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THE INTERNET AS “THE COMMON MEDIUM”

Reed E. Hundt

All nations need a common medium. A common medium needs to be (1) the customary medium for the entire population; (2) very easy for people to use; (3) culturally accessible and in common language(s); (4) open to participation by everyone; (5) good for business—because economic growth should be fostered by the medium, not undercut by it; (6) providing access for the government to the people; (7) full of news; (8) sufficiently local in its manifestation for people to know what is going on around them; (9) in a private multi-firm market; and (10) consistent with the First Amendment (one reason why it should be private). These are the ten necessary traits of a common medium.

By 1948, the year of my birth, over-the-air broadcast had become the common medium in the United States. Today, broadcast, even when transmitted over cable, is no longer the common medium. Today’s common medium is the Internet. This transition has been underway for nearly twenty years.

In late 1993, when I had only been at the Federal Communications Commission (“FCC” or “Commission”) for about a month, I received a call from one of Al Gore’s people. He said, “Come over and take a look at this.” On his computer he showed me a picture of the Louvre. I said, “Well, that’s really nice. I guess that’s this thing called the screensaver.” He said, “You don’t understand, that’s actually the Louvre. It’s the telephone network that’s carrying it here—over this thing called the Internet.” So then we talked to many people who already had a vision for the Internet. By early 1994 we had decided that the Internet would be, and ought to be, the common medium instead of broadcast.

The choice to favor the Internet over broadcast was ultimately made over many years by many people in the public and private

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* This article is based on a speech delivered at Media Concentration Around the World: Empirical Studies, March 12, 2010, Columbia Business School. The author would like to thank Cynthia J. Grady and Karen R. Sprung for their contributions to this article. All footnotes were added later and are intended only to aid the reader.

** Reed Hundt served as Chairman of the Federal Communications Commission from 1993 to 1997. He holds a BA, magna cum laude with exceptional distinction, in History from Yale College (1969) and a JD, magna cum laude, from Yale Law School (1974).
sectors. Now this selection is apparent in many industries—newspapers, telephone, studios, and many others. To do its part to facilitate the transition, the FCC has undertaken many actions, but the first, important fundamental policy decision was to link America’s telephone networks to the large installed base for personal computers. The FCC, therefore, allowed people to connect their computers to the telephone network for free and allowed Internet Service Providers (“ISPs”) to connect the telephone network to the Internet almost for free. Essentially, the Commission harvested the new-found value of the telephone network as a data network and gave it to society. (This is the way Washington used to work. It does not always work like this anymore. As you can see, it works really well now.)

Almost everyone in the internet community has long operated under the delusion that government played no role in the growth of the Internet. In many ways, to be sure, the transition from broadcast to broadband has been more technologically-driven than government-driven. But government has always played an important role.

The telephone networks argued that internet communications crossed state lines and therefore were subject to interstate access charges—a view that would have burdened the fledging technology. But the FCC held that internet communications did not cross state lines. As another boon to the Internet, reciprocal compensation required telephone companies to pay ISPs for terminating phone calls, even where no calls would ever be made back to the telephone company. At the time, there were only three places in the world to which you could make a telephone call but from which you would never receive a phone call—funeral parlors, pizza parlors, and ISPs. The FCC also helped make sure that internet commerce would not be taxed.

Another government move to support the Internet was a special universal service provision called E-rate. The E-rate program transferred billions of dollars from telephone customers to schools and libraries to subsidize access to the Internet. Internet access in the

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1 Access Charge Reform, First Report and Order, 12 FCC Rcd. 15982, 16133, 16134 (April 18, 1997).
2 Id.
4 See Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd. 8776, 9003 (May 7, 1997); see generally E-rate Program – Discounted Telecommunications Services, U.S.
classroom is the one area with respect to the Internet where the U.S. leads the world. The generation that went to school from 1995 to 2010 is the most Internet-savvy generation in the world. Most of the children in lower-income groups of that generation primarily learned to use the Internet at school instead of at home. The Internet is the first technology to have been introduced into the educational at the same pace for the poor as for the rich.

I. The Evolution Away From Broadcast

For many years, the FCC delayed the transition to HDTV, preferring analog broadcasting. In my tenure, the FCC joined with John McCain and Bob Dole to fight a quiet and losing battle against a governmental gift of spectrum for digital broadcasting. Broadcast had served the country well. It spread like wildfire after World War II, and had a number of advantages as a common medium. It was licensed to be universal. Oligopolies were created in every city so that there would be enough revenue to sustain local stations. Broadcast was organized around three principal networks. People were happy with it. Broadcast was entertaining, ad-supported, and free. Government standards made it easy for the industry to build the equipment and to work efficiently. Broadcast was accessible linguistically and culturally. The medium created common denominators across society.

Not all elements of a common medium could be enshrined perfectly in broadcast. For example, the FCC fought a long, slow, and largely unavailing battle to ensure some openness and diversity over fifty years. Government access to the public was guaranteed in broadcast by tradition, but only politicians with money could easily and routinely access the general public over it. (Rupert Murdoch, it should be noted, would have committed free time for political debate if the other broadcasters had not stymied that effort.)

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In any case, broadcast definitely was good for business by creating huge brand value in the U.S., and it was an intrinsic part of the great economic growth from 1950 to the mid–1970’s. To promote local news, the FCC passed various rules that transferred wealth from the networks to the affiliates and imposed obligations to serve the public interest on stations.广播, with some exceptions, is privately owned and run for profit. It was, and still is, very important that the government does not control any important communication medium in the U.S. In fact, the tiny niche for public broadcasting reflects the FCC’s fundamental commitment to depend on private enterprise as the model for all media.

Despite the many beneficial characteristics of broadcast, the FCC in the early 1990s began to lay the framework for the selection of the Internet as the common medium for many reasons. The Commission’s view was that the Internet was going to be, among other things, a pathway for the global propagation of Western values and, at least at first, a leading technology that happened to be of American origin. It would be part of a battle of ideas about how to live. The FCC thought the Internet would reach the whole world.

Moreover, the Internet was obviously a richer technology than broadcast. It allowed for text and pictures which provided an easier way for people to have access to information. At its heart the Internet would be a dis-intermediating medium. The Internet was more than just easy to access; it would be diverse, with every race welcome to participate. The content would be generated by people who would choose any point of view; any form of content would be possible; and any kind of ownership of the content would be admissible. All these characteristics represented discrete bodies of legal struggles with broadcasters, which the FCC thought would be obviated if the Internet replaced broadcast as the common medium.

