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ALERT

FCC Streamlines Its Broadcast Foreign Ownership Rules and Establishes New Framework for Public Companies to Assess Foreign Ownership Compliance

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On September 30, 2016, the Federal Communications Commission (FCC or Commission) issued a Report and Order (Order) adopting new foreign ownership rules. First, the Order describes new "streamlined" procedures that broadcasters must follow when filing a petition for declaratory ruling seeking FCC approval to exceed the foreign ownership limits set forth in Section 310(b)(4) of the Communications Act. Second, the Commission reformed the methodology for publicly traded broadcasters and common carriers to assess compliance with the statutory foreign ownership limits set forth in Sections 310(b)(3) and 310(b)(4) of the Act, and made clear that private companies are expected to have full knowledge of the extent of their foreign ownership. The FCC believes these changes "will facilitate investment from new sources of capital at a time of growing need for investment" in the broadcast sector while also providing greater transparency, more predictability, and reduced regulatory burdens and costs.

Section I of this alert provides brief background on the FCC's foreign ownership rules, Section II reviews the new streamlined procedures for broadcasters, Sections III-VI summarize the new framework for assessing compliance, and Section VII covers the concurring statements issued on the unanimous adoption of the Order.

I. Background

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Section 310 of the Communications Act restricts foreign ownership in broadcast, common carrier and certain other licenses. Section 301(b)(3) precludes foreign individuals and entities from having more than a direct 20 percent interest in broadcast, common carrier, aeronautical en route and aeronautical fixed licensees. Although the agency has used its "forbearance" authority to approve direct foreign ownership in common carriers above the 20 percent limit, the Order confirms that, for broadcasters, the Commission lacks authority to waive the statutory 20 percent direct ownership limit.

Section 310(b)(4) establishes a 25 percent benchmark for investment by foreign individuals, governments, and corporations in U.S.-organized entities that directly or indirectly control a U.S. broadcast, common carrier, or aeronautical radio licensee. Foreign investment above 25 percent of the voting stock or equity of U.S. organized companies that control a licensee subject to the foreign ownership restrictions must be approved by the FCC. The FCC has, for many years, approved requests by common carriers to exceed the 25 percent threshold, and, in 2013, the Commission streamlined its policies and procedures for review of foreign ownership of common carrier and aeronautical licenses. While the Commission historically has not approved foreign ownership above the 25 percent limit in the broadcast context, it has recently expressed a greater willingness to consider these requests. Indeed, in 2015, the Commission approved the request of a broadcast radio licensee to exceed the 25 percent indirect foreign ownership benchmark in the Pandora Declaratory Ruling. The Commission then issued a Notice of Proposed Rulemaking (NPRM) in which it proposed to simplify the foreign ownership approval process for broadcast licensees by extending the streamlined rules and procedures developed for foreign ownership reviews for common carrier and certain aeronautical radio licensees to the broadcast context. In the Order, the FCC has taken another step, extending, with some modifications, those procedures to its review of indirect foreign ownership in broadcast licensees.

The new rules leave intact the existing "Team Telecom" review process, under which the FCC refers certain proposed foreign investments in communications companies to a working group of representatives from the U.S. Departments of Homeland Security, Defense, Justice, State, Treasury, and Commerce, as well as the U.S. Trade Representative and Federal Bureau of Investigation. The FCC has a pending rulemaking proceeding concerning ways to improve the timeliness and transparency of the Team Telecom referral process, but for now it will continue to factor as another regulatory hurdle that communications companies seeking to increase their foreign ownership levels must pass.

