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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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OFFICE OF THE SECRETARY

In re:	)	
Implementation of Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-264
Horizontal and Vertical Ownership Limits, Cross-Ownership Limitations and Anti-trafficking Provisions	)	

To the Commission:

COMMENTS OF SANDLER CAPITAL MANAGEMENT

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SUMMARY

The Commission's adoption of a modified version of its current broadcast rules to determine when there has been a "transfer of control" of a cable system under Section 617 will prevent "profiteering" transactions which might result in higher rates or poorer service. Under the proposed test, only "substantial" (i.e., "long-form") transfers involving more than 50% of a cable system's equity should be subject to the anti-trafficking rule. Convertible debt instruments, as well as any publicly traded stock, security or limited partnership interest, should be exempt from the three-year holding period.

In addition, changes in control, when not accompanied by a substantial change in the equity ownership of a cable system, should not be subject to the three-year holding period. This would include, for example, the right to appoint a majority of a board of directors or that of a partner to exercise its right to become the managing partner of a partnership.

The specific exemption under Section 617 for "any sale required by law" should cover the sale of a cable system from a receiver or trustee to a third party for the benefit of creditors, or the acquisition for sale or subsequent sale by the creditor itself. In addition, the unavailability of capital sufficient to maintain an adequate level of cable television service should be good cause for the granting of

a waiver. Moreover, a waiver applicant that demonstrates that the transfer of a cable system will not lead to increased rates or decreased service should be viewed favorably.

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To the Commission:

COMMENTS OF SANDLER CAPITAL MANAGEMENT

Sandler Capital Management ("Sandler")[1/], by its attorneys, hereby submit comments in the above-captioned proceeding.

INTRODUCTION

Any limitations that will restrict the cable television industry's continued ability to attract investment must be viewed with concern given the significant regulations imposed by the Cable Television Consumer

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1/ Sandler Capital Management, a registered investment advisory firm, and its affiliated partnerships have extensive experience in the areas of public and private investment management, debt and equity credit research, investment banking and operations in the communications industry. Through the Sandler Partnerships and its affiliates, the Sandler organization manages net assets substantially in excess of $450 million, which have been invested in the public and private equity and debt securities of cable television companies and other media, telecommunications and entertainment businesses.

Protection and Competition Act (the "1992 Cable Act").[2/] The Commission must therefore approach its responsibilities to implement the anti-trafficking provisions of the 1992 Cable Act cautiously, and consider the impact its regulations will have on future investment in the industry.

Lending institutions, investment houses and private investors provide the cable industry with sources of capital essential to maintain stability and achieve growth. If the Commission's regulations achieve a proper balance, they will succeed in maintaining stability and growth -- but if the rules are inflexible and overbroad, then these sources of funds will look elsewhere. A vote of confidence has already been made by those that have invested their capital in the industry -- but this investment must continue. The Commission should therefore insure that its anti-trafficking regulations do not create a disincentive for investment.

Sandler submits that the Commission's existing broadcast transfer and assignment rules provide a well-defined and administratively workable basic framework for defining the types of ownership changes in cable systems that Congress intended to reach or to exempt under Section 617 of the 1992 Cable Act. Thus, with some exceptions, the Commission's existing rules and policies defining

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2/ Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, 106 Stat. 1640 (1992) (codified at 47 U.S.C., title VI) (the "1992 Cable Act").

"substantial" or "long-form" sales and assignments under Section 310(d) of the Communications Act embrace all of the transactions that Congress sought to subject to the three-year holding period. Similarly, the existing categories of pro forma or "short form" applications defined in Section 73.3540(f) and Section 73.3541 as construed by the Commission in its prior decisions will define the changes in cable ownership that Congress specifically sought to exempt.

The Commission, over several decades, has construed and honed its transfer and assignment policies distinguishing between "substantial" and pro forma changes in control to define those transactions that involve changes in ownership and control that are significant and those which involve changes of little regulatory concern -- indeed, if anything, the Congress appears to have modeled the statute on the Commission's own long-standing rules. Reference to the developed and long-standing body of case law at the Commission on the "substantial"/pro forma distinction will be of enormous value in administration of the anti-trafficking provisions of the 1992 Cable Act. Adoption of the broadcast transfer regime as the basis for the new anti-trafficking rules also will permit the Commission to serve a critical role as arbiter of the new national standard.

