Financial Issues Subcommittee Recommendation to the
Federal Communications Commission's
Advisory Committee on Diversity for Communications in the Digital Age

June 1, 2004

Recommendation on Incentive-Based Regulations

Be it resolved that the Advisory Committee on Diversity for Communications in the Digital Age recommends that the Federal Communications Commission consider the four proposals listed below as a means to promote broader access to capital for socially and economically disadvantaged businesses.

Waivers of the Structural Ownership Rules

Waivers of the Attribution Rules

First Place in Line for Future Duopolies

Waivers of the Construction Permit Expiration Rule

Recommendation on Incentive-Based Regulations

Background

Incentives have long been the preferred regulatory model for promoting diversity. The premise of incentive-based regulation is that a regulatee should be permitted to receive otherwise-unavailable benefits when it takes steps to advance minority ownership. Incentive-based regulation is the classic "win-win" paradigm, consistently enjoying nearly universal support from the industry, the civil rights community, and members of the FCC.

Over the years, the Commission administered five incentive-based minority ownership initiatives:

1. Comparative Hearing Policy. In 1973, the D.C. Circuit held that the Commission must consider minority ownership as a comparative factor in choosing among mutually exclusive applicants for new construction permits. TV-9, Inc. v. FCC, 495 F.2d 929, 935-38 (D.C. Cir. 1973), cert. denied, 418 U.S. 986 (1974) ("TV-9"). One practical effect of TV-9 was that nonminority passive investors in applicants controlled by minorities could ride the minority principals' coattails to financial success.

2. Tax Certificate Policy. The Tax Certificate Policy was developed by Chairman Wiley's Minority Ownership Task Force in 1977 and adopted by the Commission under Chairman Ferris in 1978. See Statement of Policy on Minority Ownership of Broadcast Facilities, 68 FCC2d 979, 983 (1978) ("1978 Minority Ownership Policy Statement"). The Tax Certificate Policy permitted a company selling a broadcast or cable property to minorities to defer the capital gains taxes on the sale if the seller reinvested in comparable property. The Tax Certificate Policy was responsible for over 200 minority owned stations – about 2/3 of those coming into existence until Congress repealed the policy in Deduction for Health Insurance Costs of Self-Employed Individuals, Pub. L. No. 104-7, §2, 109 Stat. 93, 93-94 (1995).

3. Distress Sale Policy. The Distress Sale Policy, also created in the 1978 Minority Ownership Policy Statement, is still in existence. It allows a broadcaster, in hearing for the nonrenewal or revocation of its license, to elect before the hearing to sell the station to a minority owned company for no more than 75% of fair market value. In this way, the licensee in the "distress" of possible loss of license can avoid the hearing, save the Commission the time and expense of trying the hearing and subsequent appeals, incur a very substantial financial penalty, and place the station in the hands of a qualified operator who would have few other opportunities to acquire a station. The Distress Sale Policy has resulted in the sale of approximately 50 stations to minorities. It is the only remaining FCC policy aimed specifically at promoting minority ownership.

4. Clear Channel Eligibility Criteria. In 1980, the Commission limited eligibility for certain new AM construction permits to minority and noncommercial applicants. Clear Channel Broadcasting in the AM Broadcast Band (R&O), 78 FCC2d 1345, 1368-69, recon. denied, 83 FCC2d 216 (1980), aff'd sub nom. Loyola University v. FCC, 670 F.2d 1222 (D.C. Cir. 1982). The Clear Channel Eligibility Criteria were repealed in Deletion of AM Acceptance Criteria in Section 73.37(e) of the Commission's Rules (R&O), 102 FCC2d 548, 558 (1985), recon. denied, 4 FCC Rcd 5218 (1989) (holding that a "sounder approach" than eligibility criteria is to use distress sales and tax certificates to promote minority ownership). Only thirteen minority owned stations had been created during the two years when the policy was in effect. Id., 102 FCC2d at 555.