The Commission also thought that the Internet fundamentally would be pro-democracy. The Internet represented an expansion of individual power and choice. Perhaps the single most important thing

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6 Localism rules, such as content requirements and advisory boards, are designed to ensure that a local broadcaster effectively serves the local community that it is licensed to serve. See Broadcast Localism, Report and Notice of Proposed Rulemaking, 23 FCC Rcd. 1324, para. 4 (Dec. 18, 2007) (citing Press Release, FCC, FCC Chairman Powell Launches “Localism in Broadcasting” Initiative (Aug. 20, 2003)).
to say was that it was two-way, so that active communities and not just passive audiences could flourish in this new common medium.

II. National Broadband Plan

The government cannot be stopped from choosing a common medium, because government wants a way to reach everyone. In the U.S., for many years, government tried to slow, impede, and stymie those who tried to rival over-the-air-broadcast’s role as the common medium. The history of cable’s early decades consisted of the government trying to make sure that cable did not undermine broadcast’s role as the common medium. Ultimately cable and satellite ineluctably became delivery mechanisms for broadcast. They simply had too many channels not to succeed. Nevertheless, broadcast continued to receive many benefits and breaks from the government, even after multichannel video demonstrated its advantages.

The 2010 National Broadband Plan reflects the end of an era of trying to maintain over-the-air broadcast as the common medium, and marked a substantive commitment to broadband as the common medium. For example, the Plan outlines a way to shrink the amount of spectrum that broadcast uses. In previous eras, government had expanded the spectrum for broadcast so as to give it a chance to thrive as it moved from analog to digital. The Plan shows a way to move cable more quickly away from pay-video to broadband. It describes ways to create new electronic public goods that can be accessed only over broadband—electronic healthcare, energy efficiency, community engagement, public safety.

The Plan intended to create more value in broadband, to increase the willingness for people to pay for it, thereby aiding in the achievement in 100% penetration for broadband. It proposes to convert a portion of satellite spectrum into more spectrum capacity for broadband. The Plan also lays out a method to create a Universal Service Fund, to support not the telephone networks, but broadband.

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The Plan represents a commitment to broadband as the common medium. News will eventually be primarily accessed on broadband. The importance of an open and public Internet has been repeatedly stressed by President Obama.\footnote{See President Barack Obama, Remarks to the United Nations General Assembly at the United Nations (Sept. 23, 2010) (as prepared for delivery).}

\section*{III. Conclusion}

The fundamental idea driving FCC Chairman Genachowski’s various broadband initiatives is that broadband will have the characteristics of the common medium.\footnote{Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Policy Statement, 20 FCC Rcd. 14986 (Aug. 5, 2005).} It will be open at a technical level. It will be open to devices. It will be open for one communicating to many, for many communicating to one, and for many communicating to many. It will be open in terms of the way people will be permitted to create audiences that demand content, instead of waiting for content to shape an audience.

All of this represents a belief in fundamental American values. We have an identifiable, describable set of values that bring us together. As expressed by Hillary Clinton in her Internet Freedom Speech,\footnote{Hillary Rodham Clinton, Sec’y of State, Remarks on Internet Freedom at the Newseum (Jan. 21, 2010).} these include the empowerment of individuals, and a commitment to entrepreneurship as a form of business activity. These values are meant to be enshrined in a common medium, making the choice of the Internet as that medium fateful for the future of America.
CONSIDERATIONS UNIQUE TO THE PURCHASE AND SALE OF BROADCAST STATIONS

Erwin G. Krasnow
John M. Pelkey
John Wells King

The acquisition of a broadcast station is not like the acquisition of a newspaper or an internet site, which can take place as soon as the financing is arranged and the legal papers are drawn up. The time between signing an agreement for the sale of a broadcast station and the station actually changing hands can take six months to a year, and in some cases even longer. Ownership or control of a broadcast station cannot be transferred until the Federal Communications Commission (“FCC” or “Commission”) consents to an assignment of license or transfer of control of the licensee. This article focuses on the special challenges resulting from the acquisition and sale of a broadcast station, a highly regulated business. It provides information on all aspects of the process of acquiring a broadcast station from the letter of intent and the due diligence process to the closing. For those unfamiliar with FCC regulation, the article provides a short course on FCC rules and policies governing broadcast stations. It also is designed to decode the mysteries of broadcast station purchase and sale contracts and present the most innovative contract strategies in today’s marketplace.

I. To Write or Not to Write: The Tortuous Letter of Intent

After the buyer and seller have worked out the basic terms of their deal for a broadcast station, a letter of intent serves to memorialize those terms in anticipation of the formal agreement.

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While generally intended to be non-binding, a letter of intent states the parties’ intention to enter into a transaction and recites the basic business points (e.g., purchase price, timetable, form of consideration), thereby helping to move the deal along. Unfortunately, parties too often enter into letters of intent without a great deal of thought. Indeed, in some radio transactions, the letter of intent—referred to as a “Memorandum of Understanding” or “Agreement in Principle”—is drafted by the broker using a fill-in-the-blanks boilerplate letter. In contrast, in other situations, the letter of intent is drafted—and redrafted—by multiple lawyers and can become the subject of seemingly endless negotiations between the parties. One of the benefits of a well-drafted and negotiated letter of intent is that it can make the negotiation of the definitive agreement speedier and easier.

Inattention to the consequences of a letter of intent can be costly. In one dramatic case for example—the proposed acquisition of Getty Oil by Pennzoil—the letter of intent formed the basis of a jury award of $11.2 billion.¹

Typically, a letter of intent takes the form of a letter addressed to the seller, signed by the buyer, and then countersigned and dated by the seller or, in the case of a sale of stock, by the selling shareholders. When there are large numbers of shareholders, it is desirable to have the letter of intent countersigned by the principal shareholders. If any trouble is anticipated from minority shareholders, the buyer would be well advised to obtain their signatures as well.