While the broadcast rules provide a workable framework for the Commission's interpretation of Section 617 of the 1992 Cable Act, Congress had narrower policy objectives than those served by the broadcast transfer policy. Thus, Congress sought only to prevent profiteering transactions that could affect cable television rates or service, while the broadcast transfer policies have the additional objectives of ascertaining legal, financial, and other qualifications of licensees. The 1992 Cable Act, like its predecessor, leaves the question of the qualifications of a cable operator, as well as regulation of a variety of operational matters, in the hands of local franchising authorities. Some changes that would constitute a "long-form" change of control under broadcast policies nevertheless are not accompanied by a transfer of equity ownership sufficient to raise any question of "profiteering" transactions that could reasonably be expected to have any impact on cable rates and services. Thus, in adopting the broadcast transfer policies as the basis for its regulations interpreting Section 617, the Commission should remain faithful to Congress's purpose and acknowledge appropriate exceptions for certain transactions.

I. The Commission Should Apply a "Substantial Transfer of Control" Standard To Those Transactions Affected by Section 617.

Congress initiated the three-year holding period to limit "profiteering transactions" that would adversely affect cable television system rates or service in the community served by the transferred cable system.[3] Viewed in light of this language, Congress did not intend the phrase "transfer of ownership" merely to refer to changes in control of a cable system, but to changes in control that could adversely affect cable television rates or service. The Commission should therefore structure its regulations so that opportunities to invest in and strengthen the cable industry are not unduly constrained.

Sandler urges the Commission, in implementing these rules, to bear in mind all of the sound policy reasons guiding its ongoing reevaluation of the broadcast attribution rules.[4] As the Commission cogently stated in that proceeding: "[E]nhanced investment opportunities should provide all media companies with more choices in funding sources, decreased capital formation costs and ultimately more resources with which to provide service to the public."[5]

A. <u>The Three-year Holding Test Should Not Interfere with the Cable Industry's Ability to Attract Capital.</u>

Cable television is a capital intensive industry. It takes enormous sums of money initially to build or

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<u>3/</u> H.R. Rep. No. 102-628, 102d Cong., 2d Sess. 119 (1992) ("House Report").

<u>4/</u> <u>See</u> <u>Notice of Proposed Rulemaking</u>, MM Docket No. 92-51, FCC 92-96, 7 FCC Rcd. 2654 (March 12, 1992).

<u>5/</u> <u>Id</u>. at 2655.

Although it is appropriate, as discussed below, for the Commission to look to various components of its ownership and transfer rules to implement Section 617, the regulations adopted must be consistent with the policy underlying the three-year holding period. Thus, the Commission recognizes "it does not appear that Congress intended the anti-trafficking rule to restrict transfers of . . . noncontrolling ownership interests."[8/] Sandler believes that, far from establishing a standard for permissible transfers under Section 617, the attribution standards more properly define those minor transfers of interests that have no relevance to Congress's concerns and do not warrant regulatory scrutiny.

B. The Commission Should Adopt Its Broadcast Transfer and Assignment Rules and Policies Applying to "Substantial" Changes in Control as the Foundation for Its Rules Construing Section 617 of the 1992 Cable Act.

As the Commission recognized in the Notice, its existing rules and policies for broadcast transfers and assignments provide a well-defined regulatory framework for identifying those changes of ownership and control that should be subject to the three-year trafficking period and those that should be exempt. Indeed, Congress apparently modeled the exemptions in Section 617, to a large extent, on those transactions that broadcast transfer policies exempt

8/ NPRM at 6-7 (paragraph 12).

from plenary procedures as _pro forma_ transactions. While the narrower purposes of the Cable Act provision make certain additional exemptions appropriate, the existing distinctions between "substantial" and "_pro forma_" changes in control largely parallel those transactions that Congress intended to subject to the holding period and those it intended to exempt. Thus, Section 617 generally exempts "any sale required by operation of any law" and "any sale, assignment, or transfer to one or more purchasers, assignees, or transferees controlled by, controlling, or under common control with, the seller, assignor or transferor." This general language mirrors the Commission's construction of Section 73.3540(f) of its rules for voluntary _pro forma_ transactions and Section 73.3541 for involuntary transactions, changes that the Commission exempts from full review.[9]

The distinction between "substantial" and _pro forma_ changes of control is rooted in the Communications Act,rules which provides that those applications which involve a "substantial change of ownership or control" be subject to a public notice period and to petitions to deny. 47 U.S.C.A.

