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The Value of the Tax Certificate

Kofi Asiedu Ofori
Tides Center

Mark Lloyd
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The Value of the Tax Certificate

Kofi Asiedu Ofori*

Mark Lloyd**

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* Mr. Ofori is a graduate of Boston University School of Law. Presently, Mr. Ofori is a consultant to the Civil Rights Forum on Communications Policy, a project of the Tides Center. The Forum advocates civil rights principles in conjunction with broadcast and telecommunications policy. Prior to his work with the Forum, Mr. Ofori served as the chief lobbyist of the Office of Communication of the United Church of Christ for communications policy. Mr. Ofori is the co-author of a study of the impact of the 1996 Telecommunications Act on Black-owned radio stations entitled *Blackout! Media Ownership Concentration and the Future of Black Radio*.

** Mr. Lloyd is the Executive Director of the Civil Rights Forum, a project of the Tides Center created to bring civil rights principles and advocacy to the communications policy debate. Mr. Lloyd also serves as General Counsel and a member of the Board of Directors of the Benton Foundation, a national foundation promoting the use of media in the public interest. He also has nearly 20 years of experience as a print and broadcast journalist. He is the recipient of several awards for his writing and reporting, including an Emmy and a Cine Golden Eagle. Mr. Lloyd is a member of the board of the Independent Television Service (ITVS), and serves on several other national boards and advisory panels. Mr. Lloyd received his bachelor's degree from the University of Michigan and his law degree from the Georgetown University Law Center. He is a member of the bar of Maryland and the District of Columbia.

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I. INTRODUCTION

In 1995, Congress repealed section 1071 of the Internal Revenue Code, which allowed the Federal Communications Commission (FCC or Commission) to issue a certificate to sellers of communications-related property to defer the gain realized upon a sale if that sale comported with a particular public policy goal. The repeal of the so-called "tax certificate" was linked to a proposed sale by Viacom of a multimillion dollar cable television system to a minority buyer.¹ Thus, it was widely reported that legislative action was directed against the "minority tax certificate." Given the reporting about the tax certificate, it would have been easy to conclude that the minority tax certificate was another government affirmative action program for rich media barons. It is no wonder then, that after little debate, the minority tax certificate was swiftly repealed.

In addition to the mischaracterization of the tax certificate as a minority preference policy, concern was expressed during the 1995 Senate hearings on tax certificates about lost tax revenues. Tax certificates were perceived by some members of Congress as an unjustifiable subsidy for big business. Senator Dole testified, "[I]t seems to me when we are cutting all of these Federal programs, as I said earlier, we should take a careful look. Even though I sympathize with the goals, I cannot sympathize with somebody walking off with a half a billion dollars in the transaction."² Senator Dole (Republican-Kansas) appears to have overlooked the cost to the public interest, in terms of reduced competition and reduced diversity of expression, that can be associated with the repeal of tax certificates.³

In 1998, under a new Chairman of the FCC, the first African American to hold that office, there was renewed interest in the tax certificate. This renewed interest coincided with an unprecedented concentration of ownership in the radio industry. Recent interest in reviving the tax certificate is to be applauded. However, in order to fully understand why the tax certificate was good public policy, it is important to keep in mind the range

1. See Ken Auletta, *Pay Per Views*, NEW YORKER, June 5, 1995, at 52. According to Auletta, the repeal of the tax certificate policy may have resulted from Viacom's "lopsided" contributions to Democrats.

2. *FCC's Tax Certificate Program: Hearing Before the Senate Comm. on Finance*, 104th Cong. 23 (1995) [hereinafter *Tax Certificate Hearing*] (testimony of Sen. Dole).

3. See *infra* Part IV.

of uses for the tax certificate. To gain this understanding, it is useful to briefly explore the statute's origin.

II. TAX CERTIFICATES AS A PUBLIC POLICY TOOL

A. *Tax Certificates for Involuntary Transfers*

In 1943, the FCC, which was not even a decade old, decided, with the help of the U.S. Supreme Court,⁴ that it was a bad idea for the Radio Corporation of America (RCA) to operate two radio networks. The concern was grounded in two related concepts firmly rooted in those progressive values that dominated U.S. public policies around the time of the Great Depression. Those two concepts, well articulated by the Supreme Court on many occasions, are the evils of monopoly or conversely the importance of fair competition,⁵ and the First Amendment virtues of diverse communications sources.⁶ The impetus for tax certificates was the need to contend with ownership trends in the nascent broadcast industry that were incompatible with the public interest values of competition and diversity.

In 1939, the Commission commenced an investigation into the monopolistic practices of powerful radio networks. The findings of the *Chain Broadcasting Report* are disturbingly similar to conditions in today's marketplace:

The record evidences a definite trend toward concentration of ownership of radio stations. . . . Eighty-seven of [the radio owners] . . . received in 1938 approximately 52 percent of the total business of all commercial broadcasting stations. To the extent that the ownership and control of radio-broadcast stations falls into fewer and fewer hands, whether they be network organizations or other private interests, the free dissemination of ideas and information, upon which our democracy depends, is threatened.⁷

The *Chain Broadcasting Report* led to the promulgation of FCC regulations that forced David Sarnoff, President of RCA, to *divest* the Na-

4. *National Brdcast. Co. v. United States*, 319 U.S. 190 (1943). The U.S. Supreme Court upheld Commission regulations designed to eliminate anticompetitive practices.

