbara Toy *have been discontinued by the station.*[111]

Thus, in its very first year of existence, in volume 1 of the *FCC Reports,* the FCC implied in *New Jersey Broadcasting* that it was renewing the license for WHOM on the expectation that the specific programming found not to be in the public interest would not recur. The conditional nature of the FCC's renewal decision could have been plainer only if the agency had said explicitly that WHOM could have its license renewed as long as it stopped broadcasting programs about horse races.

The instances of FCC influence over program content since 1934 are simply too numerous to chronicle. Some of those episodes would shock the conscience of current-day defenders of free speech, wherever they stand on the political spectrum. For example, by August 1935 the FCC sternly disapproved of another controversial subject matter—advertisements for birth control products. In *Knickerbocker Broadcasting Co.,*[112] a renewal proceeding for station WMCA in New York City, the FCC first praised the broadcaster because "[m]any of the accomplished and popular present-day radio stars were introduced to the public through the medium of the WMCA microphone."[113] But the FCC then castigated the broadcaster for its unacceptable content regarding birth control:

> Contrasted with the above meritorious conduct, however, are the activities of Station WMCA relative to certain advertising broadcasts of the product "Birconjel," entitled "Modern Women's Serenade." This program was of short duration, being broadcast for several days during March 1935. It must be termed offensive and contrary to the public interest. Mere use of the name suggests child-birth control. During the program in question sentimen-

[111] Id at 225-26 (emphasis added).
[112] 2 FCC 76 (1935).
[113] Id at 77.

> tal or suggestive music was interwoven with talks explanatory of the objectionable subject matter. Bluntly speaking, listeners from all walks of life were advised and encouraged, in terms unequivocal, that through the use of a particular medical or chemical compound, they might avoid the consequences either of child-birth or moral impropriety. Acceptance of the program was originally declined by the station authorities, but later contracted for with considerable reluctance and caution.
>
> . . . It was the Commission's original impression that the imposition upon the public of Modern Women's Serenade, heretofore described, was so unconscionable as to outweigh the merit incident to the good record heretofore established by the station, and make mandatory a denial of its application for renewal of license; but upon further consideration and careful scrutiny of the past *and proposed future conduct of Station WMCA*, the conclusion was reached that the continued operation of WMCA would serve public interest, convenience, or necessity.[114]

Today, of course, any similar attempt by the FCC to use the license renewal process to stifle discussion of reproductive rights would cause a constitutional firestorm.[115] There is no reason to suppose, however, that a regulator's propensity to condition, implicitly or explicitly, the renewal of a broadcaster's license on his avoidance of disfavored content should be limited to any one subject.

B. The Newspaper-Television Cross-Ownership Rule: The Endogeneity between the Method of Censorship and the Level of Judicial Review

In 1975, the FCC articulated two purposes for the newspaper-television cross-ownership rule: the promotion of "diversity of viewpoints" and the promotion of "economic competition."[116] Both goals have been irreversibly achieved. In the age of the Internet, the assertion that viewpoints on any issue are insufficiently diverse is hard to credit.[117] Nor is the industry-specific, prophylactic newspaper-television cross-ownership rule needed to protect competition. The Sherman and Clayton Acts suffice. In 1978, the Supreme Court upheld the consti-

[114] Id (emphasis added).

[115] See *Rust v Sullivan*, 500 US 173 (1991).

[116] See *Multiple Ownership of Standard, FM, and Television Broadcast Stations, Second Report and Order*, 50 FCC 2d 1046, 1074 ¶ 99 (1975); see also *Tribune Co. v FCC*, 133 F3d 61, 64 (DC Cir 1998).

[117] See, e.g., Bruce M. Owen, *The Internet Challenge to Television* (Harvard, 1999).

tutionality of the newspaper-television cross-ownership rule against a facial challenge in *FCC* v. *National Citizens Committee for Broadcasting*.[118] But the factual record upon which that decision rested is long obsolete. It would be a formidable abridgment of speech for the FCC to continue to confer or withhold a person's opportunity to engage in broadcast speech depending on whether his message or other lines of business comport with a conception of "diversity" that reflected the state of competition and technology in the media marketplace a quarter century earlier.