9/ Section 73.3541 of the Commission's broadcast rules treats as _pro forma_ those changes in ownership and control that result from a voluntary or involuntary bankruptcy, the judicial appointment of a receiver or trustee or the death or incapacity of a controlling principal of a broadcast licensee.

§ 309(c)(2)(B).[10/] In addition to its specific rules in Section 73.3540(f), the Commission has an extensive body of case law which has particularized its transfer standards and clarified the applications of its policies in many different

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10/ In pertinent part, the Act provides that:

> (a) Subject to the provisions of this section, the Commission shall determine, . . . [for each application for a construction permit, station license, or modification or renewal thereof, in non-emergency situations], whether the public interest, convenience, and necessity will be served by the granting of such application . . . .
>
> (b) Except as provided in subsection (c) of this section, no such application --
>
> > (1) for an instrument of authorization in the case of a station in the broadcasting or common carrier services . . .
>
> shall be granted by the Commission earlier than thirty days following issuance of public notice by the Commission of the acceptance for filing of such application or of any substantial amendment thereof.
>
> (c) <u>Subsection (b) of this section shall not apply</u> -- . . . (2) <u>to any application for</u> --
>
> > . . . (B) consent to an involuntary assignment or transfer under Section 310(b) of this title or to <u>an assignment or transfer thereunder which does not involve a substantial change in ownership or control</u> . . .
>
> (d) Any party in interest may file with the Commission a petition to deny any application (whether as originally filed or as amended) <u>to which subsection (b) of this section applies</u> at any time prior to the day of Commission grant thereof . . .

47 U.S.C.A. § 309 (1992) (emphasis supplied).

forms of transactions involving widely varied business structures.[11/]

Moreover, because the broadcast transfer rules and policies have been interpreted extensively by the Commission and the courts over several decades, their adoption as the foundation for interpreting Section 617 would provide a cogent, detailed body of law that may address many of the questions that will arise as the industry and the investment community adapt to the new legislation.

As adapted to Section 617, the broadcast transfer policies properly should be focused on a proposed transfer of a system.[12/] As a general rule, the transfer date for a system would provide a starting point analogous to being

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11/ For example, the Commission has considered how the distinction between "substantial" and *pro forma* changes or non-cognizable changes applies to partnerships, corporations and even changes in internal corporate governance. *See, e.g.*, *Storer Communications, Inc. v. Federal Communications Commission*, 763 F.2d 436 (D.C. Cir. 1985) (assessing whether a proxy fight over the composition of the Board of a publicly traded corporation amounted to a substantial change in control); *see generally*, Stephen F. Sewell, *Assignments and Transfers of Control of FCC Authorizations Under Section 310(d) of the Communications Act of 1934*," 43 *Fed. Comm. L.J.* 277 (1991).

12/ Thus, for example, "[t]hrough long administrative interpretation" the Commission has established that the test for a substantial change of control is "(a) whether 50% or more of the stock is being transferred . . . and (b) whether as a result of the transaction 50% or more of the outstanding stock will be held by a person or persons whose qualifications have not been approved of or 'passed upon' *for the particular station involved*." *Barnes Enterprises, Inc., Memorandum Opinion and Order*, 55 F.C.C.2d 721, 725 (1975) (emphasis added); *see also* *Gaffney Broadcasting, Inc.*, 35 R.R.2d 1607, 1609 (1976).

"passed upon in a long form application" for assessing whether a "substantial" change of control has occurred.

C. The Commission Should Recognize Exceptions to Its Broadcast Standards for "Substantial" Changes in Control to Exempt Those Transactions That Pose No Risk of an Adverse Impact on Cable Rates or Services.