5. *FCC v. Sanders Bros. Radio Station*, 309 U.S. 470, 474-75 (1940) (supporting the view that the preservation of free competition is one of the objectives recognized by Congress); *FCC v. Pottsville Brdcast. Co.*, 309 U.S. 134, 137 (1940). Congress required the regulation of the broadcast industry to avoid the formation of monopolies.

6. *Associated Press v. United States*, 326 U.S. 1, 20 (1945). First Amendment principles rest on the bedrock assumption that communications from diverse and antagonistic sources are essential to the welfare of the public. *See also Turner Brdcast. Sys., Inc. v. FCC*, 520 U.S. 180, 192-93 (1997).

7. *Report on Chain Broadcasting*, FCC Docket No. 5060, May 1941, at 99.

tional Broadcasting Company (NBC) "blue network."⁸ The property was sold to Edward J. Noble, the Lifesaver candy king, and eventually became the American Broadcasting Company (ABC).⁹ The 1941 FCC Commissioners and their colleagues in Congress may have been "can do" Roosevelt progressives, but they were not unmindful of the harm their new policy would cause the powerful and newly minted "General Sarnoff."¹⁰ Congress felt some obligation to soften the blow of the forced divestiture, and thus tax certificates were born. These certificates permitted the General and other broadcast monopolists to defer any capital gain realized from the "involuntary" sale of their properties.¹¹

The initial use of the tax certificate was, in some ways, recognition that the government was still sorting out the proper method for regulating the dynamic broadcasting industry. There were, after all, no rules in place to prevent RCA from establishing two networks when the *Chain Broadcasting Report* was begun. Indeed, the right of the federal government to regulate the "ether" had been established for only a dozen years.¹² Thus, as the young FCC found its regulatory feet, it often found itself creating new limits where none existed before.

B. Tax Certificates for Voluntary Transfers

Later tax certificates were used not only to soften the hardship of involuntary sales, but also to encourage *voluntary* compliance with FCC

8. For a full discussion of the dual "red" and "blue" networks operated by RCA's subsidiary, NBC, see *id.* at 70.

We are impelled to conclude that it is not in the public interest for a station licensee to enter into a contract with a network organization which maintains more than one network.

....

In most large countries today, radio broadcasting is a governmental monopoly. . . . But in avoiding the concentration of power over radio broadcasting in the hands of government, *we must not fall into an even more dangerous pitfall: the concentration of that power in the hands of self-perpetuating management groups.*

Id. at 72 (emphasis added).

9. ERIK BARNOUW, *TUBE OF PLENTY: THE EVOLUTION OF AMERICAN TELEVISION* 95 (2d rev. ed. 1990).

10. David Sarnoff's World War II exploits with Allied forces in Paris earned him the rank of Brigadier General. From then on, at RCA and NBC, he was "General Sarnoff" or "the General." *Id.* at 93.

11. Legislative language for section 1071 refers to Chain Broadcasting policies where it says, "The Federal Communications Commission, in pursuance of the policy of eliminating common ownership of directly competing radio facilities, may condition applications for renewal of licenses or other applications upon the elimination of such common control and disposition of some of the facilities or property." S. REP. NO. 78-627, at 53 (1943).

12. BARNOUW, *supra* note 9, at 57-60.

policies. Broadcast owners were granted certificates for divesting properties in order to voluntarily come into compliance with FCC regulations. Many of these broadcasters had been granted a permanent waiver of the rules in consideration of their long-standing service to the community of license. In other words, though their ownership of potentially competing media properties violated Commission rules, their stations were considered "grandfathered." Tax certificates were issued "where there [was] a causal relationship between the change in Commission policy and the sale of the broadcast facilities and the sale does effectuate the new policy."¹³

A variety of Commission rules, such as prohibiting the same-market common ownership of television and radio stations and the cross-ownership of broadcast and newspaper operations, fit this category.¹⁴ Much like the earlier policies that forced divestiture, these new policies were also prompted by the concern for diversity of expression and the need for fair competition within the local community of license. An estimated 177 tax certificates were issued as incentives to comply with Commission policy unrelated to minority ownership.¹⁵

C. Tax Certificates to Encourage Sales to Minorities

In 1978, the Commission decided to use tax certificates to encourage sales to minorities. The Commission expressed frustration that "the views of racial minorities continue to be inadequately represented in the broadcast media . . . ownership of broadcast facilities by minorities[, in addition to equal employment opportunity rules and ascertainment policies,] is another significant way of fostering inclusion of minority views in the area of programming."¹⁶ Though the focus was on promoting the expression of

13. Issuance of Tax Certificates, *Public Notice*, 19 Rad. Reg. 2d (P & F) 1831 (1970); see also Issuance of Tax Certificates, *Public Notice*, 59 F.C.C.2d 91, 36 Rad. Reg. 2d (P & F) 1510 (1976) (stating voluntary divestitures to conform to the one-to-a-market rule).

14. Amendment of Sections 73.34, 73.240, and 73.636 of the Comm'n's Rules Relating to Multiple Ownership of Standard, FM, and Television Broadcast Stations, *Second Report and Order*, 50 F.C.C.2d 1046, para. 119 n.45, 32 Rad. Reg. 2d (P & F) 54 (1975).

15. *Tax Certificate Hearing*, *supra* note 2, at 105 (statement of William E. Kennard, General Counsel, FCC).

