Evidence of a "Failing Newspaper" Under the Newspaper Preservation Act

The article reviews tests under which the courts and the U.S. attorney general may rule in favor of a Joint Operating Agreement for newspapers. The article then considers how well the five newspapers that have sought JOA status since 1970 met the specified criteria. Applying the criteria to conditions at the Detroit papers (now seeking JOA agreement approval), the article determines a "failing newspaper" condition in Detroit remains in doubt.

The Newspaper Preservation Act of 1970 makes it possible for competing newspapers to combine advertising, promotion, production, circulation, business and management functions into a single newspaper corporation. This provides economies of scale to both papers in the combined operation, an important economic advantage that Congress hoped would be a means of maintaining two papers in one city.

In addition, the act allows jointly operating papers to engage in price fixing, market allocation and profit pooling, and to establish monopoly power over markets — actions normally prohibited by antitrust laws.

To enter such a joint operating agreement (JOA), one of the papers published in the market must prove to the satisfaction of the U.S. attorney general that it is a failing newspaper, that is, "in probable danger of financial failure." Twenty-two papers that established JOAs prior to passage of the Newspaper Preservation Act were permitted to continue operating under a "grandfather clause."

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papers in four cities have sought and been permitted to establish JOAs: Anchorage, Chattanooga, Cincinnati and Seattle. Newspapers in Detroit are now seeking to join that number. This article considers the tests of failure used by the attorney general and the courts in determining whether papers may be permitted to operate jointly. It considers how well the five papers that have sought JOAs since 1970 have met the specified criteria.

Reputation of the “Failing Company” Doctrine

Prior to passage of the Newspaper Preservation Act, the determinants of whether a firm was failing were set forth in the “failing company” doctrine established in International Shoe Co. v. FTC (1970) and subsequent case and statutory law. These laws allowed a firm that could show it was failing to merge with a competitor notwithstanding laws normally intended to prevent mergers that would reduce competition between the two firms.

The defense against antitrust could be maintained if: 1) the merger was made without anticompetitive intent, 2) there were no other prospective purchasers for the firm being acquired, and 3) one of the firms was in immediate danger of collapse.

These tests of the “failing company” doctrine are intentionally strict and were enacted to make mergers between competing companies difficult.

When the U.S. Supreme Court considered the issue of joint operating agreements between newspapers in Citizen Publishing Co. v. U.S. (1969), it held that a newspaper could put forth the “failing company” defense to justify a joint operating agreement if it showed: 1) the paper was on the brink of failure, 2) the acquiring company was the only available purchaser, and 3) the company being acquired could not be saved by reorganization.

The court ruled, however, that the Citizen Publishing Co. did not meet these tests of company failure and upheld a district court order to break up the joint operating agreement.

That ruling led to efforts by the newspaper industry to seek passage of the Newspaper Preservation Act, which was intended to protect newspapers already operating under JOAs and which specified that future agreements would require the approval of the attorney general.

Spokesmen for the industry argued that newspaper competition differs from competition in other industries and that for separate newspaper voices to survive, competing papers would have to join together before the rigid conditions of failure under the “failing company” tests could be met. Congress accepted these arguments and passed the act.

As a result, the Newspaper Preservation Act made failure easier to assert by specifying that a “failing newspaper” meant “a newspaper publication which, regardless of ownership or affiliations, is in probable danger of financial failure.”

The construction of the statute and the legislative intent clearly repudiated the “failing company” doctrine and its application in the Citizen Publishing Co. case. The statute allowed papers to enter such arrangements when their financial distress was evident but before they reached a point at which absolutely no possibility for survival existed without a JOA.

The possibility of alternative purchasers was raised a decade after passage of the act when the application for the Seattle JOA was made, but the attorney general ruled that the “failing newspaper” doctrine does not require that no alternative purchasers exist.

The Ninth Circuit Court of Appeals concurred. It ruled the existence of willing buyers might be relevant to the application for a JOA, but their existence would not preclude a finding that the paper is failing if: 1) its management was reasonable and prudent, and 2) its owners could show that prospective purchasers would not solve the paper’s economic difficulties.

“Failure” Under the Doctrine

This paper examines the evidence that the attorney general and the courts have considered as appropriate indicators of a “failing newspaper” in a JOA application, and what types and how much economic and financial data are used in these indicators. It also explores how the papers in the five cities that have sought joint operating agreements have performed on these specific tests of failure.