The FCC's justification for the newspaper-television cross-ownership rule has been that the electromagnetic spectrum is a scarce resource, and that the attainment of diversity and competition in broadcasting necessitates, paradoxically, barriers to entry. But economists have long recognized that spectrum scarcity cannot logically justify structural regulation of broadcasting.[119] On occasion, individual FCC commissioners have offered two additional justifications for the rule.[120] The first is that the effect of the broadcast media is "pervasive." But this argument essentially says that the government may regulate more intrusively speech that is especially communicative. The second rationale is that the spectrum is public property and that the FCC consequently may impose conditions on its use. Even if one accepts the premise that the government owns the spectrum, public ownership cannot justify retaining the newspaper-television cross-ownership rule, for the rule is a blanket ban rather than a tailored regulation of the time, manner, and place of speech in a public place. In short, spectrum scarcity, "pervasiveness," and public ownership cannot explain why the newspaper-television cross-ownership rule persists in the face of evident diversity of viewpoints and economic competition. Even in 2003, the FCC could bring itself

[118] 436 US 775 (1978).

[119] The seminal paper is Ronald H. Coase, *The Federal Communications Commission*, 2 JL & Econ 1, 14 (1959); see also Thomas W. Hazlett, *Physical Scarcity, Rent Seeking, and the First Amendment*, 97 Colum L Rev 905 (1997); Thomas W. Hazlett, *The Rationality of U.S. Regulation of the Broadcast Spectrum*, 33 JL & Econ 133 (1990). Judge Stephen Williams similarly has observed: "Alleviation of interference does not necessitate government content management; it requires, as do most problems of efficient use of resources, a system for allocation and protection of exclusive property rights." *Time Warner Entertainment Co. v FCC*, 105 F3d 723, 725 (DC Cir 1997) (Williams, J., dissenting from the denial of rehearing *en banc*). He has disapprovingly described "spectrum scarcity" as "the idea that an excess of demand over supply at a price of zero justifies a unique First Amendment regime." Id at 724.

[120] See, e.g., *In Matter of 1998 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, 15 FCC Rcd 11,058 (2000).

only to tinker with the rule, not junk it.[121] It is telling that within days the Senate telecommunications subcommittee approved a bill that would reverse the FCC's modest attenuation of the rule.[122]

The Supreme Court long ago established that government regulation that is ostensibly content-neutral may nonetheless be enforced in a manner that unconstitutionally infringes freedom of speech.[123] The newspaper-television cross-ownership rule does not make any direct reference to content. The restrictions do not distinguish between types of speech. According to that view, the limits on newspaper ownership apply regardless of what the broadcaster wishes to say, and the limits on television station ownership apply regardless of what the newspaper publisher wishes to say. On its face, the rule is content-neutral. A court, however, will deem a law that is content-neutral on its face to be content-related if there is evidence that the statute was intended to suppress certain content.[124] "Our cases have recognized," said the Supreme Court in 1994 in *Turner Broadcasting System, Inc.* v. *FCC*,[125] "that even a regulation neutral on its face may be content-based if its manifest purpose is to regulate speech because of the message it conveys."[126] The newspaper-television cross-ownership rule does single out a class of speakers—newspaper publishers in a given city, among all other possible speakers—for differential treatment. It presumes the speech of newspaper publishers in a particular city to be inherently unmeritorious and thereupon limits speech solely on the basis of its source. Legislation that singles out certain speakers for differential treatment is treated with suspicion.[127] As Justice O'Connor's dissent in *Turner* explained: "Laws that treat all speakers equally are relatively poor tools for controlling public de-

[121] *In the Matter of 2002 Biennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996; Cross-Ownership of Broadcast Stations and Newspapers; Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets; Definition of Radio Markets; Definition of Radio Markets for Areas Not Located in an Arbitron Survey Area, MB Docket 02-277, Report and Order and Notice of Proposed Rulemaking,* MM Dkts. 01-235, 01-317, 00-244, 03-130, at ¶¶ 327-69 (released July 2, 2003) [hereinafter *2003 Media Ownership Order*].

[122] Steven Labaton, *Senators Take Steps to Reinstate Limits on Media Holdings*, NY Times at A1 (June 20, 2003) ("Moving with unusual speed, the Senate today began the process of reversing the recent decision by federal regulators to loosen media ownership rules and enable the nation's largest newspaper and broadcasting conglomerates to grown even larger").

[123] *Grosjean v American Press Co.*, 297 US 233 (1936).

[124] See *Texas v Johnson*, 491 US 397, 402 (1989).