16. According to the Commission,

[W]e are compelled to observe that the views of racial minorities continue to be inadequately represented in the broadcast media. This situation is detrimental not only to the minority audience but to all of the viewing and listening public. Adequate representation of minority viewpoints . . . enhances the diversified programming which is a key objective not only of the Communications Act of 1934 but also of the First Amendment.

Statement of Policy on Minority Ownership of Broadcasting Facilities, *Public Notice*, 68 F.C.C.2d 979, 980-81, 42 Rad. Reg. 2d (P & F) 1689, 1691 (1978) (citation omitted) [hereinafter *1978 Minority Tax Certificate Policy*]; see also Commission Policy Regarding

“minority views” (with the note that other “clearly definable groups, such as women, may be able to demonstrate that they are eligible for similar treatment”),¹⁷ the policy was firmly in keeping with the long-standing use of tax certificates to promote diversity of expression over the public airwaves. Indeed, as the Supreme Court noted in affirming two other mechanisms to enhance minority ownership, “Just as a ‘diverse student body’ contributing to a ‘robust exchange of ideas’ is a ‘constitutionally permissible goal’ on which a race-conscious university admissions program may be predicated, the diversity of views and information on the airwaves serves important First Amendment values.”¹⁸

In assessing the value of tax certificates, their use to encourage sales to minorities is especially instructive because there were other policies also directed to this particular end. For example, the Commission permitted “licensees whose licenses have been designated for revocation hearing, or whose renewal applications have been designated for hearing on basic qualification issues, but before the hearing is initiated, to transfer or assign their license at a ‘distress sale’ price to” minorities;¹⁹ and the Commission announced that minority ownership and participation in management would be considered a “plus” in a comparative hearing of competing applicants for a broadcast license.²⁰

Neither the “distress sale” nor the comparative hearing policies were as effective as the tax certificates in generating minority ownership of broadcast stations, which speaks eloquently of the value of the tax certificate. Distress sales were, and are, a “relatively rare phenomenon,” in the words of the Supreme Court.²¹ “[O]n average, only about 0.2 percent of renewal applications filed each year have resulted in distress sales.”²² Even before the comparative hearing was abolished, there is little evidence that

the Advancement of Minority Ownership in Broadcasting, *Policy Statement and Notice of Proposed Rule Making*, 92 F.C.C.2d 849, 52 Rad. Reg. 2d (P & F) 1301 (1982) [hereinafter *1982 Minority Tax Certificate Policy*]; see also *Tax Certificate Hearing*, *supra* note 2, at 103 (statement of William E. Kennard, General Counsel, FCC) (regarding the use of tax certificates to promote the deployment of personal communications services).

17. *1978 Minority Tax Certificate Policy*, 68 F.C.C.2d at 984 n.22, 42 Rad. Reg. 2d (P & F) at 1696.

18. *Metro Brdcast., Inc. v. FCC*, 497 U.S. 547, 568 (1990) (citation omitted), *overruled by Adarand Constructors, Inc. v. Pena*, 515 U.S. 200 (1995).

19. *1978 Minority Tax Certificate Policy*, 68 F.C.C.2d at 983, 42 Rad. Reg. 2d (P & F) at 1695 (citation omitted).

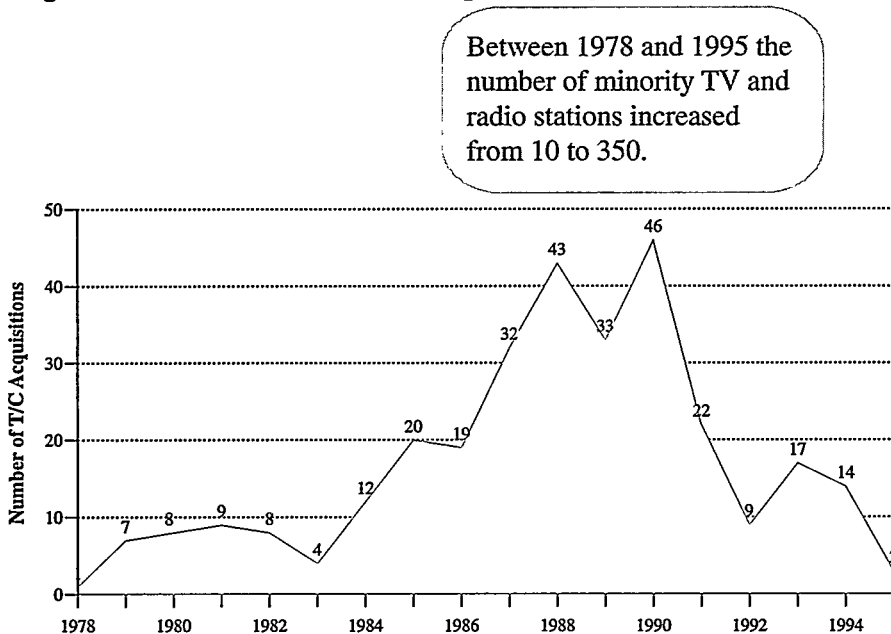
20. *WPIX, Inc., Application for Renewal of License*, 68 F.C.C.2d 381, para. 87, 43 Rad. Reg. 2d (P & F) 278 (1978) (citation omitted). The Supreme Court in *Metro Broadcasting*, 497 U.S. 547, affirmed both the distress sale and the comparative hearing policies.

21. *Metro Brdcast., Inc.*, 497 U.S. at 600 n.52.