In decisions involving whether JOAs should be permitted in the cases, three main tests have been administered to determine whether a paper meets the “failing newspaper” doctrine put forth in the Newspaper Preservation Act.

The first and most significant test is whether the “circulation spiral” exists. This phenomenon is evidenced by declining circulation levels resulting in a decline in advertising revenues that cannot be attributed to a general decline in the economy but to the fortunes of competition.

The newspaper with the largest circulation in a given market has advantages that enable it to gain ground in both circulation and advertising revenues at the expense of the paper with lower circulation, thus forcing the smaller paper into a less advantageous position, according to economist Lars Furhoff.

The leading paper then can determine standards of advertising, editorial, production and distribution quality, thus putting increased pressure on the competing paper to respond. This increases the smaller paper’s economic difficulties and traps it in a circulation spiral that aggravates the problem of selling advertising space.

Two indicators are used to find evidence of the circulation spiral: circulation performance and advertising performance.

The difficulties posed by the downward spiral of circulation and, consequently, advertising were recognized during efforts to enact legislation and were introduced as testimony in the hearings on the application for the Seattle JOA in 1981.

Case law resulting from the Seattle application recognized the importance
of the spiral as a factor in establishing newspaper failure. The court said, "Generally ... the burden only entails a showing of (1) the economic fact of probable failure (downward spiral, irreversable losses), and (2) reasonable management practices."11

The second major test of failure is whether a significant disparity exists between the circulation and advertising shares of the two competing papers. No standard circulation share level at which the smaller of two competing general circulation daily newspapers cannot survive has been established and accepted in the newspaper industry. However, it is generally accepted that a serious problem is evident when a 60- to 40\% split develops.

This author's review of 20 competing daily newspapers that discontinued publication between 1976 and 1985 found that the average share split for dying papers was 32\%, compared to 68\% for the surviving competitor. Papers that ceased publication had an average circulation of 79,825, compared to an average circulation of 170,076 for the surviving paper.12

A similar review of 37 papers that merged during the period revealed an average circulation share split of 39\% for the smaller paper and 61\% for the larger paper. The average circulation of the smaller paper was 40,790 and the average for the larger paper was 63,394. In nearly every case, the merging papers were owned by the same company.13

These two sets of figures suggest that the majority of the shakeout during the past decade has been taking place in small- and mid-sized markets rather than in large metropolitan markets.

The data further indicate that when the 60-to-40\% circulation split is reached, continued operation of two papers becomes unprofitable. This is evidenced in the data for merging papers where, without the impetus of real competition, morning and evening papers often merged. Where real competition existed, seen in the papers that ceased publication altogether, the split was 68\% to 32\%. This is the point beyond which losses appear to be too great for a firm to regain circulation control by cost cutting measures or new marketing efforts.

Based on these two sets of data, it is reasonable to assert that a 55-to-45\% circulation split is an indicator of a serious disparity and that a 60-to-40\% circulation share split is the critical point in circulation levels. When papers fall below that point, their ability to survive is questionable.

Advertising shares, measured by the percent of revenues or lineage, are equally important. An industry rule-of-thumb states that when the split between two papers exceeds approximately 55-to-45\%, the disparity begins to become serious. In situations where the split is more than 60-to-40\%, it becomes critical. Thus the significance of the 55-45 and 60-40 share split apply to both advertising and circulation.

These two indicators are important because there is an interaction between circulation share and advertising share of newspapers. A disproportionate share of advertising is given to the paper with the largest circulation. When a paper exceeds the 50% circulation level, its share of advertising is disproportionately high.

For instance, a paper with a 60\% share of circulation will generally have an advertising share of approximately 75\%. When the circulation share is low, for example, 40\%, the advertising share will generally be approximately 25\%.

The third major test in determining whether a paper is failing is financial losses. In this case, the relevant measure is real operating losses that are unlikely to be reversed. Determination that "irreversible losses" are a factor was somewhat tempered by the Ninth Circuit Court of Appeals. It stated in its Seattle application opinion that newspapers are to be prevented "from allowing or encouraging financial difficulties in the hopes of reaping long-term financial gains through a JOA."14

The desire to ensure that losses are real and irreversible and not the result of internal management decisions was seen in 1979 in the decision of the administrative law judge in the application for the Cincinnati joint operating agreement.

