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WHAT STANDARDS APPLY TO TELEVISION MARKET ANALYSIS?

Recently, after an extensive and lengthy investigtion, the Antitrust Division of the U.S. Department of Justice permitted a Local Marketing Agreement (LMA) between two television stations in Columbus, Ohio. Sinclair Broadcasting Group sought to acquire the assets of River City Broadcasting's Columbus television station and to operate the station under an LMA. Sinclair sought an LMA, which permits joint sales of advertising, instead of acquiring the River City license because common ownership of two television licenses in a single market is prohibited by Federal Communication Commission (FCC) regulations. At issue in the Division's investigation was whether the price of television advertising time to advertisers in Columbus, Ohio would rise as a result of the proposed LMA. It appears that the Division was reluctant to apply the same standards to television mergers that it applies to radio mergers even when the fact patterns were very similar.

When the Columbus LMA was first proposed, it was not clear how the antitrust authorities would evaluate its competitive implications. There was little antitrust history for an LMA in television. In 1994, the Division examined and permitted a television LMA in Cleveland, Ohio. That LMA, however, involved two UHF stations in a larger market with more stations. The most relevant recent experience appeared to be in the significant consolidation that has occurred in the radio industry as a result of the Telecommunications Act of 1996, which eliminated national ownership limits and relaxed local ownership limits. The radio industry had sought this change because extreme fragmentation of the radio industry made radio advertising expensive to buy relative to competing media that offered broader reach. The change in the rule sparked a wave of radio mergers that has significantly changed the radio landscape.

After numerous investigations, settlements and consent decrees relating to radio mergers, the Division's radio merger policy appeared to crystallize around several key points. First, the relevant market would be defined narrowly (e.g., radio only, television only, etc.). Second, market shares of advertising revenue up to 35-40 percent would be acceptable as long as the market had room for three significant competitors. Third, a majority of stations with strong signals could not be owned by a single entity. Fourth, undue concentration in particular demographic groups due to radio station formats would require divestiture.

In August 1997, the parties to the Columbus LMA notified the Division of their intentions to proceed with the LMA. The parties expected speedy approval for several reasons. First, the parties believed that the market for television advertising is quite similar to the market for radio advertising in terms of the degree of difficulty of achieving successful collusion. Market share was not expected to be a problem because the market share of advertising revenue for the proposed LMA would be

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within the safe-harbor limit set by the radio cases, even assuming the Division's inappropriately narrow relevant market. Second, after the proposed LMA Columbus would still have at least two other major competitive television stations (one NBC affiliate and one CBS affiliate), each with strong signals. Finally, there would be no issue of potential unilateral effects for a television merger because broadcast television stations do not have formats (e.g., country, classical) as is prevalent in radio.

One of the apparent reasons for the prolonged nature of the Division's investigation of the proposed LMA was the Division's concern that approval of the Columbus LMA would set a precedent for additional consolidations depending upon the outcome of pending FCC actions on television ownership rules, including the treatment of LMAs. If the "informal radio merger guidelines" were applied without modification to television, virtually every local television market in the nation would be eligible to have an LMA. (Of note, many markets already have LMAs in place.) In a sense, the Division appears to have been looking for an excuse to void the use of the radio merger guidelines outside of radio, even when the fact circumstances in television were quite similar to radio.

In addition to its apparent concerns about establishing a precedent, the Division claimed that the television stations were engaging in price discrimination because advertising spots on a given show were sold to different customers at different prices. If everything else was held constant, the logical inference is the existence of price discrimination, which can only exist if the firms have market power. If market power exists, then the proposed LMA would only make the market power more effective, more permanent or both.

The Division's approach to the price discrimination argument, however, suffered from both theoretical and factual weaknesses. The theoretical weakness is that in markets characterized by perishable products and variable demand, it is well known that seemingly identical products, such as airline seats, can be sold at different prices because they are sold at different times prior to the perishability date. As with airline seats, differences in prices of advertising spots are accounted for by differences in expectations about the likelihood of selling all spots before the air date. In addition, the parties submitted econometric results which undermined the Division's contention that systematic price discrimination against a particular set of customers existed.