22. *Id.* at 600.

it created more than a tiny fraction of minority broadcast licensees.²³ Figure 1 demonstrates, however, that tax certificates greatly served to increase the number of stations owned by minorities.

Figure 1. Broadcast Tax Certificate Acquisitions by Minorities, 1978 - 1995.



Data: FCC

Prior to the FCC's adoption of the minority tax certificate policy in 1978, there were only forty stations owned by minorities, less than 1 percent of the 8,500 commercial radio and television stations then in operation.²⁴ By 1995, that number increased to 350.²⁵ During the seventeen intervening years, 364 tax certificates were issued for transactions involving sales to minorities: 290 radio, 43 television, and 31 cable television.²⁶ Fig-

23. Andrew Barrett, Federal Communications Commission, *Minority Employment and Ownership in the Communications Market: What's Ahead in the 90's?*, Address to the San Francisco Bay Area Black Media Conference (Apr. 21, 1990).

24. FCC's MINORITY OWNERSHIP TASK FORCE, *MINORITY OWNERSHIP REPORT (1978)*, quoted in *1978 Minority Tax Certificate Policy*, 68 F.C.C.2d at 981, 42 Rad. Reg. 2d (P & F) at 1691.

25. NTIA, U.S. DEP'T OF COMMERCE, *MINORITY COMMERCIAL BROADCAST OWNERSHIP IN THE UNITED STATES 11* (1997).

26. Data supplied by the Office of Communications Business Opportunities, FCC.

ure 1 indicates the number of annual television and radio sales to minorities that involved the use of tax certificates.²⁷

Compared, then, to other potential mechanisms the Commission might employ to advance the First Amendment goal of diversity and other public policy goals of fair competition, the tax certificate proved remarkably valuable. The fact that it was the most valuable mechanism used to enhance minority ownership underscores its importance, in combination with other ownership policies, to restore competition and promote diversity. The next Part explains why tax certificates were successful.

III. THE ECONOMIC VALUE TO PRIVATE PARTIES (INVESTORS, BUYERS, AND SELLERS)

Section 1071 essentially granted favorable tax treatment by permitting the deferral of otherwise taxable gain realized from the sale of media property. In order for a taxpayer to receive such treatment, there must be a sale or exchange of property that the Commission deems to be "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations."²⁸ Over the years the provision has been extended to include the sale of television and cable television properties.²⁹

Tax certificates enabled sellers to select one of three approaches to structure what amounted to a tax-free transaction. First, a seller who would pay taxes on the gain realized from the sale of a media property may elect to have the transaction treated as an involuntary conversion under section 1033 of the Internal Revenue Code. The latter provision permits gain to be recognized only to the extent that the proceeds from the transaction exceed the cost of replacement media property. In effect, the seller does not have to pay taxes as long as he reinvests the proceeds from a sale in replacement property. Section 1033 generously permits replacement property to be acquired *prior* to the sale of the property for which the tax certificate is issued, provided the replacement property is still owned by the seller on the date when the tax certificate property was sold.³⁰

The second tax-free option permitted sellers to use the gain to reduce their basis in other depreciable property. Such property was defined as property "remaining in the hands of the taxpayer" immediately after the

27. Data for figure 1 is based upon tax certificates for which the FCC can supply a date of issuance.

28. 26 U.S.C. § 1071 (repealed 1995).

29. Policy Statement on Minority Ownership of Cable Television Facilities, *Public Notice*, 52 Rad. Reg. 2d (P & F) 1469 (1982).

30. 26 U.S.C. § 1033 (a)(2)(A)(i) (1994).

tax certificate transaction or acquired within the same taxable year. Therefore, the taxpayer's basis in assets, such as other media property, could be used to reduce tax liability.

A third approach was to combine the features of the first two options. A taxpayer could defer a portion of the gain through the acquisition of replacement property and another portion by reducing the basis of depreciable property.

In a market where station prices are appreciating at a very fast rate, the non-gain recognition features of section 1071 provided strong incentives for owners to sell and, in the case of minority tax certificates, incentives to sell to a specific class of buyers. Over the course of more than fifty years, station owners were granted an estimated 536 tax certificates.³¹

In 1982, the Commission modified its tax certificate regulations to encourage venture capital investment in minority businesses.³² The goal was to encourage start-up investment in minority-controlled entities and to contribute to the stabilization of their operations. Under the *1982 Minority Tax Certificate Policy*, tax certificates were issued to investors who purchased initial shares in minority-controlled broadcast entities or who purchased shares within one year after the issuance of the broadcast license. When these investors sold their shares, any gain on the sale was deferred under the provisions of section 1071.

The value of a tax certificate to minorities was that it enhanced their bargaining power when seeking to acquire a station. In a limited number of instances, sellers lowered the station price by an amount equal to their capital gains tax savings.³³ In such instances, minorities were able to acquire stations at a lower price than non-minorities. It should be noted, however, that the non-gain recognition treatment of section 1071 was an *option* for sellers; they were not *required* to sell to minorities at a lower price. In many instances, countervailing considerations influenced sellers not to elect section 1071 treatment.³⁴

Finally, despite Senator Dole's concern about the loss of tax revenue as a result of the tax certificate, the cost to taxpayers for the tax certificate program is significantly less than other non-gain recognition provisions of the Internal Revenue Code. According to the Joint Committee on Taxation, the cost to taxpayers for tax deferrals under section 1071 averaged \$140

31. *Tax Certificate Hearing*, *supra* note 2, at 105 (statement of William E. Kennard, General Counsel, FCC).