[125] 512 US 662 (1994).

[126] Id at 645.

[127] See, e.g., *Minneapolis Star & Tribune Co. v Minnesota Commissioner of Revenue*, 460 US 575, 584, 591-92 (1983).

bate, and their very generality creates a substantial political check that prevents them from being unduly burdensome. Laws that single out particular speakers are substantially more dangerous, even when they do not draw explicit content distinctions."[128]

A reviewing court should ask whether the newspaper-television cross-ownership rule persists in the face of manifest diversity and competition because it is an effective means to achieve an unstated goal that differs entirely from the prevention of monopoly in the marketplace of ideas or the marketplace for advertising. If, after multiple attempts over the span of more than a quarter century, the FCC cannot cogently say what good the rule serves in a market that is already highly diverse and highly competitive, then a reviewing court should ask what *bad* the rule might serve. What might explain the rule's longevity? After all, the rule was made by the FCC without statutory imperative and can be discarded by the same agency, not to mention by the Court of Appeals.

A court could easily hypothesize an illegitimate purpose that is consistent with the rule's continued existence. By constraining a broadcaster's ability to achieve economies of scope with respect to newspaper publishing, the newspaper-television cross-ownership rule increases the degree of asset specificity of investments made by the broadcaster. The extent of rent extraction to which the broadcaster is vulnerable is an increasing function of the degree of asset specificity of his investment in the licensed television station. One manifestation of rent extraction imposed on a broadcaster can be content control or censorship, as in the case of incrementally unremunerative programming that the FCC compels the broadcaster to air or incrementally profitable programming that the FCC deters the broadcaster from airing. The broadcaster's ability to resist the FCC's attempt at content control, which the agency ultimately expresses through the threat of denying renewal of the broadcaster's television license, is reduced if the FCC can block the broadcaster's ability to reduce the degree of asset specificity (and hence the cost of mandatory exit from the market) by achieving economies of scope with newspaper publishing in the same locale. If the broadcaster had no amount of undepreciated asset-specific investment at the end of his license term, then the threat of expropriation would be meaningless, as exit from the local television market would cost the broadcaster nothing. The consequences to the broadcaster of not accommodating those powerful enough to influence the FCC would be that the broadcaster would simply walk away from his station, with no economic loss. The government's ability to extract rents in that circumstance would

[128] *Turner*, 512 US at 676 (O'Connor, J., dissenting).

be nil. In contrast, as soon as the broadcaster makes long-lived, asset-specific investment in the station, he becomes vulnerable to rent expropriation and rent extraction. To avoid the risk that he will suffer total expropriation of (1) the entire quasi-rent associated with the asset-specific investment in his station and (2) the privately created economic rents earned by that station, the broadcaster may find it expedient to acquiesce, through compliant or obsequious programming choices, to the FCC's extraction of a lesser percentage of those quasi-rents or economic rents. The FCC's threat of denial of renewal need not be frequently employed for the strategy of rent extraction to be successful.

The newspaper-television cross-ownership rule limits the broadcaster's ability to reduce the extent of his investment that can be held hostage to such threats of rent extraction by the FCC. In this respect, the newspaper-television cross-ownership rule—despite being ostensibly "structural" regulation of the broadcasting industry—is actually antithetical to a free press. It is therefore too simplistic for a reviewing court to characterize the rule as merely structural regulation entitled to only a lesser level of judicial scrutiny under the First Amendment. It is *precisely because* a structural rule receives superficial scrutiny from a reviewing court that the FCC would prefer the newspaper-television cross-ownership rule to an obviously content-based rule as the means by which to extract rents from licensees. The ham-handed censorship evident in the FCC's early license renewal cases would never pass constitutional muster today. So it not surprising that more sophisticated regulatory practices would evolve since the 1930s to accomplish the same objective of influencing broadcast content. The expected intensity of judicial review endogenously influences the regulatory form that broadcast censorship will take.

If a television broadcaster could mitigate the risk of rent extraction by achieving economies of scope with a daily newspaper, the FCC's most direct countermove would be to forbid cross-ownership. The rule prevents the broadcaster from reducing the degree of asset specificity of his investment in his television station and thus reducing the magnitude of his potential loss if he is subjected to extractive regulatory policies. The rule makes a broadcaster more vulnerable to retaliation if his news reporting and commentary offended politicians or powerful private factions. Cross-ownership of newspapers and television stations promotes robust reporting on political events in a manner reminiscent of *New York Times v. Sullivan*,[129] which almost completely insulates the press from defamation claims by public figures.