In that decision, the judge ruled that overcharges from news, feature and advertising services related to the E. W. Scripps Co. had to be eliminated before he would make a determination as to whether the Cincinnati Post was a failing newspaper.15

Failure in JOA Applicants
Since 1970

Given these accepted indicators of the failure of a newspaper, this study considered the degree to which the newspapers seeking or that have been granted permission to form joint operating agreements since passage of the Newspaper Preservation Act of 1970 met or meet the elements of the three primary tests of failure.

The circulation spiral. The first test is the presence of the "circulation spiral." Losses in circulation and advertising. Of the five papers seeking JOAs, only four provided evidence of the existence of the spiral.

In Anchorage, the News' circulation declined from 16,551 in 1965 to 15,079 in 1973. During the same period, the circulation of the rival Times rose from 28,988 to 41,069. The advertising situation of the News paralleled its declining circulation situation, a problem that was compounded because the Times was able to sell advertising at half the milline rate of the News.

In the case of the Chattanooga Times, the spiral was evident in a decrease in circulation from 58,907 in 1975 to 51,072 in 1979 and in the Times' decreasing share of ad revenue from 50% in 1976 to 45% in 1979.

In Cincinnati, the Post experienced a decrease in circulation from 252,000 in 1964 to 181,842 in 1979 and a decrease in advertising revenue share from 36% in 1975 to approximately 15% in 1977.

The Detroit Free Press, which is currently seeking "failing newspaper" status, experienced an increase in circulation from 605,156 in 1980 to 644,778 in 1985. Its ad revenue share increased from 38.2% in 1981 to 38.4% in 1985.
The Seattle Post-Intelligencer evidenced a decrease in circulation from 213,171 in 1961 to 182,475 in 1981. Its ad revenue share decreased from 33.4% in 1976 to 29.5% in 1980.

Circulation/advertising disparity. The sizes of the gaps between circulation and advertising shares of the two competing papers in each of the five markets just prior to establishment of JOAs are unique to each situation, but the papers' performances conform to the anticipated economic patterns of disparity, (see Figure 1).

In terms of circulation share, the Anchorage News was clearly at a disadvantage with only 27% of total circulation in its market in 1973, compared with a 73% share for the Anchorage Times.

In Chattanooga, the News-Free Press garnered 54% of total circulation, of metro area circulation and of city zone circulation in 1979. In contrast the Times had a total, metro area and city zone circulation of only about 46%. The Cincinnati circulation share split was much tighter. In 1979, for example, the Enquirer accounted for 51% of total circulation, 49% of metro area circulation and 50% of city zone circulation. The competing Post garnered 49% of total circulation, 51% of metro circulation and 51% of city zone circulation.

The Detroit circulation share split was also tight when the papers there applied for a JOA in 1985. The Free Press held 50% of the total circulation, 45% of the primary marketing area circulation and 46% of the city and retail trading zone circulation. The competing News garnered 51% of the total circulation, with 55% of the circulation in the primary marketing area and 54% of the circulation in the city and retail trading zones.

In 1980, the Seattle Post-Intelligencer held 43% of total circulation, 37% of metro area circulation and city zone circulation. By comparison, the Times accounted for 57% of total circulation and 63% of metro area and city zone circulation.

Similar discrepancies existed in terms of advertising shares for the papers. In Anchorage, the Times enjoyed a 3-to-1 advantage over the News in 1973, receiving approximately 75% of the advertising shares. The Chattanooga Times accounted for 45% of the shares in that city in 1979, compared to 55% for the News-Free Press.

In Cincinnati in 1976, the Enquirer garnered a 66% share of advertising, while the Post acquired only 34%. The Detroit ad shares in 1985 also revealed a wide split. The News got 62% of the shares, the Free Press got 38%.

In Seattle in 1980, the Post-Intelligencer held only 29% of the advertising share compared to 71% for the Times.

Financial losses. The third indicator of failure is financial losses, measured in dollars or as a portion of revenues. In Anchorage, for instance, losses for the News averaged 49% of revenues from 1966-74, and averaged $500,000 annually from 1969 to 1974.

In Chattanooga, losses for the Times rose significantly in the four years prior to its application for a joint operating agreement. Losses of $377,000 in 1976 grew to $1.2 million in 1979.

Losses for the Cincinnati Post were 4.5% of revenues in 1977, the Detroit Free Press encountered losses of 5.2% of revenues in 1985, and the Seattle Post-Intelligencer lost 3.9% of revenues in 1980.