Although the distinction between "substantial" and *pro forma* changes of control provides a foundation for rules interpreting Section 617, the objectives of the anti-trafficking rule, which are limited to "profiteering" transactions adversely affecting rates and services, are narrower than those of the broadcast transfer policies. Congress has specifically exempted a number of transactions that would be "substantial" changes under the broadcast rules and policies.[13/] Other exceptions may also be necessary to conform the broadcast transfer rules to the policy to be served by the 1992 Cable Act.

Blind application of the broadcast transfer policies to implement the holding period not only would overstep Congress's intent, but would unfairly place the cable industry at a competitive disadvantage vis-a-vis competing multichannel video providers which are not subject to the

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13/ For example, Section 617 exempts from the holding period "any transfer of ownership interest in any cable system which is not subject to Federal income tax liability." This provision specifically would exempt tax-free exchanges of properties and tax certificate transactions that unquestionably would require "long form" approval for a "substantial" change in control for a broadcast licensee.

same restrictions. For example, multichannel video providers that use wireless and the DBS technologies are free from the type of holding restrictions contained in the 1992 Cable Act, and in this regard their ability to attract capital remains unimpaired. Similarly, the broadcast industry is no longer inhibited by anti-trafficking regulations which preclude easy entry or exit of investors.[14/] Because among all the existing and potential multichannel video programming providers the anti-trafficking rule singularly affects the cable television industry, the Commission must be careful to implement regulations that will not hamper the industry's ability to attract and maintain an adequate base of investment in order to meet the competitive challenges which lie ahead.

1. Transfers Not Subject to Federal Income Tax Liability.

The 1992 Cable Act provides broadly in Section 617(a) that the three-year holding period shall "not apply to any transfer of ownership not subject to federal income tax liability." In accordance with this congressional mandate, the Commission should establish an exception in its rules for transactions recognized under the Internal Revenue Code

14/ Report and Order, FCC Docket 82-519, 52 R.R.2d 1081 (1982). The Commission's rationale for eliminating the broadcast three-year rule in 1982 should also guide the Commission as it implements regulations under Section 617. As the Commission recognized, there is no dichotomy between good service and the profitable resale of a communications facility. Id. at 1087.

as not appropriate for the recognition of gain or loss. The rules should provide, for example, that the three-year holding period does not apply to (1) transactions with respect to which the Commission issues a tax certificate under Section 1071 of the Code, thus permitting the seller to treat the transaction as if it were an involuntary conversion under Section 1033 of the Code; (2) involuntary conversions under Section 1033 of the Code, such as when property is taken by condemnation or destroyed by fire or flood; (3) like-kind exchanges under Section 1031 such as when one cable system, or a part of a system, is exchanged for another system in whole or part; and (4) corporate transactions which are not subject to recognition of gain or loss under part III of Subchapter C of the Code, such as contributions to capital of a controlled corporation under Section 351 and corporate reorganization as define in Section 368.

The exception to the anti-trafficking rules for those non-recognition transactions should make it clear that the transaction is exempt from the three-year holding rule even though some tax liability may result from the particular transaction. Recent amendments to the tax regulations governing the matching of property involved in a like-kind exchange under Section 1031 make it impossible to have a like-kind exchange without some tax liability since the many categories of assets in a cable system to be matched against each other will never match perfectly in terms of their value and going-concern value cannot be exchanged. Also, in virtually every case, cash or some other property must be used to equalize the system values, which will result in some tax liability. Similarly, the failure to replace fully an equivalent value of depreciable property will normally result in some tax liability in a Section 1071 or Section 1033 transaction. Corporate reorganizations and distributions will also result in tax liability to the extent money or non-qualifying property is used. Indeed, the parties to an exchange transaction or a Section 1071 tax certificate transaction typically will not know in advance how much taxable gain will result. Thus, the Commission's rules must be based on whether the transaction proposed is one which is described in the Internal Revenue Code non-recognition provisions cited above. Since virtually every such transaction will result in some tax liability, having the Commission's exception depend upon a complete absence of ultimate tax liability not only would render the statutory exception a dead letter but also would make the Commission's exceptions dependent upon the uncertainty of detailed tax liability determinations, which normally will not be known until long after the transaction is completed.