Many letters of intent state that the definitive agreement will contain such representations, warranties, covenants and indemnification provisions as are customary and appropriate to transactions of similar size and nature. Some letters include specific representations and warranties about various matters, such as the condition of equipment and compliance with the Commission’s rules. Other letters deal with such subjects as the allocation of the purchase price for tax and accounting purposes, responsibility for payment of fees, expenses and taxes, covenants concerning the conduct of business before the closing, and the need for a “final order” issued by the FCC consenting to the sale. The more points covered, the more a letter of intent begins to look like a blueprint for a formal agreement, which raises the question of whether it would have been more efficient to

have proceeded to a definitive agreement to begin with. Nevertheless, a comprehensive letter of intent might save time, or it could serve as a red flag to all parties if it appears that fundamental issues cannot be resolved—a clear signal that more time will be needed to reach a definitive agreement.

II. Two Sides to the Puzzle: The Purchase and Sale Agreement

Samuel Goldwyn allegedly quipped “an oral contract isn’t worth the paper on which it is written.” He might have said that a written contract is of similar value if its provisions do not accurately reflect the understandings of the parties, to avoid disputes and litigation.

As with any acquisition, a radio station purchase can be structured in one of two ways: (1) the buyer can acquire the assets of the seller’s business; or (2) the buyer can acquire the stock (or other equity investment) of the seller’s business. Which structure the parties select will often depend on the tax consequences of one structure versus the other. Tax implications (e.g., available net operating losses, recapture of depreciation, investment credits) can have a significant impact on the costs and value of the transaction to each of the parties. For this reason, it is advisable that both the seller and the buyer obtain tax advice very early in the process. Tax consequences aside, the distinction between a stock transaction and an asset deal can be important for other reasons as well.

In a stock transaction, the purchaser acquires an ownership interest in the stock of the existing corporate owner of the radio station from one or more of its shareholders and, accordingly, acquires an interest in all of the liabilities of the corporation (whether or not they are disclosed) as well as all of the assets. Although our references are to stock purchase agreements involving the purchase of the stock of a corporation, similar considerations may apply if the acquired entity is a partnership or a limited liability company taxed as a partnership. Stock acquisitions can be advantageous from an operations standpoint, because they preserve some continuity with a station’s existing vendors, lease arrangements, and the like. In a stock deal, however, the seller customarily has a tax liability on the difference between its adjusted basis in the stock and the stock price

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2 This and other discussions of contract language and transactional dealings are based upon the authors’ collective practice and experience.
paid by the buyer. Sellers generally prefer a Stock Purchase Agreement because it (a) avoids “double taxation” (i.e., taxes on the corporation and on the shareholder(s)); (b) potentially reduces the amount of taxes, because the transaction generally is taxed at capital gains rates which are lower than ordinary income tax rates; and (c) allows the shareholders to step away completely from the business.

In an asset deal, the buyer acquires only those assets, including contracts, specifically negotiated to be sold and specified in the purchase agreement. The buyer generally does not acquire assets other than the assumed contracts or any of the seller's liabilities. Although accounts receivable are not usually retained by the seller, the buyer will try to acquire the receivables at the expense of a higher purchase price or the assumption of trade liability, to establish an immediate cash flow. Typically, asset purchases have more favorable tax implications for the buyer, particularly if the seller's station is a relatively new one that was built, rather than purchased, by the seller. The vast majority of radio station transactions are asset sales rather than stock deals. Accordingly, we focus primarily on the instrument used to memorialize such transactions: the asset purchase agreement. Though each asset purchase agreement must be tailored to meet the needs of the parties to the transaction, we discuss provisions typically found in an agreement for the sale and purchase of the assets of a radio station.

It is possible to structure the transaction as tax-free, in whole or in part, to the seller either through a tax-free reorganization in the case of using buyer's stock as consideration or a simultaneous or deferred exchange of radio stations. The liberalization of the FCC's multiple ownership rules in the 1990s and the significant appreciation in value of some stations prompted many sellers at that time to defer their income tax liability by conducting exchanges under Section 1031 of the Internal Revenue Code. The use of buyer's stock in a tax-deferred exchange also raises multiple federal securities issues, in particular the need to register the stock under the Securities Act of 1933 or to come within an exemption from the registration requirement.

Agreements come in all shapes and sizes. More text is not necessarily better. A lengthy contract provides no assurance that it will protect the parties or minimize the chances of litigation. Agreements also differ stylistically. For example, some contracts contain a special

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section devoted to “definitions” (i.e., defining the major terms used in the agreement), while others include “definitions” within the pertinent sections. In any form, a well-drafted agreement satisfies the expectations of both parties.

Purchase agreements do not make for exciting reading; however, they play an important, indeed central, role in effectuating the purchase and sale of a station. Signatories should know and understand all of their provisions. Here is a section-by-section overview of some of the most common provisions in purchase agreements.

A. Inside: The Assets to be Purchased

An experienced buyer of radio properties knows the importance of identifying in the contract all of the assets of the station that will be necessary or useful to the successful operation of the facilities. Customarily, this is achieved by a general recitation that the buyer is acquiring “all of the tangible and intangible assets owned by Seller and used or useful in connection with the operation of the station,” with the exception of any excluded assets separately identified elsewhere in the agreement. This general recitation is often accompanied by an enumeration of some of the specific assets being purchased (which is included “without limitation” of the general statement that “all” assets are being acquired).

A list of assets typically includes a description of: (1) the physical assets (tangible personal property) associated with the station (e.g., towers, transmitters, studio equipment, furnishings etc.); (2) contracts, leases and other agreements to be assigned (often with a special provision for trade or barter agreements); (3) a description of any real property to be transferred; and (4) any intellectual property (e.g., copyrights, trademarks, call letters, domain names and registrations, logos, slogans, rights to the content of websites and all good will associated with such intellectual property, etc.). The detailed description of the specific assets to be sold is usually contained in schedules attached to and made a part of the agreement. Most schedules describe the real property, the inventory (or tangible personal property), the FCC licenses, intangible personal property (such as copyrights and trademarks), and the contracts, leases and other agreements that the buyer agrees to assume.
Customarily, the purchase agreement will provide that the seller assign to the buyer all station contracts that deal with the operation of the station. In some instances, however, those agreements may not have been reduced to writing or may be in the process of being renegotiated while the buyer and seller are negotiating the purchase agreement. Under those circumstances, the buyer may not be able to assess accurately either the potential benefits or the potential liabilities of those agreements that the buyer would be assuming. One solution to this problem is to permit the seller to conclude its negotiations after the execution of the purchase agreement while adjusting the purchase price at closing based upon the results of those negotiations. For example, if one of the parties agreed that if the new tower lease into which the seller was entering resulted in net rental income that was less than a predetermined amount set forth in the asset purchase agreement, then the purchase price would be decreased by the present value of the difference between that predetermined amount and the net rental income that would be realized during the term of the renewed lease.