32. *1982 Minority Tax Certificate Policy*, *supra* note 16.

33. FCC, THE FINAL REPORT OF THE ADVISORY COMMITTEE ON ALTERNATIVE FINANCING FOR MINORITY OPPORTUNITIES IN TELECOMMUNICATIONS 8 (May 1982).

34. *See infra* Part V.

million annually between 1990 and 1994, compared to \$500 million annually for other provisions that permit the deferral of gain on like-kind exchanges.³⁵

A public policy tool that creates a strong incentive to sell is especially needed when market conditions create strong incentives for market consolidators to acquire. The next Part examines current market conditions.

IV. MARKET CONCENTRATION AND THE RETURN OF MONOPOLY

A. Fewer Radio Broadcasters

The conditions of today's radio marketplace resemble those of 1941. It is *deja vu* all over again, but few seem to notice. In 1996, Congress eliminated limits on the number of radio stations that a single company could own on a nationwide basis.³⁶ Broadcasters were also permitted to own a greater number of stations in the local markets; up to eight stations could be owned by a single company in the major markets.³⁷ Not surprisingly, this has resulted in a level of concentration of radio ownership that might embarrass even General Sarnoff. Commensurate with this concentration of ownership is an unprecedented decline in the number of radio owners. Seven hundred fewer companies now own this mainstay of American broadcasting.³⁸ By eliminating the FCC policy that placed limits on common ownership,³⁹ Congress has effectively reduced both competition and the diversity of expression.

Figure 2 shows that the top fifty radio firms collectively owned approximately 800 stations in 1996. One year after passage of the Telecommunications Act, the top *ten* firms owned 800 stations. Two years after the Act, the number of stations owned by the ten largest firms exceeded 1,300.

35. STAFF OF JOINT COMM. ON TAXATION, 101ST CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 1990-1994 (Comm. Print 1989).

36. Telecommunications Act of 1996, Pub. L. No. 104-104, § 202(a), 110 Stat. 56, 110.

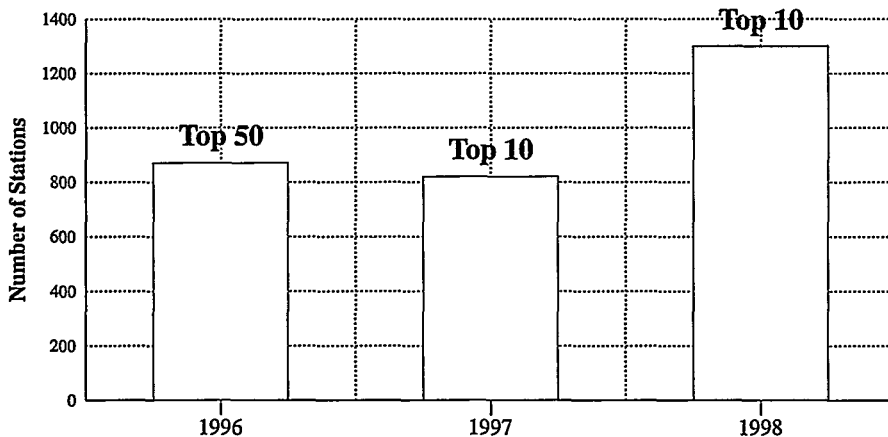
37. *Id.* § 202(b); see also 47 C.F.R. § 73.3555 (1998).

38. John Merli, *BIA Study Tracks Decrease of Ownership Diversity*, BRDCST. & CABLE, June 8, 1998, at 40.

39. The Telecommunications Act of 1996 eliminated limits on the number of radio stations that a single company may own nationwide. The Act also increased the number of stations that can be owned in a single market. Pub. L. No. 104-104, § 202(a)-(b), 110 Stat. 56, 110.

Figure 2. National Ownership Trends

The number of stations owned by the top radio owners has increased since passage of the 1996 Telecommunications Act.



Data: Who Owns What? Inside Radio, Inc.

Reduced numbers of competitors in the local markets have paralleled the tremendous growth in national ownership consolidation. In a study of market ownership trends, the Commission noted that the declining number of radio owners “is not simply the result of consolidations in a few large or small markets,” but is rather part of a pattern that exists across all market sizes (see Figure 2).⁴⁰

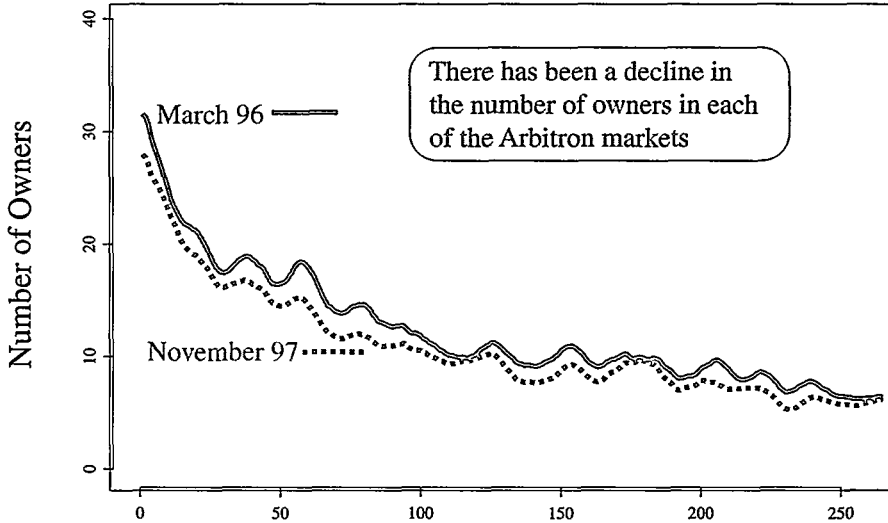
Another measure of concentration in the radio market is the Herfindahl-Hirschman Index (HH Index).⁴¹ The HH Index provides a convenient method for quantifying reduced competition. An analysis performed by the FCC demonstrates that, as of November 1997, all radio markets are in the zone above 1,800 that “warrant scrutiny” under Department of Justice guidelines (see Figure 3).⁴²