[129] 376 US 254 (1964).

One would therefore expect that a newspaper-television pair grandfathered under the newspaper-television cross-ownership rule would address more controversial subjects, and report on them more forcefully, than would a broadcaster forbidden by the rule from owning a daily newspaper in the same city. One would also expect that, because it had achieved a way to mitigate the risk of rent extraction by regulation, a newspaper-television pair would undertake a greater level of long-lived asset-specific investment than would a broadcaster forbidden by the rule from owning a daily newspaper in the same city.

C. Previous Abuse of the Newspaper-Television Cross-Ownership Rule

In 1988, the D.C. Circuit ruled in *News America Publishing, Inc.* v. *FCC*[130] that a key aspect of the FCC's enforcement of the newspaper-television cross-ownership rule violated the First Amendment.[131] That finding is remarkable, considering that the FCC's stated purpose for the rule has been to increase the diversity of viewpoints expressed by broadcasters. In August 1987, amid fanfare and controversy, the FCC abolished the Fairness Doctrine in *Syracuse Peace Council.*[132] The FCC concluded that the policy had deterred controversial speech by broadcasters and that the purported scarcity of the electromagnetic spectrum could not justify regulating the content of the broadcast press.[133] The FCC soon back-pedaled under political pressure. A few months later, the FCC threatened to deny renewal of the license for WXNE-TV, a Boston television station owned by Rupert Murdoch's company, News America Publishing, because it also owned the *Boston Herald* newspaper. By February of 1988, the FCC was arguing to the D.C. Circuit that *Syracuse Peace Council* rested narrowly on the "conclusion . . . that scarcity did not justify content regulation," and that the decision was therefore irrelevant to "structural regulation of ownership requirements,"[134] such as the newspaper-television cross-ownership rule invoked against Murdoch. That reasoning is re-

[130] 844 F2d 800 (DC Cir 1988).

[131] Id.

[132] *Syracuse Peace Council,* 2 FCC Rcd 5043 (1987), affd, 867 F2d 654, 656 (DC Cir 1989).

[133] See id at 5054-55 ¶ 73-80.

[134] Brief for the Federal Communications Commission at 20, *News Am. Publishing, Inc v FCC,* 844 F2d 800 (DC Cir 1988). The case was argued on February 11, 1988. Briefing, of course, was completed several months earlier. I was deputy general counsel of the FCC at the time, and my name appeared on the agency's brief to the D.C. Circuit. I recommended, unsuccessfully, to decision makers within the FCC that the agency notify Congress that the FCC could not defend in court the constitutionality of the appropriations rider.

markable because of the evidence of a congressional intent to use the rule to punish an irksome broadcaster and publisher.

Murdoch was able to operate his newspaper-television pair in Boston by virtue of a temporary waiver of the newspaper-television cross-ownership rule that the FCC had granted to the television station. The FCC automatically grants a temporary waiver for one year or until the license renewal date, whichever is longer, when a broadcast licensee acquires a daily newspaper, or when a newspaper publisher acquires a broadcast station, subject to the rule.[135] In November 1986, when News America acquired WXNE-TV, it already owned the *Boston Herald*, and thus the company sought and received from the FCC a temporary waiver of the newspaper-television cross-ownership rule lasting until June 30, 1988.[136] Murdoch subsequently advocated, through a coalition of newspaper publishers that included the *Washington Post* and Times Mirror, the FCC's abolition of the newspaper-television cross-ownership rule.[137]

Three days before Christmas of 1987, Congress passed a single 471-page "continuing resolution," printed only in a 1,194-page conference report, which contained appropriations for the entire federal government. Senator Ernest Hollings inserted the following rider into the resolution, which became law:

> Provided, further, that none of the funds appropriated by this Act or any other Act may be used to repeal, to retroactively apply changes in, or to begin or continue a re-examination of the rules of the Federal Communications Commission with respect to the common ownership of a daily newspaper and a television station where the grade A contour of the television station encompasses the entire community in which the newspaper is published, or to extend the time period of current grants of temporary waivers to achieve compliance with such rules . . . .[138]

Murdoch sued the FCC, challenging the appropriations rider on multiple constitutional grounds. Writing for the D.C. Circuit, Judge Stephen Williams dubbed the rider the "Hollings Amendment" and noted that its prohibition on extensions of temporary waivers of the newspaper-television cross-ownership rule affected only one company, New America Publishing: "The critical last 18 words of the

[135] *News America*, 844 F2d at 802-03.