The Commission's exception rule should be broadly stated to cover any non-recognition transaction described in the Internal Revenue Code since an exhaustive list would be onerous to create and maintain. While the most common non-recognition transactions have been described above, the exception would, of course, also apply to (1) partnership transactions not subject to recognition of gain or loss under Subchapter K of the Code, including contributions under Section 721 and distributions under Section 731; (2) transfers to trusts, and lifetime and testamentary gifts; (3) sale of stock to employee stock ownership plans or certain cooperatives under Section 1042; (4) transfers between spouses under Section 1041; and (5) transfers within a corporate group which has elected to file consolidated federal income tax returns. This list is only illustrative of common non-recognition transactions and is not intended to be complete.

Accordingly, the Commission's exception rules should be stated broadly to apply to any non-recognition transaction described in the Internal Revenue Code and should not be dependent upon a complete absence of tax liability.

2. Convertible Debt.

Congress's objectives under the 1992 Cable Act require that debt instruments convertible into voting equity be treated differently than the broadcast transfer rules and policies otherwise would provide. Under the Commission's broadcast rules, the conversion of a debt instrument such as a convertible debenture into voting equity may require prior approval by a "long form" application if conversion would result in a substantial change in voting control. C.f. 47 C.F.R. §73.3555. This is consistent with the consideration in broadcasting that there be prior approval of a new controlling party. Congress' concerns with respect to cable transactions were quite different. Here the issue is whether "profiteering" might place cable systems in the hands of ill-funded, debt-laden new owners that could not maintain services absent substantial rate increases. Conversion of a debt instrument to equity, however, has the opposite result: the former debtor becomes a stockholder and the cable system, relieved of the burden of the debt, is rendered stronger. Under these circumstances the cable system is actually put in a better position to acquire additional capital to improve its service.

A franchising authority would still be in a position to consider the qualifications of a party that moved into a control position by such a conversion. As far as the policy underlying the federal holding period is concerned, however, transactions of this sort should be both exempted and encouraged. Thus, the conversion of debt into equity where a system was acquired less than three years before the conversion, should not trigger the three-year holding period. Moreover, to encourage the holders of such instruments to move to an equity position, the Commission should provide that the holding period for the sale of stock or other interests obtained in such conversions will be determined based on the date that the original instrument was acquired, rather than the conversion date.

3. Public Market Transactions.

The Commission should clarify specifically that the holding period does not apply to any publicly traded stock, security, or limited partnership interest. There is certainly nothing in Section 617 to suggest that Congress intended the dramatic disruption to the industry or the public securities markets that application of the holding period to these interests would cause. In large part, such an exemption would follow, in most cases, from the application of the attribution guidelines, as part of the broadcast transfer policies, to treat most such transactions as "non-cognizable." Even where the stock or other interest is "cognizable," however, public market transactions do not present the risk of "profiteering" transactions or "flips" of cable systems. With its concern that cable systems maintain quality service at low rates, Congress certainly did not intend to foreclose cable operators from using the public markets to obtain the capital required to meet those objectives.

D. The Commission Should Adopt A Two-Tier Test to Implement the Anti-Trafficking Rules.

The Commission suggests that it may be preferable to establish a fixed threshold, rather than adopting a transfer of control standard based on Section 310(d) of the

Communications Act of 1934, as amended.[15/] Sandler believes that a fixed threshold is appropriate except in those circumstances in which a transfer is pro forma as defined in subsection 73.3540 (f) of the Commission's rules and the body of case law interpreting that section.[16/] Otherwise, the Commission should adopt a fixed standard that would trigger the three-year holding period only when more than 50% of a company's or partnership's equity in a cable system is transferred. This standard would address the concerns that prompted Congress to enact the anti-trafficking rule in the first place,[17/] but would not unduly restrict the ability of parties to structure their equity investments in the industry.

The Commission notes that under Section 310(d), transfers of control are not limited to transfers of majority stock, but may include any transfer of actual

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15/ NPRM at ¶ 12.

16/ Where a transfer is pro forma, it should not be subject to the holding period. The three-year holding period thus would not apply to the transfer of systems between partnerships and their affiliated entities where the general or managing partner of the partnerships and the affiliated entity are under common control or management. This interpretation is consistent with the House Report, and is also consistent with the definition contained in the 1984 Cable Act, which defines a cable operator, in part, as a person or group of persons "who otherwise controls or is responsible for, through any arrangement, the management and operation of . . . a cable system." 47 U.S.C. §522 (4).