5. Mickey Leland Rule. Adopted in 1985, the rule provided that an interest of up to 49% in minority-controlled stations would not be subject to attribution with respect to two stations per service beyond the otherwise applicable national ownership. See Multiple Ownership of AM, FM and Television Broadcast Stations (MO&O on reconsideration), 100 FCC2d 74, 94 (1985) (prior and subsequent histories omitted). The Mickey Leland Rule was only used by four companies, two of them minority owned. It was rendered moot by the elimination of the national multiple ownership rule in the 1996 Telecommunications Act.

In 1992, the Commission proposed a sixth incentive-based initiative, incubator programs, which are discussed infra.

Constitutional Issues

Among all possible forms of FCC regulatory efforts to promote diversity, incentive initiatives are the most likely to pass constitutional muster. First, they do not deprive anyone of any actual or presumed entitlement. Second, their application can be structured to depend on individualized, case-by-case decisionmaking. This kind of "full file review" met with approval in Grutter v. Bollinger, 539 U.S. ___, 123 S.Ct. 2325 (2003). Third, incentive plans are even more narrowly tailored than the plans that met approval in Adarand Constructors, Inc. v. Slater, 228 F.3d 1147 (10th Cir. 2000), cert. dismissed as improvidently granted sub nom. Adarand Constructors, Inc. v. Mineta, 534 U.S. 103 (2001) ("Adarand VII") and, more recently, in Concrete Works of Colorado v. City and County of Denver, 321 F.3d 950 (10th Cir.), cert. denied, 124 S.Ct. 556 (2003).

Consideration of the appropriateness of various incentive-based proposals could take place concurrently with Commission consideration of the definition of the class of eligible beneficiaries of these programs. The programs could be designed using any of three paradigms:

1. Small Businesses. This was the classification used by the Commission when it created the "Cluster Spinoff Option" in the 2003 omnibus media

ownership decision. 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996 (R&O and NPRM), 18 FCC Rcd 13620, 13810-12 ¶¶488-490 (2003) ("Omnibus Ownership Report"), on appeal in Prometheus Radio Project v. FCC, No. 03-3388 (3d Cir., argued February 11, 2004). One concern with any small business program is that it may in practice have only a very dilute impact on minority ownership. For example, when it adopted the Cluster Spinoff Option, the Commission acknowledged that it did not know the racial composition of the eligible applicant pool. Id. at 13913, Appx. G, Final Regulatory Flexibility Flexibility Analysis, ¶12 (noting that perhaps as many as 95% of all commercial radio broadcasters might qualify). Further examination by MMTC revealed that the eligible class for the Cluster Spinoff Option actually included 88% of radio broadcasters, and that the composition of these broadcasters was 4.5% minority owned (barely more than the 4.2% of radio stations owned by minorities). See MMTC Petition for Reconsideration in Docket 02-277 (Omnibus Broadcast Ownership Proceeding), filed September 4, 2003, p. 8.

2. Minority Ownership. This is the classification used in each of the five incentive-based policies, described above, that have been administered by the Commission. The "minority ownership" classification includes companies controlled by minorities even though minorities do not hold a majority of the equity. See Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC2d 849 (1982) (adopting the recommendation of the Rivera Commission). The Supreme Court has affirmed that minority status may be used as a classification to remedy extreme discrimination; see U.S. v. Paradise, 480 U.S. 149 (1987), which upheld a quota system to guarantee the prompt racial integration of the Alabama State Police. It is a fair question, worthy of study, whether discrimination has so infected ownership of broadcasting that narrowly tailored race-conscious remedies might be justified.

3. Socially and Economically Disadvantaged Businesses (SDB). This is the classification used in Adarand VII and in Senator McCain's legislation seeking restoration of much of the tax certificate policy. In Senator McCain's paradigm, the SDB classification would include most but not all minorities and it also includes some nonminorities; the use of minority status as a factor in eligibility determinations would be governed by a fact-specific rulemaking. Virtually all of the nation's civil rights organizations have endorsed Senator McCain's approach.