[136] Id at 804. Murdoch owned television stations in New York City and Chicago. By the time that the D.C. Circuit heard *News America*, he had sold the *Chicago Sun-Times* and the *New York Post* to comply with the newspaper-television cross-ownership rule in those two cities. Id.

[137] Id at 808.

[138] Id at 802.

Amendment are general in form but not in reality; they burden a single publisher/broadcaster."[139] The Amendment "in fact . . . covers only Murdoch,"[140] he wrote, and it "strikes at Murdoch with the precision of a laser beam."[141]

Various members of the Senate made post-enactment statements in the *Congressional Record* to support the assertion that the Hollings Amendment was not directed solely at Murdoch. The D.C. Circuit did not believe these statements,[142] even though it ultimately concluded that it was unnecessary to consider congressional intent because, even without proof of such motivation, the appropriations rider violated the First Amendment.[143] Judge Williams wrote that "the full text of the post-enactment Senate discussion, whatever its weight, serves to confirm our view that the Hollings Amendment was directed solely at Rupert Murdoch and his media holdings."[144] The examples were numerous. Senator Edward Kennedy said:

> Mr. Murdoch was well aware of the law when he acquired his television stations in Boston and New York. He had a choice then, and he has a choice now. He can keep his newspaper—or he can keep his broadcasting station. But he cannot keep them both . . . . The principle is right—and Rupert Murdoch is wrong to try to change it. Instead of attacking me, he should try to explain why he thinks he's entitled to an exemption from the law.[145]

Senator Hollings criticized Murdoch's participation in the coalition seeking abolition of the newspaper-television cross-ownership rule:

> Nobody appeared in opposition to the cross-ownership rules other than this sneaky operation of Rupert Murdoch. Now, I found out that the prevaricator and the manipulator has gotten the high road of the headlines and editorials . . . .[146]

Senator Timothy Wirth insisted that the Hollings Amendment "has nothing to do with the politics of Massachusetts" or "with editorial cartoons."[147] He also noted that "Rupert Murdoch . . . arrived here

[139] Id.

[140] Id at 805.

[141] Id at 814.

[142] Id at 806-07 ("Even in ordinary circumstances courts give little or no weight to such post-enactment statements. Here the timing renders the statements still more suspect.") (citations omitted).

[143] Id at 810.

[144] Id at 807.

[145] Id at 808 (citing 134 Cong Rec S59 (daily ed. Jan. 27, 1988) (remarks of Sen. Kennedy)).

[146] Id (citing 134 Cong Rec S59 (daily ed. Jan. 27, 1988) (remarks of Sen. Hollings)).

[147] Id at 809 (citing 134 Cong Rec S67 (daily ed. Jan. 27, 1988) (remarks of Sen. Wirth)).

from Australia."[148] Senator Lowell Weicker had a different criticism than the country of birth of Murdoch, a naturalized American:

> As one who, by innuendo, has been dragged through the mud by Mr. Murdoch, as one who woke up one morning to read that I had a Communist spy nest in my office because a young intern, unpaid, happened to talk to somebody on the streets of Washington, I can assure you that when it comes to media ownership in the United States, my doubts have nothing to do with his citizenship. I just think he probably is the No. 1 dirt bag owner of any publications or media in this Nation.[149]

Far from being convinced that these post-enactment statements proved the Hollings Amendment to be not directed solely at Murdoch, the D.C. Circuit regarded such statements as "clues of heated criticism of several senators by Murdoch's papers."[150]

The D.C. Circuit rejected the FCC's argument that structural broadcast regulation should automatically receive a less intense standard of judicial review than content regulation. Even content-neutral FCC regulations that purport to address solely matters of market structure must be scrutinized "under a test more stringent than the 'minimum rationality' criterion typically used for conventional economic legislation under equal protection analysis."[151] The court characterized broadcast regulation as a continuum, such that ostensibly structural regulations can have the practical effect of restricting broadcasters' freedom of speech: "Clearly one can array possible rules on a spectrum from the purely content-based (e.g., 'No one shall criticize the President') to the purely structural (e.g., the cross-ownership rules themselves)."[152] Along that continuum, a structural prohibition may be "structural only in form," revealing "well recognized ambiguities in the content/structure dichotomy."[153]

With this insight, the D.C. Circuit found that "the Hollings Amendment is far from purely structural. Indeed, it is structural only in form, as it applies to a closed class of one publisher broadcaster."[154] The court found the Amendment "astonishingly underinclusive" in terms of advancing the putative legislative purpose that the FCC retroactively "hypothesized"—to prevent temporary waivers of the

[148] Id (citing 134 Cong Rec S141 (daily ed. Jan. 27, 1988) (remarks of Sen. Wirth)).