In addition to the foregoing considerations, the growth of the Internet has necessitated further expansion of the asset list. Most radio stations in the U.S. maintain a presence on the Internet, and many of these are also using the Internet as a medium for their broadcast content. In this environment, a prudent buyer cannot ignore the need to include the “e”-assets of the station when drafting the contract for the purchase of a radio station.

At a minimum, website assets that need to be considered include web hosting agreements, domain name registrations, service provider agreements for website components, including audio streaming and third-party video content (e.g., news, weather, traffic), and related e-commerce agreements. Although copyright licenses for streaming are not assignable (a buyer must obtain its own), the records of the seller’s performance royalty payments to SoundExchange should be included as assets, to enable the buyer to respond to a claim of copyright infringement for any period prior to closing.4

4 SoundExchange is an independent, non-profit performance rights organization that collects royalties on behalf of sound recording copyright owners and artists for non-interactive digital transmissions. SOUNDEXCHANGE, http://www.soundexchange.com (last visited Sept. 11, 2010).
Two contrasting approaches to this issue can be found in two agreements. In the first agreement, the buyer obtained a broad clause in the recitation of assets to be acquired that encompassed:

All Domain leases and Domain names of the Station, the unrestricted right to use of HTML content located and publicly accessible from those Domain names, and the “visitor” email database for those sites.

This type of provision would appear to afford the buyer solid general protection for the most desirable e-commerce assets of the station. It is not tailored, however, to address any particular concerns that the buyer or the seller may possess with respect to the assets, such as any limits restricting the seller’s ability to convey its interest or any collateral obligations or commitments related to the assets that may have to be assigned and assumed in connection with the transfer. Nor does the general language above protect the seller from possibly giving away too much. By contrast, a similar provision in another agreement does address such issues. In that deal, the parties provided specifically that assets encompassed by the purchase and sale would include:

All of the Seller’s rights in and to, to the extent assignable and to the extent relating primarily to the Stations, any Internet Domain Name, any Internet Web page, the content accessible therefrom and the visitor data collected; provided, however, that any contract related thereto constitutes an Assumed Contract.

While neither of these provisions defines the appropriate scope of such an Internet assets provision, they do evidence that the subject is one that warrants careful consideration by both sides, and careful attention to drafting by counsel.

Customarily, the seller will retain the accounts receivable and any amounts to which the station might be entitled as a result of station operations prior to the closing date. Even if the agreement provides that the buyer will collect the accounts receivable, those collections and any receipts for amounts owed to the station as a result of operations prior to the closing usually are turned over to the seller. This is not always the case, however. For example, in one agreement, the parties provided that, among the assets to be sold to the buyer were
“all accounts receivable and all amounts payable to the station, if any, from the United States Copyright Office or such arbitral panels as may be appointed by the United States Copyright Office that relate to the period” prior to the closing. Although the provision is unusual, its use can make sense in a situation where the seller is trying to wrap up affairs. In return for a fixed increase in the price paid to it at closing and the ability to close out its operations sooner than might otherwise be the case, the seller foregoes the uncertain future income it would have received from the collection of accounts receivable and possible future payments from the Copyright Office.

B. Outside: The Assets Excluded from the Transaction

The agreement must also describe the assets that are not to be purchased. Assets ordinarily excluded and, therefore, retained by the seller, include:

- Cash or cash equivalents (e.g., certificates of deposit or Treasury bills).
- Accounts receivable.
- Any contracts, agreements and leases other than the agreements specifically assumed by the buyer.
- Any rights to refunds of federal, state or local franchise, income or other taxes or fees arising out of activities occurring prior to the closing date.
- Life insurance (and its cash surrender value).
- Security deposits paid to utility companies or other parties.
- Seller’s corporate records, except records pertaining to or used in the operation of the station.
- Any pension, profit sharing or employee benefit plans.
- Trade deals, in some instances.
- Some sellers include the call signs of the station as excluded assets. This can be important if the seller has other radio properties that it will continue to operate following the sale and wants to be able to use the call sign on one of them. In such cases, the agreement customarily requires the buyer to submit the proper request to the FCC for authority to change the call letters of the station effective on the closing date.
C. How Much: How and When

One section of a purchase agreement deals with the consideration to be paid for the acquisition. The agreement usually lists the aggregate amount of the purchase price. The purchase price can be based on a formula (for example, as a multiple of broadcast cash flow). If non-competition or consulting agreements are involved, the section may also indicate the amount of money allocated to these agreements. In the past, buyers often preferred to earmark a portion of the purchase price to such agreements in order to take advantage of more favorable tax treatment; payments pursuant to non-competition and consulting agreements can be treated by the buyer as a deductible expense. However, this is no longer the case, because non-competition expenses are now deductible over a 15-year period (not the duration of the covenant or the payment period) under Section 197 of the Internal Revenue Code of 1986, as amended, and thus are, for tax purposes, the same as goodwill.\footnote{See I.R.C. § 197 (2006).}

The section on purchase price usually discusses whether there is an “earnest money” escrow deposit. In most transactions, the escrow fund serves as an assured funding mechanism for the payment of “liquidated damages” to the seller in the event of a breach of contract or default by the buyer.\footnote{“Liquidated” damages are the amount of damages that a party who breaches a contract is required to pay without reference to the actual injury suffered by the non-breaching party.} Typically the amount of the escrow deposit is 5% of the purchase price, although the seller may insist on an escrow deposit approaching 10% if the buyer does not have an established track record of closing on its purchases. The escrow payment might be in the form of cash or an irrevocable letter of credit. The cash or letter of credit is deposited with a financial institution, the broker, or counsel pursuant to a negotiated escrow agreement. Escrow agreements usually specify who pays any fees of the escrow agent (typically shared by seller and buyer), who receives any interest on escrowed funds, procedures for third party claims, and the manner in which funds shall be paid. A form of escrow agreement usually is included in the purchase agreement as an exhibit.