As is usually the case, the Division did not indicate why it decided not to challenge the LMA. It may be that the Division was attempting to preserve the fiction of a narrowly defined market of television advertising. Alternatively, it may have been an effort to avoid testing the validity of the price discrimination theory. Further investigations of LMAs may shed more light on the standards that the Division applies in its analysis of television transactions.

Principal Joseph W. McAnneny and Vice President Michael G. Baumann have analyzed numerous radio station acquisitions. They were retained by counsel to Sinclair Broadcasting and River City Broadcasting to analyze the Columbus LMA.

DAMAGES FROM THE ABANDONED CONSOLIDATION OF NON-PROFIT INSTITUTIONS

In early 1994, two non-profit healthcare institutions in Massachusetts, The Sisters of Providence Health System (SPHS) and Holyoke-Chicopee Area Health Resources (Holyoke), entered into a contract to consolidate their institutions. Under the consolidation, all of the Holyoke facilities, assets, and obligations (and the benefits flowing from them) were to be absorbed by SPHS, which would be the surviving entity. In 1995, Holyoke withdrew from the agreed-upon consolidation, giving rise to a suit for damages brought by SPHS. The non-profit nature of Holyoke, which was to be acquired in its entirety, became a crucial aspect of the damages analysis.

The calculation of damages involving an acquisition of assets requires an estimate of the difference between

the value to the acquirer of the assets and the cost of acquiring them. In a case involving for-profit corporations, the cost of the acquisition is often known, at least within certain parameters. Acquisitions of for-profit corporations involve the purchase of assets that are ultimately owned by the shareholders. Those shareholders must receive compensation (shares in the new company, or cash, or both) if the corporation is to be acquired or merged into a new corporate entity. Thus the cost to the acquiring company is readily established. The value of the assets to the purchaser may be more difficult to determine, but it is typically estimated by conventional means. Calculating damages from the breach of an acquisition contract would take into account the expected cost and the estimated value.

The same basic damages analysis applies in a breach of contract involving a non-profit corporation. Harm to the surviving entity would be the difference between the net value to the acquiring firm of the assets and the cost incurred in acquiring them. Non-profit institutions, however, are in effect self-owned; there are no ultimate owners beyond the institution itself. If the non-profit institution is to be acquired in its entirety, there would be no ultimate owners to whom payment for the assets would be made. The acquiring entity incurs no acquisition costs apart from the usual transactional costs. (An exception would arise when only part of the non-profit entity is acquired, and the remaining portion (e.g., a foundation) receives compensation for selling some of its assets.)

On that basis, computing damages in the SPHS/ Holyoke matter becomes conceptually straight-forward. Because SPHS would have incurred no acquisition costs, its damages are equal to the value to SPHS of the Holyoke assets. In this case, damages have two components. Most obvious is the value of the income that the Holyoke assets would have produced on a stand-alone basis. The consolidated system also was expected to create additional value by generating efficiencies (i.e., cost savings) from the combined operation of the two health systems. In order to avoid a possible adverse jury verdict, and under court-ordered mediation, Holyoke agreed to make a substantial payment to SPHS.

Thus, the model for calculating damages in this matter is essentially the same as for a case involving for-profit corporations, but there is at least one fundamental distinction. While the difficulties of establishing the value of the acquired assets remains, determining the acquisition cost for such a transaction is surprisingly simple.

Principal Barry C. Harris and Vice President Paul E. Godek have substantial experience estimating damages in different industries. Dr. Harris testified at trial for SPHS.

THE 1997 EFFICIENCY PROVISIONS IN THE MERGER GUIDELINES

After revision in 1997, the Horizontal Merger Guidelines' section on efficiencies is in many respects identical to the 1992 version. As in the previous version, it discusses the efficiency-enhancing potential of mergers, reiterates the importance of efficiencies being merger-specific and verifiable, and maintains that the expected benefits of any efficiencies must be larger when there is a greater likelihood and magnitude of a potentially adverse impact on competition. The tone of the 1997 revision is, nevertheless, much closer to that of the more restrictive 1968 and 1982 Guidelines. In addition, the 1997 revision differs significantly in limiting efficiencies only to those that might offset possible price effects.

