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ALERT

2014 Quadrennial Regulatory Review—Review of the Commission's Broadcast Ownership Rules, Second Report and Order Summary

September 1, 2016

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I. INTRODUCTION

On August 25, 2016, the Federal Communications Commission (FCC or Commission) released the text of a Second Report & Order that concludes both its 2010 and 2014 "quadrennial review" proceedings (the "2016 Order"). The Commission is required by statute to review its rules governing the ownership of broadcast radio and television stations every four years to determine whether they "are necessary in the public interest as the result of competition" and to "repeal or modify any regulation [the Commission] determines to be no longer in the public interest." In addition to reviewing its rules according to this standard, the Commission also considered certain issues remanded to the agency by the U.S. Court of Appeals for the Third Circuit in decisions that were issued on review of the Commission's 2006 and 2010 quadrennial review proceedings.

In the combined 2010/2014 proceeding, the Commission determined that its existing media ownership rules, with some minor modifications, remained necessary in the public interest. In addition, the FCC reinstated its decision to consider television joint sales agreements (JSAs) to be "attributable" ownership interests, established a definition for "Shared Services Agreements" and adopted disclosure requirements for such agreements, and reinstated its revenue-based eligible entity standard.

II. MEDIA OWNERSHIP RULES

A. Local Television Ownership Rule

The Commission concluded in the 2016 Order that the local television ownership rule was necessary to protect competition for viewers and for local advertising revenues. Accordingly, the Commission retained, with only minor change, its existing restrictions on local television ownership and re-adopted the JSA attribution rule that had been vacated by the Third Circuit. In addition, the Commission adopted a definition of Shared Services Agreements (SSAs) and required that they be disclosed but did not make them attributable at this time.

The local television ownership rule, which has been in effect since 1999, bars co-ownership of two full power, commercial TV stations (a so-called "duopoly") in a local market unless at least eight independently owned, full power television stations, or "voices," remain. In addition, the rule prohibits a single entity from owning more than one station among the top four ranked stations in a local market, based on audience share. In seeking to justify the eight voices test, the Commission determined that a minimum of eight independently owned and operated television stations was required to preserve competition in local television markets. With respect to its decision to retain the top four prohibition, the FCC concluded that top four station combinations had the potential to provide a single firm with an unacceptably high market share. In addition, the Commission decided to retain its existing waiver standard for failed and failing stations without change.

However, the Commission did alter the rule in two respects. First, because analog signal contours no longer are applicable following the digital transition, the agency revised the rule to substitute a station's digital Noise Limited Service Contour (NLSC) for its analog Grade B contour. Existing combinations that violate the rule as a result of the change in contour methodology are grandfathered, but cannot be transferred to third parties.

Second, the Commission found that a transaction in which station owners "swap" network affiliations so that one owner obtains control of two top-four stations in a market violates the local television ownership rule even if no FCC licenses change hands. The agency stated that these transactions, left unchecked, would permit entities to circumvent the intent of the rule and do not serve the public interest. Thus, affiliation swaps must comply with the top-four prohibition at the time a network affiliation agreement is executed.

The 2016 Order also re-adopted the Commission's earlier finding that television JSAs should be considered attributable for purposes of measuring compliance with the local television ownership rule, which had been vacated by the Third Circuit in *Prometheus III*. The FCC found that attribution was necessary to ensure compliance with the broadcast ownership rules, and that there is "anecdotal evidence" that "attribution of television JSAs has helped promote minority and female ownership opportunities." JSAs that existed as of March 31, 2014 (the date on which the Commission first adopted the JSA attribution rule) will be allowed to remain in effect until September 30, 2025. In addition, grandfathered JSAs may be transferred or assigned to third parties without terminating grandfathering relief. However, JSAs entered into or revised after March 31, 2014—including any JSAs adopted or revised after the Third Circuit's decision to vacate the rule—are not entitled to any grandfathering relief and must immediately be brought into compliance with the agency's rules.

The FCC also adopted a definition of SSAs and found that it should require disclosure of such agreements, but did not make them attributable. Under the 2016 Order, an SSA is defined as "any agreement or series of agreements, whether written or oral, in which (1) a station provides any station-related services, including, but not limited to, administrative, technical, sales, and/or programming support, to a station that is not directly or indirectly under common de jure control permitted under the Commission's regulations; or (2) stations that are not directly or indirectly under common de jure control permitted under the Commission's regulations collaborate to provide or enable the provision of station-related services, including, but not limited to, administrative, technical, sales, and/or programming support, to one or more of the collaborating stations." Oral agreements must be reduced to writing. The Commission clarified, moreover, that incidental station interactions unrelated to station operations, such as "charitable collaborations" do not fall within the definition of SSAs, nor do "ad hoc or 'on the fly' arrangements during breaking news coverage." Each station participating in an SSA must upload a copy of the agreement to its online public inspection file, regardless of whether the agreement involves stations in the same market or different markets.