A purchase price section also spells out how the buyer is to make payment at the closing. The cash portion of the purchase price is
usually paid by wire transfer. If part or all of the purchase price is to be deferred, or financed by the seller, a brief description of the terms of the “seller paper” is typically included, accompanied by a promissory note attached as an exhibit to be executed by the buyer at the closing. In most transactions involving seller financing, a prudent seller also will request that the buyer execute one or more financing instruments (e.g., a security agreement, stock pledge agreement, and guaranty agreement(s)). Most buyers will negotiate for a provision which subordinates seller financing to bank debt. The seller often obtains a “security interest” in the assets of the station (most often junior in position to a similar right given to the buyer’s senior lender). A security interest is a legal interest in property that secures the payment of a debt or other obligation by giving the creditor the right to sell the property to satisfy the debt, and establishes certain priorities to the property among creditors. The Commission prohibits any provision that provides for a security interest in FCC licenses and permits. For a more complete discussion, see Section IV. Like the promissory note, forms of such financing instruments are usually included as exhibits.

D. Assumption by the Buyer of Specified Liabilities and Obligations

This section makes provisions for the assumption of liabilities and obligations by the buyer and the seller. Principally, the buyer assumes contracts, leases, and agreements, which are customarily listed separately in a schedule to the agreement. Some contracts are designated as material contracts for which consent to assignment must be obtained from the contracting party as a condition to closing. The seller usually remains liable for all liabilities and obligations accruing or occurring prior to the closing (including obligations arising under assumed contracts, leases and agreements), as well as for any contract, lease or agreement not included in the schedule of contracts to be assumed by the buyer.

It is not uncommon for some of the more important agreements being assumed by the buyer to require the consent of a third party. Customarily, the purchase agreement will require the seller to use “all commercially reasonable efforts to obtain any and all such third party consents.” To avoid the situation where the third party seeks a monetary payment in return for granting such consent, the parties to

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one agreement inserted a clause that “the Seller shall use all commercially reasonable efforts to obtain any and all such third party consents . . . provided, however, that the Seller shall not be required to pay or incur any cost or expense, other than routine and reasonable administrative costs, to obtain any third party consent that the Seller is not otherwise required to pay or incur in accordance with the terms of the applicable Business Contract or Business License.” The parties to that agreement also sought to deal with a situation wherein the third party might refuse to grant its consent, by providing that “if any such third party consent is not obtained before the Closing, the Seller shall, at the Purchaser’s request, cooperate with the Purchaser in any reasonable arrangement designed to provide to the Purchaser after the Closing the benefits under the applicable Business Contract or Business License.”

E. Closing

This section specifies the date, time and place of the closing and sets forth the conditions for the closing, including the need for FCC approval and other governmental or third party consents.

F. Representations and Warranties by the Parties

The “reps and warranties” portion of an agreement consists of promises or statements about the parties’ respective status and their authority to perform the obligations under the agreement, as well as the nature or quality of what the seller is selling and the buyer is buying. The section describing the representations and warranties of the seller usually comprises the most extensive portion of the agreement, since it is designed to protect the buyer from unpleasant surprises at (and after) the closing. Often a purchase agreement will provide that a breach of a representation or warranty will trigger the non-breaching party’s right to indemnification (i.e., to be made whole) for any damages that result from the breach.

There are certain steps that a diligent buyer can take to minimize the risk of getting less than it bargained for. First, the buyer must be scrupulous in performing its due diligence. The FCC records should be checked and, more importantly, a qualified engineer should be retained to perform a due diligence inspection of the station. The engineering due diligence inspection would include an inspection not only of the
transmission and studio equipment, but also an on-the-ground review of station operations. AM directional stations and community sites with multiple antennas, because of potential radiofrequency radiation ("RF") issues, bear special technical scrutiny and expertise. It is not uncommon for stations that are in receivership or bankruptcy to have been poorly operated and to have been subjected to slipshod maintenance. The engineer must visit the transmitter site and make sure that it is properly fenced and bears all requisite signage warning of RF and high voltage dangers and informing visitors of the FCC antenna structure registration number that has been accorded to the facility. No on-site transmitter site inspection can be considered to be complete without a confirmation that the transmitter site is located at the correct coordinates. It is all too common for an on site inspection to disclose that a station’s transmitter site is not accurately reflected on the station’s license. That is particularly true in the case of stations that have spent their existence at the cusp of receivership or bankruptcy. In addition to performing a rigorous due diligence inspection, the buyer should also insist upon a holdback escrow so that if problems are discovered with the station after the closing, the buyer has a ready source of funds that can be used to remedy the situation.

It is not always possible to negotiate an agreement, however, that provides for a holdback escrow in a receivership or bankruptcy context. Under those circumstances, the buyer has no choice but to weigh the potential for problems with the station against the reduced purchase price that the buyer should be able to negotiate for the station. If the price of the station is low enough, it may make sense for the buyer to take the risk and purchase the station, especially if the chances of uncovering significant liabilities associated with the station are slim. A recently constructed FM station using rented facilities likely carries far fewer risks for a buyer than an AM station that owns real property with a transmitter site that has been in use since before PCBs were essentially outlawed.⁸

⁸ PCBs or Polychlorinated Biphenyls, are regulated by The Toxic Substances Control Act in 15 U.S.C. § 2605, enacted on October 11, 1976. The Act authorizes the Environmental Protection Agency to secure information on all new and existing chemical substances, as well as to control any of the substances that were determined to cause unreasonable risk to public health or the environment. The production of PCBs is currently banned in the United States. 40 C.F.R § 761 (2009).
G. **Conditions to the Buyer’s Obligation to Close**

This section sets forth the conditions that typically must be satisfied before the buyer will be required to close. Such conditions usually include:

- Seller is in compliance with its covenants, representations and warranties.
- Approval as to form and substance of instruments to be delivered to the buyer at closing (i.e., the closing documents, including the purchase agreements and any related documents or agreements such as evidence of FCC consent, etc.).
- Legal opinion of the seller’s counsel has been received.
- The FCC has issued consent to the assignment of license or transfer of control, and the consent has become a Final Order.
- All necessary third party consents to the assignment of contracts, leases, etc. to the buyer have been obtained.
- No legal proceedings that would affect the transaction or impair the value of the assets are pending or threatened.
- FCC Licenses are in good standing.
- Assets are being transferred free and clear.
- There has been no material adverse change in the assets, business or prospects of the station.