Indicator patterns. The three factors of failure provide five indicators by which to judge whether failure exists. The five papers that have sought joint operating agreements have had different patterns of indicators of failure, as

<table>
<thead>
<tr>
<th>Advertising Share</th>
<th>Sales Times •</th>
<th>Anchorage Times •</th>
<th>Seattle Times •</th>
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<tbody>
<tr>
<td>70%</td>
<td>· Cincinnati Enquirer</td>
<td></td>
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<td></td>
<td>· Detroit News</td>
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<table>
<thead>
<tr>
<th>60%</th>
<th>· Chattanooga News-Free Press</th>
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<tbody>
<tr>
<td>50%</td>
<td>Chattanooga Times •</td>
</tr>
<tr>
<td>40%</td>
<td>· Detroit Free-Press •</td>
</tr>
<tr>
<td>30%</td>
<td>· Cincinnati Post •</td>
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<tr>
<td>20%</td>
<td>· Seattle Post •</td>
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<tr>
<td>10%</td>
<td>· Post-Intelligencer</td>
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<tr>
<th>0 // 30%</th>
<th>40%</th>
<th>50%</th>
<th>60%</th>
<th>70%</th>
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<tbody>
<tr>
<td>Circulation Share</td>
<td>· Anchorage News</td>
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FIGURE 1: Disparity between advertising and circulation shares in papers entering joint operating agreements since 1970.
TABLE 1: Indicators of Failure in Newspapers Seeking JOAs

<table>
<thead>
<tr>
<th>City</th>
<th>Circulation Loss</th>
<th>Spiral Advertising Loss</th>
<th>Disparity Circulation</th>
<th>Disparity Advertising</th>
<th>Total Financial Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anchorage</td>
<td>Y</td>
<td>Y</td>
<td>Y-C</td>
<td>Y-C</td>
<td>Y</td>
</tr>
<tr>
<td>Chattanooga</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>Y-S</td>
<td>Y</td>
</tr>
<tr>
<td>Detroit</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>Y-C</td>
<td>Y</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>Y-C</td>
<td>Y</td>
</tr>
<tr>
<td>Seattle</td>
<td>Y</td>
<td>Y</td>
<td>Y-S</td>
<td>Y-C</td>
<td>Y</td>
</tr>
<tr>
<td><strong>Total Yes</strong></td>
<td><strong>4</strong></td>
<td><strong>4</strong></td>
<td><strong>2</strong></td>
<td><strong>5</strong></td>
<td><strong>5</strong></td>
</tr>
</tbody>
</table>

Y-S = Yes, serious disparity
Y-C = Yes, critical disparity

revealed in Table 1.

Of the papers granted JOAs, all passed at least four of the test of failure, with the Anchorage News and Seattle Post-Intelligencer scoring perfect $5$s.

Only the Detroit Free-Press, which is currently seeking JOA approval, does not pass the majority of the five tests, as it provides only two of the five indicators of failure. It shows no evidence of the circulation spiral. In fact, the data indicate that the paper is moving upward, not downward, in both circulation and advertising. The disparity of circulation between the Free Press and the News has not yet reached the "serious" disparity level, a third important indicator.

The Free Press provides evidence of difficulty in only two areas: the disparity in advertising shares between itself and the News; and financial losses. Interestingly, the News—which is purportedly the "successful" paper—has a pattern nearly identical to that of the Free Press, with the exception of being on the preferential end of the disparity between advertising shares. The News' losses have paralleled those of the Free Press.

Whether the Free Press' indicators are enough to justify a ruling that the paper constitutes a "failing newspaper" remains to be seen.

NOTES

2. The papers in Anchorage terminated their agreement after five years of operation and are now competitors once again.
7. Committee For An Independent Post-Intelligencer v. Hearst Corporation, 70 F.2d 467 (9th Cir. 1933); cert. den. 464 U.S. 892 (1983).
12. The data were calculated by establishing the mean circulations and circulation shares for both dying and surviving daily papers in the markets. Papers included were from the following markets: 1976-Hartford, Conn.; 1977-Cleveland, Tenn. and State College, Pa.; 1978-Chicago, Ill. and Goleta, Calif.; 1980-Paterson, N.J.; Oklahoma City, Okla.; Madison, Wis.; 1981-Rogers, Ark.; Washington, D.C.; Philadelphia, Pa.; Austin, Texas; 1982-Buffalo, N.Y.; White Plains, N.Y.; Cleveland, Ohio; 1984-North Las Vegas,
Nev.; Woodstock, Ill.; and Dover, N.J.


15. Recommended Decision of Donald R. Moore, Administrative Law Judge, Docket 44-03-24-4, p. 56.