Finally, the 2016 Order rejected arguments that it should: (1) adopt a waiver standard that would allow certain television combinations in small markets, even between top-four stations; (2) consider multicasting in determining local television ownership limits; and/or (3) limit the ability of station owners to form dual network affiliations through multicasting. In addition, the FCC found that it would be impossible to analyze the impact of the broadcast television incentive auction upon the local television ownership rule, given that the auction was ongoing at the time the 2016 Order was issued. The implications of the auction for the media ownership rules will be considered in the context of future quadrennial reviews.

B. Local Radio Ownership Rule

The FCC did not alter the local radio ownership rule in the 2016 Order. That rule provides as follows:

- in markets with 45 or more radio stations, a company may own eight stations, only five of which may be in one class—AM or FM;
- in markets with 30-44 radio stations, a company may own seven stations, only four of which may be in one class—AM or FM;
- in markets with 15-29 radio stations, a company may own six stations, only four of which may be in one class—AM or FM; and
- in markets with 14 or fewer radio stations, a company may own five stations, only three of which may be in one class—AM or FM.

To justify its decision, the Commission stated that the existing caps balance efficiency benefits for stations with the public interest in maintaining a competitive market. The agency also decided to keep the pre-existing AM/FM subcaps in place because they promote new entry into radio for small businesses, women, minorities, and other entrepreneurs. In addition, the FCC claimed that the subcaps are needed to address relevant technical and marketplace differences between FM and AM stations.

The Commission also rejected proposals to (1) assign different values to stations of different classes when calculating how many stations an entity owns in a local market, (2) adopt a case-by-case approach to determining ownership levels based on population coverage, and (3) alter its treatment of transactions involving markets that Nielsen Audio and/or BIA define as "embedded markets." As to this last point, the Commission acknowledged that transactions involving embedded markets could lead to anomalous results, and stated a willingness to entertain market-specific waiver requests related to this issue.

The Commission did, however, alter the local radio ownership rule in four minor respects. First, the Commission's rules prohibit a party from receiving the benefit of a change in Nielsen Audio Metro boundaries or "home" market designation unless that change (1) has been in place for at least two years, and (2) results from an FCC-approved change in the station's community of license from a community that is within a Metro's boundaries to one that is outside of it. In the 2016 Order, the Commission clarified that this exemption applies only if the community of license change also involves the physical relocation of the station facilities to a site outside the relevant Nielsen Audio Metro market boundaries. Second, the Commission modified its rules governing grandfathered radio combinations, providing for a temporary three-month waiver in situations where a community of license change makes it impossible for an applicant with a grandfathered cluster to demonstrate compliance with the local radio ownership rule at the time it files for the community of license change. Third, the Commission extended grandfathering relief to intra-market community of license changes, including community of license changes within the physical boundaries of the Metro market as well as any community of license change where the station remains designated as "home" to the Metro market. Fourth, the Commission decided that it would no longer treat the Puerto Rico Nielsen Audio Metro as a single market, but would instead utilize a contour overlap approach to defining radio markets in Puerto Rico.

C. Newspaper/Broadcast Cross-Ownership Rule

In the 2016 Order, the FCC noted the continued importance of newspapers and broadcast television stations as the predominant sources of local news and information and concluded that newspaper/broadcast cross-ownership restrictions remain necessary to protect viewpoint diversity. As such, the Commission retained the existing newspaper/broadcast cross-ownership (NBCO) rule with minor modifications. The Commission also adopted a limited exception to the rule and established a waiver standard.