40. FCC, REVIEW OF THE RADIO INDUSTRY, 1997, at 6 (Mar. 13, 1998).

41. The Herfindahl-Hirschman Index is used by the Antitrust Division of the U.S. Department of Justice to measure market competition. See *Merger Guidelines-1992*, 4 Trade Reg. Rep. (CCH) ¶ 13,104, § 1.5 (Apr. 7, 1992). Based upon control of market revenues, the HH Index ranks markets in terms of whether they: (a) do not warrant scrutiny (HHIs less than 1,000); (b) warrant some concern (HHIs between 1,000 and 1,800); and (c) warrant scrutiny (HHIs over 1,800).

42. FCC, *supra* note 40, at 8 n.14.

Figure 3. Declining Local Market Competition



Source: FCC

Nov. '97 Arbitron Markets

Figure 4 also demonstrates that all markets experienced a decline in the amount of competition during the eight-month period between March and November 1997. As more revenues became concentrated in the hands of fewer owners, fewer dollars became available for the remaining competitors. The above analysis suggests that competition has decreased as a result of changes in ownership policy (i.e., ownership deregulation and the repeal of tax certificates).

Market consolidation is a *fait accompli*. It cannot be reversed by reliance upon marketplace forces. Radio deregulation has come at the cost of a tremendous reduction in the amount of competition in the marketplace.⁴³ Market entry by small and minority competitors has been stifled by soaring station prices.⁴⁴

An estimated \$11 billion worth of mergers and acquisitions took place within the first six months after passage of the Telecommunications Act, as large group owners took advantage of ownership deregulation.⁴⁵ Station prices soared as high as twenty times cash flow in the major markets as market consolidators rushed to acquire new stations. Minorities were generally not party to these transactions, except as sellers. The num-

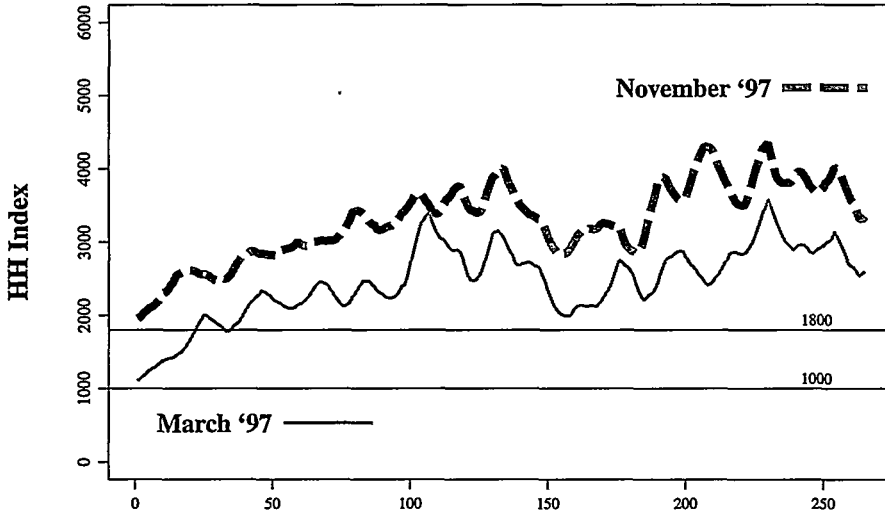
43. *Id.* at 8.

44. KOFI OFORI ET AL., BLACKOUT? MEDIA OWNERSHIP CONCENTRATION AND THE FUTURE OF BLACK RADIO 41 (1997) (stating that market consolidators justify paying premium prices for stations based upon the benefits of increased market share).

45. *Who Owns What?*, INSIDE RADIO, INC., Sept. 2, 1996.

ber of African-American-owned radio stations declined by twenty-six, and overall minority ownership of television and radio declined from 350 to 322 during 1996.⁴⁶

Figure 4. Economic Concentration by Market and Year



Source: FCC

November 97 Arbitron Markets

The passage of the Telecommunications Act in 1996 and repeal of the tax certificate policy the year before combined to hinder the ability of minorities to take advantage of ownership deregulation and expand their operations. In the absence of tax certificates, minorities were unable to negotiate for new stations and to compete with the capital resources of the large group owners. Large group owners, on the other hand, quickly moved to consolidate market share (see Figures 2, 3, and 4).

B. Large Operators Drive Out Small Operators

In order to demonstrate the importance of large operations in the new marketplace and thus the need for tax certificates, station performance and ownership size were compared. The results indicate that growth in the number of stations is accompanied by an overall increase in station performance.

