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Guiding Investors Through The FCC's Changing Regulatory Terrain

*The Editor interviews **Tom W. Davidson,** Partner, and **Kimberly Reindl,** Senior Counsel, Akin Gump Strauss Hauer & Feld LLP.*

Tom W. Davidson

Kimberly Reindl

Editor: Please describe Akin Gump's Communications & Technology Practice.

Davidson: Akin Gump has a highly diversified domestic and international regulatory, transactional and policy practice in the communications sector. We represent clients in all the major communications industry sectors before the Federal Communications Commission (FCC) in licensing, compliance and policy matters. In addition, our section either separately or with the assistance of lawyers in our corporate and financial restructuring sections represents clients in these industry sectors in various transactional matters, including M&As, private and public offerings of debt and equity, and financial restructurings. We also negotiate and draft commercial agreements for these clients, and we work closely with specialists in our public law and policy section to provide substantive support for advocacy work. Our expertise in communications-related matters extends to the Department of Justice, the Department of Commerce, the State Department and the Library of Congress's Copyright Office. Finally, we represent many private equity and hedge funds, pension funds and lenders in structuring FCC-compliant investments in FCC-regulated businesses and securitizing the investments.

Editor: Kimberly, as former counsel at the FCC, would you share with our readers any recent FCC developments that will impact investment in telecoms?

Reindl: The most significant development at the FCC for investors over the next few years will be incentive auctions for the broadcast spectrum (for which the FCC received authority in February). The Commission has established a task force and brought in a very well-qualified group of advisors to oversee the process, and we expect to see the first of several public notices toward the end of September seeking comment on how the auctions will work – how the broadcasters will be compensated if they choose to give up all or part of their spectrum, what sorts of operational conditions will apply to licenses being auctioned, etc. No other country has ever attempted anything like this, and we have no idea how many and which broadcasters will participate, but the FCC is doing a very good job of asking for input. Investors will have many opportunities to get involved both in the auction process and in the infrastructure development afterward. Our broadcast and wireless experience and contacts at the FCC put us in an excellent position to advise clients on this issue.

Another development that will impact private equity and venture capital investors is the FCC's relaxation of certain restrictions on foreign investment. The statutory restriction on foreign ownership of wireless, broadcast, and aeronautical licenses prohibits certain direct foreign investment or ownership of entities holding those licenses, and it also places restrictions on indirect, non-controlling investments. The Commission recently issued an order stating it will forbear from applying the strict statutory cap on indirect, non-controlling investments in wireless common carrier licensees and will review these transactions instead on a case-by-case basis. This is a good development for investors because it will provide them some additional flexibility in structuring their investments in entities holding wireless licenses.

Editor: Are there any non-FCC developments in the communications space that telecom investors should keep an eye on?

Reindl: Due to the greater adoption of high-speed broadband throughout the country and the expansion in the ways in which content can be distributed and consumed, we're seeing more frequent conflicts between owners of content and distributors of content. This convergence of what used to be distinct services has caused a trend toward greater overlap between copyright law and communications law. The FCC and the industry should pay close attention to what the courts might be saying in some of the private disputes between the rights holders and the distributors and what the Copyright Office is doing in terms of policy, because related issues invariably end up in front of the FCC.

Editor: Please share with us some of the regulatory issues in the financing and securitization of a communications company.

Davidson: One of the biggest issues facing a lender to a company that holds an FCC license is how to securitize the investment, given that the lender is not permitted under federal law to hold a security interest in the license. Because the FCC license typically represents the most valuable asset held by the debtor, the inability of the lender to obtain a security interest in the license poses a dilemma for the lender.

In order to adequately collateralize a loan

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to a company holding an FCC license, the lender typically requires the debtor to place the license in a wholly owned subsidiary in which the FCC license is the sole asset, and the creditor takes a pledge of the debtor's ownership interest in the licensee subsidiary. Such an approach protects the FCC license from unsecured creditors in the event of a bankruptcy. In addition, the creditor also takes a security interest in all tangible and other intangible assets of the debtor and takes a pledge of the stock of the debtor.

Editor: How is the FCC addressing deals that might be seen as anti-competitive?

Reindl: One of the trends that started several years ago was the promotion of "intermodal" competition. The idea was that allowing a certain amount of consolidation would make for stronger competitors, so, ultimately, cable companies would be competing against telephone companies to provide services that are essentially interchangeable from the consumer standpoint. We're seeing more of this as the technologies converge. The Justice Department's Antitrust Division and the FCC work closely together on assessing significant deals in the telecom sector. (I was on the FCC's Transaction Team.) The FCC's authority is limited to the FCC licensees, so it has the jurisdiction to review only those M&As that involve a transfer of control of an FCC licensee. The DOJ performs a straight antitrust/competition analysis, while the FCC has a broader public interest mandate that allows it to consider additional factors beyond competition that may be good for consumers. As such, the FCC has imposed more behavioral conditions on transaction approval than structural conditions (such as divestitures of certain business units).