The appropriateness of one or more of these paradigms is the subject of the six "Section 257 Studies" released by the Commission December 12, 2000. The studies were initially addressed in the public workshop held by the Subcommittee on January 10,

2004. See Report on Subcommittee Workshop, January 10, 2004 (discussing statements of Allen Hammond, Esq. of Santa Clara University School of Law and Thomas Henderson, Esq. of the Lawyers Committee for Civil Rights Under Law). In the coming months, the Subcommittee will review the Section 257 studies.

Incentive-Based Proposals

1. Waivers Of The Structural Ownership Rules

A company would be afforded a two-year or (in some cases) permanent opportunity to acquire, avoid divestiture of, or be authorized in the future to own an attributable (including a controlling) interest in stations above certain otherwise-applicable ownership limits. To obtain this benefit, a company would demonstrate that it is concurrently undertaking, or has recently undertaken, one or more of the steps set out below. The extent of the waiver, and its length, would be commensurate with the value of the opportunity being afforded to the beneficiary companies.

a. Sales of Stations to SDBs

With the possible exception of lack of access to capital, the unavailability of quality stations to buy is the single greatest barrier to the growth of minority owned broadcast companies. Therefore, the single most important incentive the Commission could create is one that would allow a company to conclude an otherwise-prohibited transaction if the company sells stations to SDBs.

In the Omnibus Ownership Report, the Commission specifically referred this proposal to the Diversity Committee. Id., 18 FCC Rcd 13636 ¶49 and n. 76.

Waivers of the multiple ownership and the former anti-trafficking rules for sales to minorities were first proposed in a petition filed by NTIA Director Henry Geller in 1977. The Commission generally agreed that such waivers were desirable. Petition for Issuance of Policy Statement, 69 FCC2d 1591, 1597 (1978) ("[t]he entry of minority ownership is an independent policy goal further supporting such a waiver request, and conceivably might tip the balancing of other considerations in a close case, but it would be inappropriate to suggest a general approach to waiver requests which involve such competing policy interests.") Since then, the Commission has often taken minority ownership into account as a factor in whether to grant temporary waivers of the structural rules. See, e.g., Stockholders of Infinity Broadcasting Corporation, 12 FCC Rcd 5012, 5036 ¶47 (1996) (weighing favorably, as a factor in support of a one-to-a-market rule waiver in connection with the CBS/Infinity merger, the fact that Infinity "has already filed an application to assign one of the stations it will divest to a minority-controlled entity"); Viacom, Inc., 9 FCC Rcd 1577, 1579 ¶9 (1994) (holding that Viacom's proposal to seek out minority buyers for two radio stations to be spun off from its merger with Paramount "would be impossible for it to administer were we to require an immediate divestiture and we find that an 18-month period will spawn public benefits warranting grant of a temporary waiver"); Miami Valley Broadcasting Corp., 78 FCC2d 684, 720

(1980) (five station spinoffs to minorities were a contributing factor in the Commission's decision to grant an antitrafficking waiver to facilitate the GE-Cox merger (which ultimately failed to close)); Combined Communications Corporation, 72 FCC2d 637, 656 ¶45 (1979), recon. denied, 76 FCC2d 445 (1980) (declaring that the opportunity to approve the spinoff from the Gannett/Combined Communications Corp. merger of WHEC-TV, Rochester, New York to a minority owned company "represents a most significant step in the implementation of our continuing effort to encourage minority ownership of broadcast properties.") In none of these cases did the Commission hold that the spinoffs were a necessary condition to its ultimate public interest finding, but it did take the spinoffs into consideration in rendering those findings.