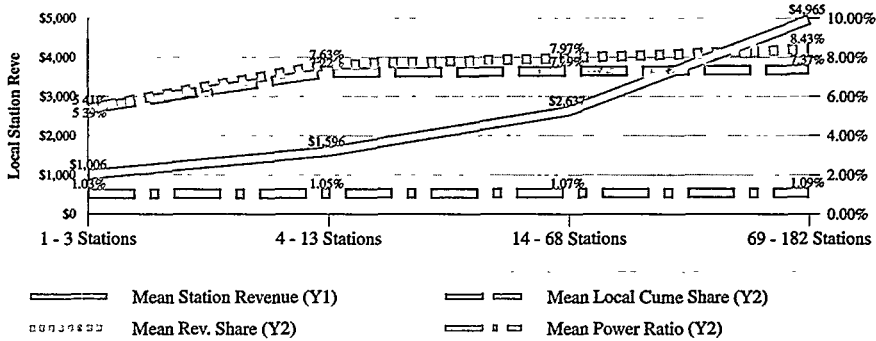
The analysis examined a sampling of 3,502 radio stations.⁴⁷ The stations were divided into quartiles based upon the number of stations owned

46. OFORI ET AL., *supra* note 44, at 30; NTIA, *supra* note 25, at 11.

by the parent company in the local and national markets. For the national market the quartiles were 1 to 3, 4 to 13, 14 to 68, and 69 to 182 stations. The quartiles for the local markets were 1 to 2, 3, 4 to 5, and 5 to 10 stations. Figures 4 and 5 provide data on the performance of stations based upon the ownership quartile of the parent company. The means of the following variables were used to measure station performance: station revenues, local commercial share, market revenue share, and power ratio.⁴⁸

Figure 5. National Ownership Economies

National Number of Stations vs. Local Station Performance



Mean Station Revenue	\$1,006	\$1,596	\$2,637	\$4,965
Mean Local Cume Share	5.39%	7.22%	7.29%	7.37%
Mean Rev. Share	5.41%	7.63%	7.97%	8.43%
Mean Power Ratio	1.03%	1.05%	1.07%	1.09%

Data: BIA Master Access

Figure 5 indicates that the most significant change in station performance associated with change in company size was station revenue. Mean station revenue increased from \$1.006 to \$4.965 million as the quartile of national ownership increased from 1 to 3 stations to 69 to 182 stations. There were also significant increases in market revenue share (5.45

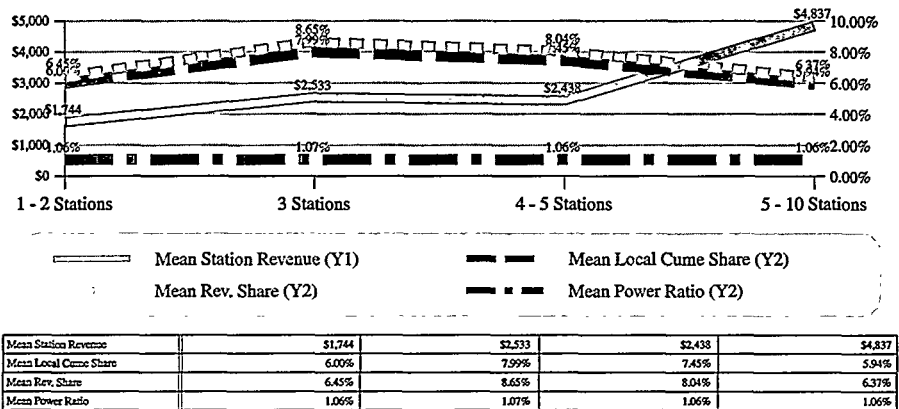
47. Stations used in the analysis were selected from the BIA MasterAccess database by BIA Research Inc. dated July 7, 1998. Stations were not selected on a random basis. The basis of selection was data availability in the MasterAccess software. The selection criteria were local commercial share is greater than zero, power ratio is greater than zero, and market revenue share is greater than zero.

48. *Station revenue* is gross station revenue for 1997 expressed in thousands. *Market revenue share* is the station's share of total market revenues. *Local commercial share* is the station's share of commercial station listeners in the local market averaged for 1997. *Power ratio* is a measure of the station's ability to convert listener share into revenue share (calculated by dividing the market revenue share by local commercial share).

percent to 8.4 percent) and local commercial share (5.43 percent to 7.37 percent). There was no appreciable change in power ratio (1.02 percent to 1.09 percent).⁴⁹

An examination of local ownership indicates that, with the exception of station revenue, there is a less dramatic change in station performance. As the quartile for local station ownership increased from 1 to 2 stations to 5 to 10 stations, mean power ratio remained unchanged, and there was a decrease in the variable market revenue share and local commercial share. Mean station revenue, however, increased from \$1.7 million to \$4.8 million (see Figure 6).

Figure 6. Local Ownership Economies
Local Ownership & Station Performance



Data: BIA Master Access

The fact that companies with more stations generate higher station revenues despite no corresponding change in local commercial share and other performance variables suggests a linkage between large company size and increased ability to obtain purchases and/or higher prices from advertisers. Further investigation is warranted to determine whether large firms condition the purchase of commercial time on one station upon the purchase of time on other stations that they own. Another area of inquiry is

49. See BIA RESEARCH INC., 1998 RADIO STATE OF THE INDUSTRY REPORT, for a similar analysis.

to determine whether large firms leverage their control of market share to raise advertising prices.