First, the FCC modified the scope of the NBCO rule in several respects. In the television context, the FCC updated the geographic scope of the restriction to prohibit cross-ownership if (1) the community of license of the television station and the community of publication of the newspaper are both in the same Nielsen Designated Market Area (DMA), and (2) the digital principal community contour (PCC) of the television station encompasses the entire community in which the newspaper is published. The Commission explained that the DMA requirement ensures that the newspaper and television station serve the same media market, and the contour requirement ensures that they actually reach the same communities and consumers within the larger geographic market. The FCC made similar changes in the radio context. In areas designated as Nielsen Audio Metro markets, cross-ownership will be prohibited if (1) the radio station and the community of publication of the newspaper are both in the same Nielsen Audio Metro market, and (2) the entire community

in which the newspaper is published is encompassed by specified service contours (the 2 mV/m groundwave contour for AM stations, and the 1 mV/m contour for FM stations). If neither the radio station nor the newspaper is located within a Nielsen Audio Metro market, then the NBCO rule will be triggered, as before, when the entire community in which the newspaper is published is encompassed by the relevant service contour. The Commission grandfathered any existing newspaper/broadcast combinations that no longer comply with the rule as a result of these changes to the scope of the rule, but declined to allow transfers of grandfathered combinations.

Second, the FCC adopted an exception to the rule for combinations in which one of the stations is "failed" or "failing." In order to qualify for the exemption as a "failed" property, a newspaper must have stopped circulating, or a station must have been dark, due to financial distress for at least four months immediately prior to the filing of an application with the Commission. Properties that are involved in court-supervised involuntary bankruptcy or insolvency proceedings also qualified as "failed." To qualify as "failing," a broadcast station must have had a low all-day audience share (i.e., 4 percent or lower). In addition, to qualify as "failing," a broadcast station or newspaper must have been in poor financial condition (i.e., had negative cash flow) for the previous three years, and the combination must be demonstrated to produce public interest benefits. All parties seeking "failed" or "failing" exemptions must also show that the in-market buyer is the only reasonably available candidate willing and able to acquire and operate the failed or failing property and that selling the property to any out-of-market buyer would result in an artificially depressed price.

Third, the FCC adopted a "pure case-by-case" waiver standard that will involve an evaluation of the totality of circumstances of each individual transaction without reference to any set of defined criteria or automatic presumptions, but with a particular focus on the impact the proposed merger would have on viewpoint diversity in the market. Although acknowledging that this approach might not promote consistency or predictability in the marketplace, the Commission found that this approach would provide maximum flexibility and would lead to the best result in individual markets. An applicant seeking a waiver under this standard will have to show that grant of the waiver will not unduly harm viewpoint diversity. Parties may also seek waivers for "good cause" under 47 U.S.C. § 1.3. At the same time it modified its waiver standards, the FCC altered the timetable on which parties must seek waivers. Under the prior rules, a broadcast licensee that triggered application of the NBCO rule with a newspaper acquisition could continue to own the newspaper for the longer of one year or until the station's next renewal date. The 2016 Order instead requires that parties seek a waiver prior to consummating the transaction that implicates the rule.

D. Radio/Television Cross-Ownership Rule

In the 2016 Order, the Commission retained its existing television/radio cross-ownership rule, which governs the number of commercial radio and television stations an entity may own in the same market. The rule permits a single entity to own varying numbers of stations depending on the size of the market, as follows:

- in a market where at least 20 independently owned media "voices" would remain post-merger, up to two TV stations (subject to the local television ownership rule) and up to six radio stations (subject to

the local radio ownership rule), or one TV station and seven radio stations;

- in a market where at least 10 independently owned media "voices" would remain post-merger, up to two TV stations (subject to the local television ownership rule) and up to four radio stations (subject to the local radio ownership rule); and
- in all other markets, up to two TV stations (subject to the local television ownership rule) and up to one radio station.

The FCC reasoned that retention of the TV/radio rule serves the public interest by preserving viewpoint diversity in local markets.

In order to reflect changes in the way that station contours are measured following the digital transition, the Commission also modified the scope of the rule in two respects. First, it decided to use the digital PCC to assess whether a television station's contour encompasses a radio station's community of license. Second, it determined that it should count all voices within a television station's digital NLSC for the purposes of determining how many voices would remain in a market following a station acquisition. The FCC grandfathered any existing newspaper/broadcast combinations that no longer comply with the rule as a result of these changes to the scope of the rule, but declined to allow transfers of grandfathered combinations.

E. Dual Network Rule

The dual network rule generally allows entities to own more than one broadcast network, but it prohibits mergers or affiliations between and among the four largest national networks (ABC, NBC, CBS, and FOX). In the 2016 Order, the agency decided to retain the rule, stating that doing so was necessary to foster competition in the provision of primetime entertainment programming and the sale of national advertising time. The FCC found that neither broadcast networks outside of the top four nor cable networks have the ability to compete meaningfully for consistent, large primetime audiences. Noting the large disparity between advertising rates earned by top four broadcast networks and other broadcast and cable networks, the Commission also expressed concern that a combination of two top four television networks would reduce the choices available to advertisers seeking large national audiences, and could lead the networks to pay less attention to viewer demand for innovative, high-quality programming. In addition, the FCC found that any merger of two top four networks would hinder the bargaining power of individual stations in negotiating network affiliation contracts. According to the Commission, affiliates also would have diminished ability to resist the networks' influence over their local programming, which in turn, could hamper stations' ability to serve their local communities.