II. Streamlined Procedures Now Applicable to Broadcasters

Under the Commission's new rules, broadcast licensees may follow a streamlined procedure to request approval for:

- up to and including 100 percent aggregate foreign ownership (voting and/or equity) by unnamed and future foreign investors in the controlling U.S. parent of a broadcast licensee, subject to certain conditions;
- any named foreign investor that proposes to acquire a less than 100 percent controlling interest to increase the interest to 100 percent at some future time; and

- any non-controlling named foreign investor to increase its voting and/or equity interest up to and including a non-controlling interest of 49.99 percent at some future time. (¶15)

In addition, broadcasters filing a petition for declaratory ruling must obtain specific approval for foreign investors that hold or would hold, directly or indirectly, more than 5 percent (and in certain circumstances, more than 10 percent) of the U.S. parent's voting and/or equity interests, or a controlling interest in the U.S. parent. (¶16) Broadcasters seeking permission to exceed the 25 percent foreign ownership benchmark must file a petition for declaratory ruling, setting out specific information prescribed the FCC's rules. In these basic respects, the procedures applicable to broadcasters are similar to those that apply to common carriers and others subject to the foreign ownership limitations. However, the Order sets forth five major modifications of the current foreign ownership approval process applicable to common carriers that will be specific to broadcast licensees seeking permission to exceed the 25 percent foreign ownership benchmark.

1. Disclosable Interest Holders

Petitions for declaratory ruling must provide certain information about "disclosable interest holders." Specifically, broadcasters will be required to disclose the name, address, citizenship, and principal business of any individual or entity that holds or would hold, after implementation of any planned ownership changes, an "attributable interest" in the broadcast licensee, as determined under the traditional broadcast attribution rules. (¶20) Although the attribution rules have a number of exceptions, in general, any entity or individual holding: (1) a five percent or greater voting stock interest in a corporation; (2) any general partnership, uninsulated limited partnership, or uninsulated limited liability company interest; or (3) in certain cases, more than 33 percent of a licensee's "total asset value" (defined as all equity plus all debt), would be considered attributable and thus a "disclosable interest holder." This differs from the disclosable interest holder definition that applies to common carriers, which requires disclosure of any entity or individual that holds a 10 percent or greater equity or voting interest.

The FCC notes that the new rule "provides regulatory certainty and ease of compliance while minimizing disruption to broadcasters. The attribution rules represent longstanding broadcast policy, and broadcasters are familiar with these rules." (¶21)

2. Specific Approval of Named Foreign Investors

Petitions for declaratory ruling generally must also identify and request specific approval for any foreign individual or entity, or "group" of foreign individuals or entities, that holds or would hold directly or indirectly more than five percent (or, in certain situations, more than 10 percent) of the equity and/or voting stock of, or a controlling interest in, the U.S. parent of a licensee. The entities requiring specific approval are referred to as "named foreign investors." Under this standard, it appears that a broadcaster with no attributable foreign owners—and thus no foreign "disclosable interest holders"—will still need to seek specific approval for "non-attributable" foreign investors if their non-attributable interest exceeds the five (or, if applicable, 10) percent threshold for specific approval. The FCC acknowledges that the criteria used to identify which investors qualify as "named foreign investors" (which apply equally to broadcasters and others) are "broader in scope than the broadcast attribution rules." (¶ 24)

Petitions must also include the name and citizenship of entities and individuals that hold "attributable interests" in the named foreign investors. (¶22) So, again, it appears that information regarding individuals or entities with an "attributable interest" in a "named foreign investor" will need to be provided, even if the named foreign investor itself holds a non-attributable interest in the broadcast licensee (such as a non-voting stock interest, insulated limited partnership or insulated LLC interest).