[149] Id (citing 134 Cong Rec S142 (daily ed. Jan. 27, 1988) (remarks of Sen. Weicker)).

[150] Id at 810.

[151] Id at 802; see also id at 814.

[152] Id at 812.

[153] Id (citing Geoffrey R. Stone, *Restrictions of Speech Because of Its Content: The Peculiar Case of Subject-Matter Restrictions*, 46 U Chi L Rev 81 (1978)).

[154] Id.

newspaper-television cross-ownership from becoming permanent through repeated extension.[155] There were many ways to write a statute to do that without producing a law applicable solely to Murdoch, the court noted.[156] "In short," the D.C. Circuit said, "every publisher in the country other than Murdoch can knock on the FCC's door and seek the exercise of its discretion to secure, either by a single temporary waiver or by a waiver coupled with an extension, a period of exemption from the cross-ownership restrictions longer than that to which News America is restricted as a matter of law."[157]

For fifteen years, the FCC responded to the *News America* decision by ignoring it. From 1988 to June 2003, while the *FCC Record* has sprawled over several hundred thousand pages, the FCC cited *New America* only four times in its own decisions, and then only for a minor procedural proposition unrelated to the constitutionality of the newspaper-television cross-ownership rule or the proper level of scrutiny of broadcast regulation under the First Amendment.[158] In its report and order on media ownership in July 2003, the FCC for the first time acknowledged *News America* for the proposition that "strict scrutiny [has been] applied to structural regulations that had a direct effect on content and viewpoint."[159]

V. CONCLUSION

Federal regulators since the early 1930s have sought to control broadcast content. With that experience as prologue, the FCC's sustained inability to provide a persuasive rationale for the newspaper-television cross-ownership rule invites the question whether the rule serves a function that is politically expedient, opaque, and durable—but constitutionally illegitimate. Through economic analysis, one can hypothesize such a function. Though ostensibly a structural regulation of the broadcast industry, the newspaper-television cross-ownership rule increases a broadcaster's vulnerability to political efforts to control content. The rule does so by raising the amount of the broad-

[155] Id at 814.

[156] Id.

[157] Id.

[158] The FCC cited *New America* only for the proposition that a request for a permanent waiver of an FCC rule entails a "considerably heavier" burden of justification than a temporary waiver. See *Kortes Communications, Inc*, 15 FCC Rcd 11,846, 11,851 ¶ 15 n.13 (2000); *Columbia Montour Broadcasting Co., Memorandum Opinion and Order*, 13 FCC Rcd 13007 ¶ 18 (1998); *Stockholders of Renaissance Communications Corp, Memorandum Opinion and Order*, 12 FCC Rcd. 11,866, 11,884 ¶ 43 (1997); *Newspaper/Radio Cross-Ownership Waiver Policy, Notice of Inquiry*, 11 FCC Rcd 13,003, 13,005-06 ¶ 4 n.15 (1996).

[159] *2003 Media Ownership Order*, *supra* note 121, at n.1369.

caster's investment in his station that is at risk of loss if the FCC does not renew his license. Asset-specific investment by the broadcaster exposes him to the risk that the regulator can influence the broadcaster's content choices by threatening to terminate the revenue stream necessary to recover the portion of the cost of his asset-specific investment that remains undepreciated at the end of the current license term. The regulator's ability to block cost recovery of the broadcaster's undepreciated asset-specific investments thus can provide the lever for government control of broadcast content. Extreme skepticism is therefore warranted when the FCC represents that the newspaper-television cross-ownership rule has no potential to infringe freedom of speech or of the press. *News America* is evidence that enforcement of the rule by the FCC is susceptible to influence by those in government who wish to punish publishers and broadcasters who criticize powerful public officials.