H. **Conditions to the Seller’s Obligation to Close**

This section, like the one discussed above, sets forth the conditions under which the seller will be required to close. Though shorter than the list of conditions that qualify a buyer’s obligation, the seller’s list contains several of the same elements, such as:

- Buyer shall have paid the purchase price.
- Buyer is in compliance with its covenants, representations and warranties.
- The FCC has issued consent to the assignment of license or transfer of control, and the consent has become a Final Order.\(^9\)
- Approval as to form and substance of instruments that will be delivered to the seller at the closing.
- Legal opinion of the buyer’s counsel has been received.

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\(^9\) For a definition of Final Order, see *infra* at Section IV(A).
I. **Risk of Loss**

Unless otherwise specifically negotiated, this section makes clear that the seller bears the risk of any loss, damage, or impairment of any of the assets that takes place prior to the closing. It usually obligates the seller to replace, repair, or restore such assets to their prior condition as soon as possible. This provision might provide representations concerning casualty insurance and specifically require the seller to assume the risk for all deductibles.

J. **Termination or Breach**

This section discusses the rights of the buyer and the seller to terminate the agreement, as a matter of right or due to breach or default by the other party. There are usually different provisions in this section depending on whether the termination or breach of contract is caused by the seller’s breach or default, the buyer’s breach or default, or events beyond the control of either party, such as the FCC’s failure to grant consent. Termination is usually effected after the provision of written notice (usually 30 days), which gives the breaching party an opportunity to cure the breach. Some agreements specify a fixed, pre-determined amount as liquidated damages, which the buyer must pay to the seller in the event buyer fails to close. Generally, the courts will uphold the amount agreed upon by the parties as liquidated damages if they are a reasonable estimate of the actual damages that the parties could suffer in the future.\(^\text{10}\)

The “earnest money escrow deposit” usually serves as an available liquid asset pool to secure the payment of at least a portion of the liquidated damages for the seller. One contract contained the following provision detailing the basis of liquidated damages:

> The Buyer and the Seller acknowledge that in the event that the transactions contemplated by this Agreement are not closed because of a default by the Buyer, the Adverse Consequences to the Seller as a result of such default may be difficult, if not impossible, to ascertain. Accordingly, in lieu of indemnification pursuant to Section 7(c), the Seller shall be entitled to receive from the defaulting Party for

\(^{10}\) Arthur L. Corbin, 11 Corbin on Contracts § 58.1 (Joseph M. Perillo ed. 2010).
such default the Earnest Money Deposit as liquidated damages without the need for proof of damages, subject only to successfully proving in a court of competent jurisdiction that the Buyer materially breached this Agreement and that the transactions contemplated thereby have not occurred. The Seller shall proceed against the Earnest Money Deposit as full satisfaction of liquidated damages owed by the Buyer and as its sole remedy for a failure of the transactions contemplated hereby to occur as a result of a material breach of the terms of this Agreement by the Buyer.

The liquidated damages provision may not pass court muster unless the damages resulting from a breach are incapable or difficult to estimate and the stipulation of damages in the provision is a reasonable forecast of just compensation.

Most agreements include a specific performance clause that entitles the buyer to obtain a judicial order requiring the seller to sell the station to the buyer in the event of breach or default by the seller. Such clauses usually contain a statement that the seller stipulates that the assets include unique property that cannot be readily obtained on the open market and that the buyer will be irreparably injured if the Asset Purchase Agreement is not specifically enforced. In addition, there is typically a provision that the seller agrees to waive the defense in any lawsuit that buyer has an adequate remedy at law and to interpose no objection to the propriety of specific performance as a remedy. Because of the many variables that can delay the grant of an application by the FCC (e.g., the filing of a petition to deny or an informal objection), many agreements provide for a contract expiration date (typically nine months to one year from the filing of the application) and permit either party to withdraw if the Commission designates the application for a hearing, regardless of the timing.

K. Survival of Representations and Warranties

This section specifies the period of time that the representations and warranties of the buyer and the seller will remain effective beyond the closing. This is an important issue for both the seller and the buyer. There is a natural tension between the parties on the survival period.
From the point of view of the buyer, the seller’s representations and warranties should survive the closing to the extent of the applicable statute(s) of limitations. The seller, by contrast, generally wants to limit the length of time that its representations and warranties will remain effective. A lengthy survival period may mean that the seller (or its business entity) will be required to remain in existence longer than the seller’s principals wish. In fact, the buyer may insist that the purchase agreement include a provision requiring that the seller remain in existence until the expiration of the survival period to help ensure that the seller will be available and able to stand behind its representations and warranties.

Various approaches can resolve the tension and determine the survival period of representations and warranties. Typically, the parties will agree on a fixed period of time within which the representations and warranties survive, after which no claims can be made for breach. The shortest typical deadline is generally six months after the closing. Two years is typical of the longest deadline, with certain representations (such as those for taxes, environmental liabilities, title, fees to brokers, and the Employee Retirement Income Security Act (“ERISA”) continuing through the applicable statute of limitations. Some agreements provide that the representations and warranties will survive for one audit period (typically not more than 18 months). The deadlines may vary depending on the nature of the warranty. There may be several categories into which warranties are allocated. For example, some agreements provide for no time limitation on the representations of the seller concerning its authority to engage in the transaction or its title to the real estate. In some instances, the purchase agreement places no limitations on survival:

All representations, warranties, covenants and agreements contained in this Agreement, or in any certificate, agreement, or other document or instrument, delivered pursuant hereto, shall survive (and not be affected in any respect by) the Closing, any investigation conducted by any party hereto and any information which any party may receive.
L. Indemnification by the Buyer and the Seller

This section describes the procedures and the limitations for indemnification in the event of a breach of contract. (“Indemnification” refers to the obligation to reimburse a party for all or some part of the expenses and damages sustained). The indemnification section typically requires the seller (and sometimes, its shareholders and principals) to indemnify the buyer not only for breaches of warranties, representations and covenants but also for other kinds of claims (such as tax or environmental liabilities) that may occur after the closing but were not assumed by the buyer. In some transactions, the indemnification obligation is secured with an escrow of a portion of the purchase price or an offset of payments relating to a non-competition agreement or a promissory note. Also, the indemnification section creates liability for the seller after the date of the closing even for matters that the seller had no knowledge of before the closing. For example, a typical indemnification clause may require the seller to indemnify the buyer from any post-closing claim resulting from a pre-closing “act, omission or event.”