3. Insulation Criteria

Under the current rules applicable to common carriers, the Commission determines the foreign equity and voting interests held in limited partnerships or limited liability companies based, in part, on whether interests are "insulated" under criteria set forth in the foreign ownership rules. The FCC's broadcast attribution rules also contain specific insulation criteria, which differ from those used in the common carrier analysis. The Order specifies that broadcast petitioners must use the broadcast insulation criteria when calculating foreign equity and voting interests in controlling U.S. parents of broadcast licensees. The Commission notes that broadcasters are familiar with these criteria, and "many broadcast interests have relied upon and have executed their organizational documents based on these insulation criteria." (¶28)

While this is true, it could prove to be a problem when an otherwise non-attributable interest holder is a "named foreign investor." For example, assume a non-U.S. limited partnership holds a non-voting stock interest in the U.S. parent of a broadcast licensee that exceeds the five percent equity threshold. Under traditional broadcast attribution analysis, neither the limited partnership nor any of its limited partners would be deemed to hold an attributable interest in the broadcast licensee because non-voting stock is non-attributable. This would be true even if the investor's limited partnership agreement does not contain the standard broadcast insulation criteria. Now, however, it appears that the limited partnership would be a "named foreign investor" and would need to disclose information about its "attributable" owners. Thus, if the limited partnership agreement does not have the broadcast insulation criteria (which, as noted, would not have been needed under traditional broadcast attribution analysis), information about all of the limited partnership's "attributable" limited partners will need to be disclosed.

4. Service- and Geographic-Specific Rulings

Under the current common carrier rules, a foreign ownership ruling applies to all types of common carrier wireless services (*e.g.*, satellite, CMRS, microwave, AWS), and is *not* geographically specific. The Commission adopts a similar approach in the Order—broadcast licensees will not be required to file new petitions for each broadcast station acquisition or when acquiring licenses in an additional broadcast service (*e.g.*, a company that owned only radio stations and obtained a foreign ownership declaratory ruling would not need an additional declaratory ruling to acquire a television station). Licensees, including any covered affiliates or subsidiaries, that have rulings for foreign investment may apply those rulings to after-acquired broadcast licenses, regardless of the broadcast service or the geographic area in which the stations are located. However, entities that have obtained a broadcast ruling may not use that ruling to cover an after-acquired common carrier (and vice versa). (¶¶31-32) Instead, a separate ruling will need to be obtained. At the same time, the FCC states that it will entertain petitions seeking approval as both a common carrier and broadcaster, provided that the petitioner includes all information required in both common carrier and broadcaster petitions. If such a petition were granted, the ruling would apply to subsequent acquisitions of both types of licenses.

5. Filing and Processing of Broadcast Petitions

Broadcasters seeking a declaratory ruling regarding the 25 percent foreign ownership benchmark must file petitions electronically in CDBS as an attachment to the underlying application for a construction permit, assignment, or transfer of control application filed with the Commission. A broadcast petition filed in the absence of an underlying broadcast application must be filed electronically in ECFS as a non-docketed filing. In either case, the petition will subsequently receive a docket number and a public notice seeking comment will be released. (¶34).

III. Methodology for Assessing Compliance with the 25 Percent Foreign Ownership Benchmark

1. Known or Reasonably Should Be Known Standard

The Commission has long held that all licensees subject to the foreign ownership requirements are responsible for monitoring their ownership and maintaining compliance with the rules. This obligation has proven to be especially troublesome for publicly traded corporations, which often lack complete information about their owners. Traditionally, the FCC advised these licensees to conduct periodic surveys, which themselves proved to be ineffective because most shares today are held in "street name," which makes it difficult to determine the actual owners of the shares.

In order to deal with these problems, the Commission has now adopted a new standard: A licensee with a U.S.-organized public company in its ownership chain will be permitted to rely solely on ownership information that is "known or reasonably should be known" to the public company to ascertain the company's foreign equity and voting interests under Sections 310(b)(3) and 310(b)(4). (¶44) In a significant change from a prior practice that had been approved in the common carrier context, however, the FCC concluded that a licensee may not rely on the "address of record" of a shareholder to serve as a proxy for that shareholder's nationality. However, if the only information about a shareholder is a foreign address, the shareholder should be counted as foreign unless a further inquiry is conducted that determines that the shareholder is not foreign. (¶ 64)