The 1992 version (and the virtually identical 1984 version) begin by noting that the "primary benefit of mergers to the economy is their efficiency-enhancing potential." In contrast, the 1997 version begins by stating that "competition usually spurs firms to achieve efficiencies." Moreover, as was true of the 1968 and 1982 versions, the revised section explicitly characterizes efficiencies as "difficult to verify and quantify" and notes that even reasonable, good-faith projections may not be realized. The 1984 and 1992 versions contain no language that is similarly pessimistic and sweeping.

The revised Guidelines also seem to signal that the agencies would not permit a merger that was anticompetitive even if it produced significant net efficiencies. Specifically, the Guidelines state that the agencies " will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market." In other words, if a merger seemed likely to enhance market power and lead to higher prices, the agencies would only take into account efficiencies that would create the incentive and ability for the merged firm to lower prices, thereby leaving post-merger prices either unchanged or lower. Moreover, the revised Guidelines limit cognizable efficiencies to those that "do not arise from anticompetitive reductions in output or service." Broadly interpreted, this provision could be used to rule out virtually any efficiency claims in mergers that present competitive concerns.

The explicit emphasis on limiting consideration of efficiencies to those that might counteract possible price effects is a significant change from previous policy statements. In the two previous versions of the Guidelines, the agencies explicitly left open the possibility that anticompetitive mergers might nonetheless be allowed if the agencies were convinced that allowing the merger was necessary to achieve significant net efficiencies. The 1984 and 1992 Guidelines explicitly state that "some mergers that the Agency otherwise might challenge may be reasonably necessary to achieve significant net efficiencies."

Broadly interpreted, this provision could be used to rule out virtually any efficiency claims in mergers that present competitive concerns.

The type of efficiencies that would give the merged firm an incentive to reduce prices are those that are likely to reduce marginal rather than fixed costs. Efficiencies that reduce short-run marginal cost may create an incentive for the merged firm to lower prices even if the firm has some market power. In the long run, of course, all costs are marginal, and the revised Guidelines do indicate that these types of costs will be considered. The Guidelines, however, have always had a short-term focus: market definition has always ignored long-term substitution possibilities, and entry that takes more than two years has always been considered irrelevant. While the agencies can always exercise prosecutorial discretion, the 1997 Guidelines seem to indicate that if a merger raised serious competitive concerns, the agencies would give little or no weight to efficiencies that primarily affect fixed costs, even if significant resource savings were at stake.

Many observers have cautioned against the possible dangers of efficiencies as an absolute defense in a merger analysis because of the significant evidentiary problems that typically would be involved in the short period afforded the agencies. It is one thing, however, to warn against the dangers of accepting efficiencies claims too readily while being willing to accept claims if the evidence is clear and convincing. It is another to rule out an entire class of efficiencies or afford efficiencies little weight, regardless of the strength of the claim, because a transaction raises competitive concerns.

The Guidelines have never embraced a formal balancing mechanism, but in recent years they appeared to leave open the possibility that this result could be achieved as a matter of prosecutorial discretion. The 1997 revision appears to narrow the class of efficiencies that are considered cognizable and to rule out the possibility that efficiencies could provide the basis for allowing a transaction that appears to enhance market power. The purpose of the Guidelines is to provide practitioners and their clients with a clear understanding of the enforcement standards. If they are an accurate statement of current policy, the revised Guidelines represent a step backward for those favoring a more liberal approach to efficiencies. In some cases, the resource savings from efficiencies that are given little weight by the agencies could be substantial, and the agencies risk sacrificing these benefits by discouraging some transactions that "may reasonably be necessary to achieve significant net efficiencies."

Principal Bruce R. Snapp has worked extensively with the Merger Guidelines in antitrust analysis. This piece is excerpted from a longer article in Computer Industry.