Some clauses provide for unlimited indemnification, but must be qualified by a number of requirements. Other indemnification provisions specify a “cap” or maximum amount of coverage, an amount that frequently equals the total purchase price. Others provide for a safety net or “basket,” which is a minimum amount of loss that the indemnified party must exceed before the obligation of the “indemnitor” (the party who is obligated to indemnify the other party against the loss or damage) becomes effective—it is, in effect, a deductible. One of the purposes of such a threshold deductible is to avoid disputes over insignificant amounts of money. The amount of the basket usually depends on the size of the transaction—the larger the purchase price, the more likely the basket will be greater. Some buyers negotiate for a “threshold” deductible that, once crossed, entitles the indemnifying party to cover all damages rather than just the losses that exceed the amount of the basket.

The parties should keep in mind that an indemnification is worth only as much as the indemnitor. Some companies may not be able to stand behind their indemnification. If the seller plans to dissolve or disband after the closing, special arrangements should be made to specify who will be responsible under the indemnification
section of the agreement (e.g., the main stockholders or principals of the seller). Also, some buyers insist on the execution of a post-closing indemnification escrow agreement to secure indemnification rights and also obtain set-off rights with respect to the collection of seller's accounts receivable and payments under promissory notes. In recent years, some sellers have negotiated for the use of new insurance products to insure representations and warranties to back indemnification, although the premiums for such policies can be quite expensive.

As discussed more extensively in the next section, if the transaction and the parties are of sufficient size, a filing is required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The filing fee is quite significant (currently, $45,000.00 for transactions under $126.9 million) and must be paid by the buyer in full to the Federal Trade Commission. The parties usually negotiate whether the fee will be paid by the buyer or split between the seller and the buyer.

III. Giving the Deal its Due (Diligence)

Generally speaking, the due diligence process consists of the investigation and evaluation of the financial condition and operations history of a business enterprise. The purpose of due diligence is to obtain information about the strengths and weaknesses of the target enterprise, potential legal or other obligations or vulnerabilities, cash flow and future profit potential, competitive position, and other matters that can help the buyer decide whether to go forward with a purchase. If the acquisition is completed, the same information derived from the due diligence process can provide the buyer critical guidance for initial operating decisions. An acquisition is certainly one of the more complex and risky business activities a businessperson can undertake. A thorough due diligence review will help a buyer define acceptable levels of risk.

The due diligence process involved in the acquisition of a radio station should include a review of the general economic and operating conditions as well as such areas as the financial and accounting systems, sales, programming, technical facilities, legal matters,

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12 Id.
marketing, FCC compliance, employee benefits, taxes, personnel and environmental matters. The objective of the due diligence review is to obtain information that will not only help decide whether or not to proceed with the acquisition, but also assist in determining the amount of the purchase price or projected working capital adjustment. This chapter discusses the legal and engineering due diligence process but does not cover the extensive business due diligence that each buyer necessarily must accomplish.

The extent of the due diligence investigation depends on the experience and needs of the buyer, the magnitude of the purchase price, time constraints and various other factors. For example, the financial scope of the effort may range from reviewing the prior year’s financial statements and tax returns to a complete audit examination as of a specified date.

A. Due Diligence Legal Review

The legal due diligence process is a team effort, employing primarily the expertise of lawyers and accountants specializing in different areas, such as corporate, tax, labor, employment benefits, FCC, environment, and real property, all working together with the buyer. The legal due diligence process often begins prior to reaching an agreement in principle with the seller, and continues throughout the acquisition process. Indeed, a major objective of the definitive acquisition agreement (particularly the warranties and representations) is to obtain information necessary for, and to verify the results of, a due diligence investigation. It may save time once an agreement in principle is reached to request copies of the documents, which will eventually need to be supplied for the definitive agreement. Most buyers will not sign a definitive agreement until satisfactory due diligence has been conducted, or in the alternative, the agreement allows the buyer to terminate the transaction in the event that the results of due diligence review are not satisfactory.

The acquisition agreement should provide the buyer with the opportunity to undertake business, engineering and legal investigations. The scope of the due diligence investigation prior to closing may depend in part on the nature of the representations and warranties contained in the acquisition agreement, whether the representations and warranties will survive the closing, and the
strength of the indemnification provisions. If the representations will not survive the closing, or if no effective provision for indemnification exists, completing an exhaustive investigation will be more important. While all acquisition agreements contain representations and warranties and usually indemnification provisions, it is far more preferable to unearth all possible liabilities before the buyer executes the agreement, rather than resort to a lawsuit after the sale.

The results of the due diligence investigation will assist the buyer in evaluating the transaction and providing needed protection. Even though the due diligence process is generally the same whether stock or assets are acquired, what is discovered in the process may lead the buyer to decide whether an asset or a stock acquisition is preferable. If a stock purchase agreement is entered into, a prudent buyer will negotiate for stronger representations and warranties to secure protection against hidden liabilities.

It is the responsibility of the lawyer to prepare an acquisition agreement tailored to the facts and circumstances of the particular transaction. For example, if the accountant uncovers past income-tax deficiencies of the seller, the buyer’s lawyer should include in the agreement a provision stating that the buyer is not liable for the tax obligations of the seller. Also, the buyer should undertake a comprehensive legal investigation, which should include the seller’s litigation history, FCC problems, contractual obligations, liabilities, ownership of realty and personalty, labor relations obligations, copyrights, trademarks and licenses, and obligations to brokers and finders.

B. Business and Financial Review

Any due diligence review of a station must include a careful analysis of the seller’s business practices and financial records. At a minimum, that review should include the following:

- The buyer should inspect the station’s accounts receivable. Are the accounts bona fide? Have there been extensive pre-payments? Are there any advertisers that account for a disproportionately large share of the station’s business? Are any advertisers being given unusually large discounts and has that practice extended over a protracted period?
- The buyer must also carefully assess the seller’s payables. Is the seller current on fees owed under its programming agreements?
Is it current on its Arbitron payments?\textsuperscript{14} If it is streaming, is the station current on payments to SoundExchange? Are royalty payments current to ASCAP, BMI, and SESAC?\textsuperscript{15}

• All of the station’s financial records must be analyzed to determine the extent to which the records are not being maintained in accordance with generally accepted accounting principles (“GAAP”) and to assess the impact of such noncompliance upon the station’s financial outlook.

• All programming agreements should be closely reviewed to determine the profitability of the arrangements and the length of the commitments. Is the station saddled with paying fees for programming that it no longer airs? Is the station about to lose the rights to its most profitable program or personality?