The Order notes numerous sources from which a publicly traded company can (and is now expected to) obtain ownership and citizenship information. For example, Section 13(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), and Exchange Act Rule 13d-1 require a person or "group" that becomes, directly or indirectly, the "beneficial owner" of more than five percent of a class of equity securities registered under Section 12 of the Exchange Act to report the acquisition to the U.S. Securities and Exchange Commission (SEC). Accordingly, the rules adopted by the Commission require licensees or their publicly-traded parents to review the beneficial ownership reports filed with the SEC (Schedules 13D and 13G) and monitor other widely available sources of information about institutional ownership of U.S. publicly traded equity securities. (¶46)

Licensees and their controlling U.S. parents should also assess the ownership of their publicly traded equity securities more broadly through additional sources of information, including, for example: (i) Internet-based news and other sources; and (ii) data gatherers that compile and distribute information and analysis about ownership of publicly traded equity securities for a fee. (¶49) The FCC notes that much of this information is based on quarterly filings submitted by institutional investment managers (including foreign-organized managers) with investment discretion over an aggregate value of $100 million or more in stocks traded on the primary U.S. stock exchanges. These filings are submitted pursuant to Section 13F of the Exchange Act and related rules and are referred to as 13F filings. Thus, the FCC states that licensees and publicly traded companies should monitor 13F filings as well, even though such filings do not necessarily reveal the ultimate beneficial owner of a company's stock. The Commission also suggests that Form ADV, which all registered institutional investment managers must file, may contain additional information regarding the citizenship of managers identified on 13F filings and on Schedules 13D and 13G.

The Order further specifies that the following will be considered "known"—and therefore must be ascertained—under the new rules:

- citizenship of owners of registered shares and shares held by officers and directors;
- citizenship of the shareholders of securities held by pre-IPO founders of the company;
- nonregistered voting shares held by beneficial owners required to be identified in a company's annual and quarterly reports;
- shareholders and their citizenship identified as a result of shareholder litigation, financing transactions, and proxies voted at annual or other meetings; and
- shareholders whose interests and citizenship are actually known to the company by whatever source, whether the interests exceed 5 percent or not. (¶50)

De minimis interest holders, including Non-Objecting Beneficial Owner (NOBO) shareholders that are not otherwise identifiable (*e.g.*, through SEC filings), generally will not need to be identified. (¶51) The new rules also eliminate the need for a publicly held licensee or controlling U.S. parent to attempt to use surveys or random sampling techniques for purposes of ensuring that the licensee is able to certify compliance with Section 310(b). (¶53) The FCC also found that participation in the Depository Trust Company's "SEG-100" program—which allows for the deposit of foreign-owned shares into a segregated account for monitoring—serves as a "useful check" on monitoring foreign ownership levels but cannot be used as a standalone method for demonstrating compliance with Section 310(b), and that companies are not required to participate in it to monitor compliance. (¶ 56)

2. Determining Citizenship

The Commission also provided additional guidance that licensees should follow in monitoring their foreign ownership.

- For purposes of determining the citizenship of their directors, officers, and employees, U.S. public companies should obtain citizenship information through direct inquiry.
- If the company has other registered shareholders, the company should rely on publicly available information and/or attempt to query these interest holders directly. (¶58)
- Companies are entitled to rely on publicly available information with respect to non-registered identifiable interest holders, including information gleaned from SEC filings, information specifically known to the company, and/or information received by the company through direct inquiries. (¶59)

For purposes of classifying a U.S. public company's identifiable beneficial ownership interests (which the FCC equates with voting interests) and equity interests as "U.S." or "foreign," the Order specifies that licensees should apply the following guidelines:

- A licensee may classify beneficial interests as "U.S." where the licensee has established a reasonable basis for concluding that the beneficial owner and all individuals and entities in the beneficial owner's vertical chain of control are U.S. citizens and/or U.S.-organized entities that are ultimately controlled by U.S. citizens.
- Where the beneficial owner is itself a foreign-organized entity, or where there is a foreign-organized entity in the beneficial owner's vertical chain of control, the licensee should classify the voting interest in the shares held by the beneficial owner as "foreign" even if the beneficial owner is ultimately controlled by U.S. citizens.
- Where the licensee has identified more than one person as beneficially owning (*i.e.*, having the right to vote) the same shares, and at least one such person is foreign, the licensee should classify the voting interests in those shares as foreign even if the other beneficial owner's interests would otherwise warrant treatment as "U.S."
- With respect to a U.S. public company's identifiable equity interests, the licensee may classify such equity interests as "U.S." where the licensee has established a reasonable basis for concluding that the ultimate beneficiary or beneficiaries of the shares are U.S. citizens or U.S.-organized entities that are controlled by U.S. citizens. (¶61)

In the Order, the FCC rejected the assertion made by some commenters that it is not possible to conduct an up-the-chain analysis of public companies to determine the citizenship of such companies' indirect interest holders. In so doing, the Commission reiterated that "the relevant interests will be limited to those that are known or reasonably should be known to the public company in the ordinary course of business."The Commission further stated that its guidelines prescribe a reasonable means for licensees to look up the chain of ownership to capture indirect foreign interests. (¶62)

3. Calculating Foreign Ownership Levels

For purposes of calculating aggregate levels of foreign ownership, a licensee must separately aggregate the "known or reasonably should be known" foreign voting interests and the "known or reasonably should be known" foreign equity interests of the public company in its ownership chain. If, as a result, neither the foreign voting interests nor the foreign equity interests exceed 20 or 25 percent, as applicable, then the company will be deemed compliant with the statutory ownership limit. (¶68) In a significant change from past practice, licensees need not apply any presumed percentage of foreign ownership to unidentifiable shareholders of a U.S. public company. (¶70)

The FCC declined to allow a U.S. public company to have non-attributable foreign ownership up to an aggregate 49.99 percent non-controlling amount. However, the Order states that the Commission "intends to monitor how the rules we adopt today respond to the needs and concerns of interested parties, and may review these issues again at a later date once the effectiveness of our new rules is evaluated and assessed." (¶71)

IV. Compliance Procedures

1. Monitoring Compliance

The Commission concludes that monitoring is a reasonable approach to ensure compliance with foreign ownership limits. However, the Commission declined to adopt periodic compliance and monitoring options proposed by some commenters in response to the NPRM. (¶75) Rather, the obligation to monitor compliance is an ongoing one.

2. Remedial Procedures Available to Publicly Traded Companies

The Commission recognizes that a publicly traded company relying on information gleaned from SEC filings in the ordinary course of business may become aware of new investments in the company that cause it to exceed the foreign ownership limits only after those investments are made. In these situations, the licensee may generally file a remedial petition for declaratory ruling seeking approval of the above-benchmark, aggregate foreign ownership interests, or the company itself may remedy the non-compliance by, for example, redeeming the foreign interest(s) that rendered the licensee non-compliant. (¶80)

Although the Commission emphasized that licensees are required to obtain agency approval before the aggregate direct or indirect foreign ownership limits are exceeded, it stated that it does not, "as a general rule," expect to take enforcement action related to the non-compliance involving publicly traded companies provided that: (1) the licensee notifies the relevant Bureau by letter no later than 10 days after learning of the investment(s) that rendered the licensee non-compliant and specifies in the letter that it will file a petition for declaratory ruling or take remedial action to come into compliance within 30 days of the date it learned of the non-compliant foreign interest(s); and (2) the licensee demonstrates in its petition for declaratory ruling (or in a letter notifying the relevant Bureau that the non-compliance has been timely remedied) that the licensee's non-compliance was due solely to circumstances beyond the licensee's control that were not reasonably foreseeable to or known by the licensee with the exercise of the required due diligence. (¶80) As part of this demonstration, the licensee also will need to demonstrate that it exercised due diligence in monitoring its foreign ownership levels. (¶¶ 83-84)