Editor: What are the regulatory implications of the increased use of VoIP technology in telecom?

Reindl: Thanks to improvement in quality, VoIP – a classic example of a disruptive innovation – is now competing head-to-head with traditional voice telephony offerings. One of the regulatory challenges with VoIP relates to the costs the underlying networks bear in supporting these products. The FCC is currently revamping its intercarrier compensation system, and in that proceeding is asking whether VoIP providers should have to pay interconnection fees for VoIP traffic that is terminated on a telephone network. Increasing use of VoIP raises some of the same traffic management issues that led to the adoption of the net neutrality rules, currently on appeal in the D.C. Circuit.

Editor: Would you comment on the proliferation of mobile apps in recent years and how regulators are responding?

Reindl: Mobile applications raise many interesting and diverse legal questions for our clients, from accessibility to content protection to consumer privacy and data security, so it's an exciting time to be doing this type of work. Some of the most popular mobile applications transcend the traditional regulatory silos – videos can be streamed to a mobile telephone, and IP telephone services may be used on a mobile telephone – and regulators have had difficulty anticipating some of the issues raised. But it's clear that the FCC, the NTIA (which is working with industry stakeholders to develop a voluntary code of conduct for handling personal data) and the FTC are paying very close attention to the issues, especially with respect to privacy.

Editor: Would you speak to FCC rules limiting the number of media outlets a company may have in a particular market?

Davidson: The FCC's media ownership rules have been the subject of constant review by the agency and federal courts for many years. The most important of the media ownership rules are the local television ownership rule, local radio ownership rule, radio/television cross-ownership rule and newspaper broadcast cross-ownership ban.

The local television ownership rule effectively prohibits the ownership of more than one television station in all but the largest television markets, i.e., an entity may not hold an interest in two television stations in the same Nielsen-designated market area unless either 1) the coverage contours of the stations don't overlap, or 2) following the combination, at least one of the stations is not among the top four Nielsen-rated stations, and there are at least eight independently owned full-power commercial and noncommercial television stations in the market.

The local radio ownership rule places a numerical limit on a number of commercial radio stations in which an entity or individual may hold an attributable interest in a local market – depending on the size and number of stations in the market. The number of stations you can own depends upon the size of the market and number of stations in the market. For example, in the largest markets, with 45 or more full-power radio stations, ownership of up to eight radio stations is permitted, no more than five of which may be either AM or FM.

The radio and television cross-ownership rule allows the ownership of up to two television stations, as described above depending on market size, and one commercial radio station in the same market regardless of the number of other media in the market. Ownership in additional radio stations is permitted depending on the number of independently owned media voices in the market. The newspaper broadcast cross-ownership rule prohibits the common ownership of a radio or television station and a daily newspaper in the same market.

Earlier in the year, the FCC instituted a rulemaking proceeding in which it seeks comments on making changes to these rules. In the proceeding, the FCC proposes to eliminate the radio/television cross-ownership rule and relax the newspaper-broadcast restrictions in the 20 largest markets. Major changes to the existing rules are not anticipated.

Editor: Please discuss the ramifications of *FCC v. Fox Television*.

Davidson: In *FCC v. Fox Television*, the Court held that the FCC erred in sanctioning the broadcast of fleeting expletives and brief nudity where it had not provided adequate notice that such broadcasts could be deemed actionably indecent. In reaching the decision, the Supreme Court focused on the fact that, by failing to afford notice to broadcasters that the fleeting expletives or momentary nudity could result in monetary forfeitures, the Commission violated the due process requirements under the Fifth Amendment. The Court declined to address expressly whether the FCC's current indecency policy – which considers the context of the broadcast to determine what is offensive in accordance with contemporary community standards – is unconstitutionally vague under the First Amendment. Thus, at least for the moment, the FCC's current indecency policy remains the standard by which the FCC will evaluate indecency matters *not* involving fleeting expletives or brief nudity. And, the industry is now on notice that broadcasting fleeting expletives or brief nudity is illegal under the FCC's policies. Meanwhile, in the event the FCC continues to take action against broadcasters under its general indecency policy, broadcasters are likely to continue to challenge such actions on various grounds, including the argument that they did not have adequate notice under the due process clause of what is prohibited by the general indecency policy.