17/ NPRM at ¶ 11.

working control in whatever manner exercised.[18/] This would include, for example, the right to appoint a majority of a board of directors or changes in which a partner in a partnership exercises a right to become the managing partner and relegates the former managing partner to the status of limited partner, without any significant change in equity. Such changes in control, when not accompanied by any substantial change in the equity ownership of the cable system, do not risk adverse changes in subscriber rates or cable service, and certainly do not involve the "profiteering" transactions against which Congress sought to guard.

These changes are significant, but routine, events which would require filing a "long form" application under broadcast transfer policies largely because the quid pro quo of equity involvement is usually some form of participation in management affairs. However, there is no indication that Congress intended to limit the flow of equity investment by restricting the control that individual investors could exert over the affairs of a company. For all of these reasons, the Commission should adopt criteria which trigger the three-year holding rule only in the absence of a "short form" transfer and only when more than 50% of a cable system's equity is transferred.

18/ *Id.*

E. The Three-Year Holding Period Should Not Apply To Individual Systems Owned by An MSO Which is Sold.

The three-year holding rule should not be applied to individual systems owned by an MSO. Forestalling the sale of a 50-system MSO for three years simply because it recently constructed or acquired a new system would make little sense. Where ownership of an entire company is in issue, the three-year holding period should be defined by the system held by the MSO for the longest period of time. Any other interpretation of the holding rule would require that an MSO determine its business plans three years in advance and avoid any new business opportunities in the interim; a drastic result not intended by Congress.

The anti-trafficking rules should also be inapplicable to spinoffs of systems acquired by an MSO as part of a larger transaction. For example, if an MSO acquires another MSO's 50 cable systems, it should be permitted to sell some of the acquired systems within the three year period. Such spin-offs customarily occur where, for example, several of the systems are not located within an area that is compatible with efficient operations of a cable operator's existing systems. There is no indication that the three-year holding rule was intended to proscribe this type of transaction.

F. Implementation of the Anti-Trafficking Rules Should Not Delay the Transfer Process.

The franchising authority should have primary responsibility for monitoring the anti-trafficking rules. Sandler supports the Commission's tentative conclusion that local franchising authorities can most efficiently monitor compliance with the anti-trafficking restrictions, thereby assuring that the transfer of a cable system will not unduly be delayed. A certificate filed with a franchising authority should carry with it a presumption that the cable operator is in compliance with the statute or is exempt under one of its provisions.[19/] As discussed below, the Joint Parties believe that the Commission's special relief procedures would be an appropriate vehicle by which a franchising authority could test whether such a certificate was bona fide. In order to insure that the statute and the Commission's implementing regulations are interpreted consistently, the Commission should retain jurisdiction over all disputes relating to the anti-trafficking rules.

Operators seeking to transfer ownership of a cable system prior to the expiration of the three-year holding period should only be required to provide the franchising authority with a certificate citing the appropriate provision in the Commission's regulations which supports the exemption.

19/ NPRM at ¶ 8.

II. The Commission Should Entertain Waiver Applications When Necessary to Serve the Public Interest.

Sandler believes that the Commission has broad, unqualified, waiver powers under Section 617(d), not limited to cases of default, foreclosure or other financial distress. As the statute says, "[t]he Commission may, consistent with the public interest, waive the requirement of subsection (a). . . ." The only limitation on the Commission's waiver authority is that, if franchise authority approval is required by the franchise agreement, the Commission cannot waive the three-year restriction unless the franchise authority has approved the transfer.[20/] In addition to its general waiver authority, the Commission also has the power to "use its authority . . . to permit appropriate transfers in the cases of default, foreclosure, or other financial distress."

Section 617(d)'s references to "public interest" determinations and "appropriate" transfers indicate Congress' willingness to let its expert agency act pursuant to general waiver powers. In contrast, the references to "default, foreclosure, or other financial distress" merely indicate circumstances in which Congress has pre-determined that waivers are <u>always</u> consistent with the public interest. Congress would only have granted the Commission specific, rather than a general waiver power, had it intended to limit

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20/ Section 617(d).