Spinoffs from media mergers have traditionally presented the most effective means of promoting minority ownership. Thus, this proposal is especially timely, since lifting of the stay of the Omnibus Ownership Report will probably trigger a wave of broadcast mergers and acquisitions. Owing to their diminished access to capital, SDBs will be at a disadvantage in bidding for properties coming onto the market in the near future.

b. Incubator and Financing Programs

In Revision of Radio Rules and Policies (MO&O and Further NPRM),, 7 FCC Rcd 6397, 6391-92 ¶¶22, 24-25 (1992), the Commission proposed allowing an ownership rule waiver to a company that establishes a program that substantially promotes minority ownership. Under the Commission's proposal, a company could assist SDBs by providing management or technical assistance, loan guarantees, direct financial assistance through loans or equity investments, training, or business planning assistance.

Under the Commission's 1992 paradigm, as an alternative to establishing a relationship with specific SDBs, a company could take steps to advance SDB ownership generally. For example, it could establish business planning centers, ownership training programs (along the lines of the NAB's Leadership Training Program), lines of credit syndicated by financial institutions that assist SDBs, or participation in venture capital funds that incorporate mentoring by its participating companies' senior executives.

When the Commission offered its incubator proposal, it concluded that "encouraging investment in small business and minority broadcasters is a goal worth pursuing. Minority broadcasters who have had difficulty acquiring the resources to become station owners could significantly benefit from such assistance." Id. at 6391 ¶21. The proposal was offered by a unanimous vote of the Commission, and therefore must be regarded as worthy of further review.

Ultimately, the 1992 incubator rulemaking was rolled into the 1995 minority ownership rulemaking. See Policies and Rules Regarding Minority and Female Ownership of Mass Media Facilities (Notice of Proposed Rulemaking), 10 FCC Rcd 2788 n. 2 (1995). That docket, MB 94-149, has been idle for nine years.

c. Share-Times

MMTC has proposed that the Commission create a new class of "Free Speech Stations" having at least 20 non-nighttime hours per week of airtime, independently owned by SDBs, and primarily devoted to nonentertainment programming. See MMTC Comments, Radio Ownership Proceeding (MB Docket 01-317) (filed May 8, 2002), pp. 111–173.

Free Speech Stations would have at least 20 non-nighttime hours per week of airtime. Id. at 118. They would be independently owned by small disadvantaged businesses, and they would be primarily devoted to nonentertainment programming. Id. at 119. A Free Speech Station would share time on the same channel with a largely deregulated "Entertainment Station" owned by the owner of a cluster of stations in the same market. Id. at 118. As an incentive to a cluster owner to bifurcate a channel to accommodate a Free Speech Station and an Entertainment Station, the Commission could allow the cluster owner to buy another fulltime station in the market even if that acquisition would otherwise be impermissible under the local ownership rules. The Commission is permitted to allow such an acquisition by Section 202(b)(2) of the Telecommunications Act, which authorizes the Commission to allow an entity to own, operate or control more radio stations in a market than the number specified in 47 C.F.R. §73.3555(a)(2) "if the Commission determines that such ownership, operation, control or interest will result in an increase in the number of radio broadcast stations in operation." (Share times are "radio stations" under 47 C.F.R. §73.1715; thus, they qualify for the Section 202(b)(2) exception to the local ownership caps.) The additional fulltime station bought by the cluster owner would also be bifurcated into a Free Speech and an Entertainment Station. In this way, a cluster could grow steadily up to the limits allowed by antitrust law. Further, as a result of this plan, the number of sources and viewpoints available to the public would grow exponentially, and SDB ownership would get a much-needed boost.

The timeliness of this proposal derives from the Commission's 1996 promise to conduct a rulemaking to implement Section 202(b)(2). Implementation of Sections 202(a) and 202(b)(1) of the Telecommunications Act of 1996 (Broadcast Radio Ownership (Order), 11 FCC Rcd 12368, 12370 n. 2 (1996) (promising that "[t]he implementation of [Section 202(b)(2)] will be addressed in a Subsequent Notice of Proposed Rulemaking.") The rulemaking has never been conducted, however. To fulfill its promise, the Commission could determine that the creation of share-time "Free Speech Stations" is responsive to Congress' objectives in adopting Section 202(b)(2).