For publicly traded common carriers, these procedures are available to remedy violations of both the 20 percent direct foreign ownership limit imposed by Section 310(b)(3) and the 25 percent indirect foreign ownership limit imposed by Section 310(b)(4). However, the FCC clarifies that a publicly traded broadcast licensee that is, or becomes, noncompliant with the 20 percent direct statutory limit in Section 310(b)(3) must take steps to come into compliance immediately upon learning of the non-compliance. (¶82)

Finally, the Commission states that if a licensee has elected to file a remedial petition for declaratory ruling, it will not require any other remedial action (*e.g.*, redemption of shares) while the petition is pending. However, the licensee "must have a mechanism available to come into compliance" if the FCC ultimately denies the petition, and the agency reserves the right to require immediate remedial action to address national security or other "significant concerns" raised after consultation with the relevant executive branch agencies. In this regard, although the Commission decided that it would not require licensees to place restrictions in their organizational documents that enable them to ensure continued compliance with the foreign ownership rules (¶ 77), many entities subject to foreign ownership restrictions have included these types of provisions in their organizational documents.

3. Privately Held Entities

Rejecting arguments to the contrary, the Commission affirms in the Order that privately held entities should have knowledge of all of their owners, including their citizenship, and should be able to track their foreign ownership levels relatively easily. Accordingly, the Commission will continue to require privately held entities to account for the ownership of all their voting and non-voting equity interests—and, they must maintain compliance with the rules. (¶87) Thus, the agency is less likely to be forgiving to a private company that has exceeded the limits, as the FCC expects those companies to be fully aware of their foreign ownership at all times and seek any necessary approvals before the foreign ownership limits are exceeded.

V. Legal Authority and Corrections and Clarifications of Existing Rules

The Commission also discusses its legal authority for adopting the new methodology and finds that its approach is consistent with applicable precedent. (¶¶89-98) In addition, the FCC found that interests that are not known to a U.S. public company and that the public company cannot reasonably be expected to know in the ordinary course of business are not contrary to the public interest in the absence of countervailing evidence, and do not need to be included for purposes of calculating a licensee's aggregate levels of foreign ownership under Section 310(b). (¶97)

The Commission also adopts several technical and clarifying revisions to its rules necessary to effectuate the changes discussed in the Order. (¶¶99-103)

VI. Transitional Issues

The rule changes adopted in the Order will be applied prospectively. Thus, licensees subject to an existing foreign ownership ruling must continue to comply with the terms and conditions of their rulings, including Commission rules and policies in effect at the time the ruling was issued. Petitions for declaratory ruling that are pending before the Commission as of the effective date of the rules will be decided based on the new rules. (¶104)

VII. Order Unanimously Adopted

The Order was approved unanimously by all five FCC Commissioners at the FCC's September 29, 2016 Open Meeting. Commissioner Clyburn praised the rule changes as "provid[ing] more efficient approaches, offer[ing] greater transparency and predictability, and enhanc[ing] access to capital opportunities for broadcasters, while reducing regulatory burdens and costs." Commissioner Rosenworcel noted that investment is key to ensuring a bright future for broadcasting and that the new rules "remove barriers for investment and provide clarity for broadcasters seeking support for new technologies and new ways to reach the communities they serve." Commissioner Pai emphasized that, while making it easier for broadcasters to access capital, the new rules do not compromise national security. Chairman Wheeler touted the rule changes as in line with the Commission's process reform efforts aimed at "leveling the playing field, so different industries aren't unreasonably held to different standards." Commissioner O'Rielly voted for the item but "would have done things differently," including raising the overall reporting threshold. Commissioner O'Rielly also called upon the Commission to finish its proceeding on Team Telecom, stating that "We can take all the steps we want, but if Team Telecom can hold up applications for years in a regulatory abyss, all of these improvements are of little value."