II. DIVERSITY ORDER REMAND

In the 2016 Order, the Commission re-adopted its revenue-based eligible entity standard, which the Third Circuit had vacated and remanded to the agency in *Prometheus II*. In so doing, the Commission found that reinstating the eligible entity definition "will serve the public interest by promoting small business participation in the broadcast industry and potential entry by new entrepreneurs." The Third Circuit also directed the

Commission to consider race- and gender-based classifications. The Commission did so but declined to adopt such classifications, stating that the record appeared insufficient to satisfy the stringent legal requirements that apply to race- and gender-based classifications.

In addition, the agency re-adopted each of the measures relying on the revenue-based test that the Third Circuit had previously remanded, as follows:

- A revision of the construction permit rules to allow for the sale of an expiring construction permit to an eligible entity that pledges to build out the permit within the time remaining in the initial permit, or within 18 months, whichever period is longer;
- A revision of the equity/debt plus (EDP) attribution standard for eligible entities;
- A revision of the distress sale policy to allow the sale of a license subject to a revocation hearing or license renewal hearing on basic character issues to an eligible entity prior to the hearing;
- A preference for applicants seeking to acquire duopolies where the applicant agrees to finance or incubate an eligible entity;
- An agreement to consider request to extend divestiture deadlines when applicants have actively solicited bids for divested properties from eligible entities; and
- A revision of the grandfathering policy under the local radio ownership rule permitting the sale of a grandfathered station combination intact provided that the buyer files an application to assign the excess stations to an eligible entity within 12 months.

The Commission also catalogued a variety of additional diversity-enhancing initiatives that are already being pursued, including the following:

- A number of previously adopted rules that were not remanded by the Third Circuit, such as (1) a ban on discrimination in broadcast transactions; (2) a "zero tolerance" policy for ownership fraud; (3) a requirement to include anti-discrimination provisions in advertising sales contracts; and (4) the failed station solicitation rule, which is intended to provide out-of-market buyers, including women and minorities, with advance notice of a sale before the seller seeks a waiver of certain ownership rules;
- The efforts undertaken by the Commission's Office of Communications Business Opportunities to promote small business participation and ownership diversity, including workshops and conferences;
- Steps to help facilitate investment in the broadcast industry by foreign investors, including in the 2013 declaratory ruling and pending rulemaking proceeding concerning broadcast foreign ownership;
- A recommendation to Congress to pass tax deferral legislation to spur ownership diversity among small businesses, including those owned by women and minorities;
- Efforts to enhance the AM radio service;
- A study of Hispanic television viewing; and

- Continuing improvements to ownership data collection and accessibility.

Although the agency declined to adopt additional diversity-related rules in the 2016 Order, it did agree to consider other such measures in the future. Specifically, the Commission stated that it would:

- Consider how to promote minority ownership in relevant media-related rulemaking proceedings in the future;
- Explore whether, and if so, how, to extend the requirement that cable systems "encourage minority and female entrepreneurs to conduct business with all parts of its operations," to broadcasters;
- Direct the Media Bureau to consider, in the next quadrennial review, additional proposals to enhance ownership diversity; and
- Direct the Media Bureau, Enforcement Bureau, and Office of the Managing Director to discuss the feasibility, implications, and logistics of shifting the enforcement of the media equal employment opportunity rules to the Enforcement Bureau.

III. SEPARATE STATEMENTS

Commissioners Clyburn, Pai, and O'Rielly issued statements in connection with the 2016 Order. Commissioner Clyburn voiced support for the outcome of the proceeding, noting in particular the adoption of the "failed/failing" property exception to the NBCO rule and the need to proceed with caution given the uncertainty created by the broadcast incentive auction. At the same time, Commissioner Clyburn faulted the FCC for failing to take more proactive steps to address minority and female ownership. Commissioners Pai and O'Rielly dissented from the 2016 Order, with both identifying multiple legal flaws and faulting the Commission for not adopting any meaningful reforms to its broadcast ownership rules.

If you have any questions about the 2016 Order or the media ownership rules, please contact the Wiley Rein attorney who regularly handles your FCC matters or one of the attorneys listed on this alert.