2. Waivers Of The Attribution Rules

In 1999, the Commission held that a company will have an attributable interest in a second company if the sum of the equity plus the debt ("EDP") held by the first company in the second exceeds one-third of the second company's equity plus its debt. See Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests (R&O), 14 FCC Rcd 12559, 12573-91 ¶¶26-65 (1999) (subsequent

history omitted). The EDP rule creates an opportunity for an ownership incentive initiative.

In particular, an SDB might find it difficult to acquire a particular property, to retain an existing one, or to build out a construction permit. In such an instance, the Commission could waive the EDP rule to permit a larger company to take an above-EDP but noncontrolling interest in the SDB in order to enable the SDB to buy a station, retain an existing one or build out a construction permit.

Further, a below-EDP interest in SDBs could retain its nonattributable character (i.e., be "grandfathered") even if the company holding the below-EDP interest subsequently acquires other properties that would otherwise cause the below-EDP interest to become attributable. Presently, a nonattributable below-EDP interest in an SDB could become attributable if the company holding such an interest buys a station in the same market as the SDB, or if the below-EDP interest holder begins to supply 15% or more of the SDB's programming. The risk of future attribution of a presently nonattributable interest discourages sub-EDP investments by large companies in SDBs. In particular, a large company's non-strategic EDP interest in an SDB could subsequently prevent the large company from bidding successfully for a major acquisition target that owns properties in the SDB's home market. Grandfathering of the nonattributable nature of below-EDP interests would correct this disincentive and encourage investments in SDBs.

3. First Place In Line For Future Duopolies

Presently, when the local television ownership rules permit only one additional duopoly in a market, a "race to the courthouse" could determine which duopoly application is processed first. See Processing Order for Applications Filed Pursuant to the Commission's New Local Broadcast Ownership Rules (Public Notice), FCC 99-240 (released September 9, 1999). To cure this problem, the Commission could create an incentive plan under which a company financing or incubating an SDB will be reserved a place in line that it could subsequently use to duopolize another same-market facility. This vested first-place in a duopolization queue would provide the large broadcaster with the secure knowledge that its public spiritedness in incubating or financing an SBD will be rewarded with a guaranteed opportunity to acquire a greater complement of local properties.

There is precedent for using advantageous placement in a processing queue as a minority ownership incentive. In the 1978 Minority Ownership Policy Statement, the Commission promised that tax certificate and distress sale applications "can be expected to receive expeditious processing." Id. at 983.

4. Waivers Of The Construction Permit Expiration Rule

In 1998, Entravision Holdings LLC ("Entravision") submitted a petition for rulemaking (RM-9567; filed March 10, 1999 and still pending) which sought to revise the

construction permit expiration standard established pursuant to §§319(a)-(b) of the Communications Act. The implementing rule, 47 C.F.R. §73.3598, provides that a construction permit must be built out in three years, unless the time is tolled. Entravision proposed that the Commission allow holders of expiring construction permits to sell them to entities in which minorities own at least 20% of the equity, or to entities which commit to serve the programming needs of minority or foreign language groups for at least 80% of their operating time. Entravision's concept could be modified to make it applicable to any SDB that pledges to build out the permit in a specified time (e.g., the time remaining on the original permit, or one and a half years, whichever is greater).

SDBs are often highly motivated to build out unbuilt permits and thereby add a new independent voice to the community. Larger, same-market competitors often lack this motivation because their business plans typically emphasize duopolizing, crossowning or clustering stations that are already on the air.

The Entravision plan, as revised above, would be superior to the current procedure for automatic expiration of permits because it would allow the Commission to quickly and efficiently place an expiring permit in the hands of a company that would be likely to promote diversity in the immediate future. This plan would rescue the investments of permittees who tried in good faith to build out their facilities, enhance the likelihood that the public will receive service on an expedited basis, and relieve the Commission of the time and expense of putting allotments out for bid again. In each of these respects, the proposal is conceptually similar to the Distress Sale Policy.