The present analysis demonstrates that the acquisition of stations has been accompanied by an appreciable increase in station revenues. It also implies that small firms are at a competitive disadvantage. Stations with large parent companies have greater revenue streams with which to hire the best on-air talent, to invest in program production, and to spend on sales promotion. These competitive advantages ultimately work to the disadvantage of small and minority firms.⁵⁰

If the principles of fair competition and the protection of diversity of expression over public airwaves continue to be laudable goals, present marketplace circumstances cry out for regulatory intervention. The next Part offers recommendations regarding a return to tax certificates or the establishment of other tax incentives.

V. TAX CERTIFICATES AND OTHER INCENTIVES TO PROMOTE CONCENTRATION AND DIVERSITY

Regulations adopted for radio during the 1940s, and adapted over the years for other forms of communication, may provide a model for the future. The goal of restoring competition and diversity in today's radio marketplace should be embraced. A first step would be for Congress to reestablish limits on the common ownership of radio stations. For the purpose of the local market caps, the Herfindahl-Hirschman Index⁵¹ can be used as an objective standard for determining whether a merger or acquisition conflicts with the public interest.

Secondly, Congress should reestablish the tax certificate policy. In conjunction with an FCC policy favoring minority ownership, tax certificates can be used to encourage owners of stations that are grandfathered under new ownership caps to sell them to minorities. The ability of incentive regulation to influence industry behavior is evidenced by the estimated 536 instances in which owners elected tax-free treatment in the past.⁵²

In the present marketplace, however, tax certificates alone may be insufficient to ensure increased minority ownership. Alternative methods of selling communications properties tax free present challenges for the Mi-

50. The vast majority of minority competitors are not market consolidators. Perhaps the only exceptions are Radio One, Inc., which owns four stations in Baltimore and accounts for 17% of the market revenues, and Spanish Broadcasting System, which owns six stations in Miami and accounts for 11% of the market revenues. *Who Owns What?*, INSIDE RADIO, INC., July 13, 1998, at 15-16.

51. *See supra* Part IV.

52. *Tax Certificate Hearing*, *supra* note 2, at 105 (statement of William E. Kennard, General Counsel, FCC).

minority Tax Certificate Program. During the 1995 Senate hearing on tax certificates, ex-FCC Commissioner Tyrone Brown provided seven examples of tax-free sales of cable television systems that did not involve tax certificates.⁵³ Stock-for-stock swaps and tax-free exchanges are other examples of tax-free transactions.⁵⁴ Further, if the tax rate for capital gains, presently 20 percent, were to decline, the incentive for electing tax certificates will also decline. For these reasons, policy decision makers should consider offering tax credits to enhance the incentive to sell to minorities.

Separate and apart from the challenge of providing incentives to sell to minorities is the problem of premium station prices. Unprecedented high station prices in the radio industry make it inefficient to acquire just one station in the major markets. Current market prices only make business sense for established market consolidators—broadcasters who already own three to four stations in a market and are willing to pay a premium to increase their market share. By imposing limits on multiple and duopoly ownership, however, Congress and the Commission can indirectly affect station prices. Under such a regulatory scheme, tax certificates can play an important role by encouraging the sale of stations that are grandfathered by new ownership limits. Competition and diversity within the ownership structure of the radio industry can thus be achieved.

Many legal scholars are debating whether minority ownership regulations under legislation similar to section 1071 can withstand heightened judicial scrutiny in light of *Lutheran Church-Missouri Synod v. FCC*.⁵⁵ The Authors of this Article maintain that the Supreme Court's decision in *Metro Broadcasting* is controlling, and that the D.C. Circuit's *Lutheran Church* decision is a constitutional leap. Commission regulations that promote the First Amendment values of diversity of expression over the public airwaves are not only constitutionally permissible, but constitutionally required. The U.S. Supreme Court's decision in a federal contracting case is not on point.⁵⁶ The latter did not overrule language in *Metro Broadcasting* that found it is a permissible objective of affirmative action to promote the diversification of broadcast licenses.⁵⁷

53. *Id.* at 80 (comments of Tyrone Brown).

54. *Id.* at 20 (comments of William E. Kennard, General Counsel, FCC).

55. *Lutheran Church*, 141 F.3d 344 (D.C. Cir. 1998).

56. *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200 (1995).

57. *Metro Brdcast., Inc. v. FCC*, 497 U.S. 547, 567-68 (1990); *see also Adarand*, 515 U.S. at 258 (Stevens, J., dissenting).

The majority today overrules *Metro Broadcasting* only insofar as it is "inconsistent with [the] holding" that [federal affirmative action measures are subject to strict scrutiny]. The proposition that fostering diversity may provide a sufficient interest to justify [a racial or ethnic classification] is not inconsistent

Discussion has also centered around whether Congress should adopt a *minority* or a *small* business tax certificate policy. In fact, there is not even the remote possibility that Congress had minorities in mind when it enacted the tax certificate policy in 1943. As explained above, the original intent of section 1071 was to influence industry compliance with FCC ownership policies. Increased minority ownership was *one* of several “ownership policies” that the Commission successfully administered under the rubric of section 1071. Therefore, Congress need only enact what it repealed—a tax certificate policy with “competition and diversity” as its goal.

with the Court’s holding today—indeed, the question is not remotely presented in this case

Id. (citation omitted).