• Although more difficult to assess, the seller’s standing in the community must be analyzed. A buyer that purchases a station that traditionally has been behind in making payments to vendors or that has a history of heavily relying on trade arrangements may find it necessary to engage in a public relations campaign to alter the community’s perception of the station.

C. Engineering Review

A due diligence engineering review goes beyond the nuts and bolts of station equipment. While it is important to know the general condition of equipment in order to plan future purchases, other factors can have a far greater impact on station value than the condition of a control board. For example, can the power of the station be increased? Can the tower be moved to a location to serve the market better or to allow the sale of valuable real estate?

\textsuperscript{14} Arbitron is a U.S. consumer research company that collects listener data on radio audiences. \textsc{Arbitron}, http://www.arbitron.com (last visited Sept. 11, 2010).

Aside from equipment and upgrade concerns, it must be determined whether the station is in compliance with the FCC’s rules. There are also environmental issues including the presence of PCBs and radio frequency radiation.

The concerns in the due-diligence engineering review can be broken down into four areas: (1) Analysis of the station’s upgrade potential; (2) Assessment of potential competition in the market; (3) Operation in accordance with FCC rules and authorizations; and (4) Inspection of equipment.

IV. Keeping Them Happy at the FCC

The sale of a radio station and the transfer of its license involve legal considerations that are not present in the transfer of most other business enterprises. Unlike unregulated businesses, the closing of a radio station sale cannot take place unless the FCC gives its blessing. Many potential FCC pitfalls may adversely affect both the buyer and the seller. This section presents some practical suggestions for avoiding such pitfalls and making sure that the terms of the purchase agreement satisfy FCC rules and policies.

A. Requirement of Prior FCC Approval

The Communications Act of 1934 provides that a broadcast station construction permit or license may not be assigned nor may control of an entity holding a license be transferred, except upon application to the FCC and a finding by the Commission that the “public interest, convenience and necessity will be served thereby.”16 This prohibition applies equally to transfers of de jure (legal) and de facto (actual) control. “Control” in FCC parlance encompasses any means whereby an individual or entity can “dominate” or “determine” the licensee’s policies and/or corporate affairs, especially those relating to personnel, finances, and programming. Premature transfers of control have resulted in the disapproval of assignment and transfer applications, large fines, and in some cases, the initiation of proceedings to revoke the station’s license.17 Accordingly, the asset purchase agreement should specifically provide that consummation of the transaction is subject to the prior written approval of the FCC.

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17 See Lorain Journal Co. v. FCC, 351 F.2d 824 (D.C. Cir. 1965).
For example, one asset purchase agreement included the following provision:

The consummation of this Agreement shall in all respects be subject to the prior consent by the FCC to the terms and conditions of this Agreement, and in particular to the assignment of the Licenses to Purchaser. Purchaser and Seller shall use their best efforts to prepare and file as promptly as practicable, but in no event later than ten (10) business days after the date hereof, with the FCC all applications and other necessary documents to request the FCC Order. After these applications and documents have been filed with the FCC, Purchaser and Seller shall prosecute the applications with all reasonable diligence to promptly obtain an FCC Order.

Some contracts condition the closing on the grant of FCC consent becoming final and no longer subject to review. The following is a definition of a “final order” commonly contained in the acquisition agreement:

“Final Order” means an order or action of the Commission as to which, under FCC Rules, the time for filing a request for administrative or judicial review, or for instituting administrative review sua sponte, shall have expired without any such filing having been made or notice of such review having been issued; or, in the event of such filing or review sua sponte, as to which such filing or review shall have been disposed of favorably to the grant and the time for seeking further relief with respect thereto under the applicable FCC or court rules shall have expired without any request for such further relief having been filed.

B. Licensee Control

The Communications Act requires that the licensee retain control over the station up to and until the closing and that the buyer
assume control immediately upon closing.\footnote{See 47 U.S.C. § 310 (2006).} To meet this requirement, the asset purchase agreement may provide that: “[b]etween the date of this Agreement and the Closing Date, Buyer, its employees or agents, shall not directly or indirectly control, supervise or direct, or attempt to control, supervise or direct, the operation of Stations, and such operation shall be the sole responsibility of and in the complete discretion of Seller, except as may be provided in this Agreement.”

C. Avoiding an Unauthorized Transfer of Control

The FCC requires that station owners exercise sufficient control over major management decisions (finances, personnel, and programming) to ensure that the licensee retains ultimate responsibility for station performance.\footnote{See, e.g., 47 C.F.R. § 73.624(c)(2) (2009); 47 C.F.R. § 73.646(d) (2009); 47 C.F.R § 73.669(c) (2009). See generally 47 U.S.C. § 310(d) (2006) (license ownership restrictions).} The Commission regularly has advised prospective buyers to refrain from the premature exercise or assumption of control of the stations involved.\footnote{The Commission has issued monetary forfeitures against licensees found to have prematurely transferred control of a station. See, e.g., Birach Broad. Corp., Notice of Apparent Liability for Forfeiture and Order, 25 FCC Rcd. 2635 (Mar. 17, 2010) (fining the licensee $15,000 for an unauthorized transfer of control of a radio station and failure to adhere to requirements for maintaining a main studio).} Because the presence of the prospective owner’s employees at the station on a day to day basis lends itself to situations which could easily result in the premature exercise of control, the FCC repeatedly has advised prospective buyers to refrain from the day-to-day participation in the station’s affairs while the application awaits Commission approval.

Under such circumstances, how can a buyer ensure that prior to the closing, the target station is being operated to its expectations? Four devices for dealing with this problem are (1) a consulting contract; (2) a services agreement; (3) a joint sales agreement (if the buyer currently has a radio station in the market); and (4) a local marketing agreement. Under the first option, the seller and buyer enter into an agreement pursuant to which the seller retains the buyer as a consultant. Under the auspices of this agreement, the buyer as consultant acts as the licensee/seller’s contractor and may provide services touching upon the operation of the station to the extent spelled out in the agreement and always subject to the oversight and control of the licensee. Under
the consulting agreement, the seller usually pays the buyer some specified sum in exchange for the consulting services. The expense needs to be considered in setting the purchase price for the station.

Under the local marketing agreement (“LMA”), also known as a Time Brokerage Agreement, the buyer buys the broadcast time of the target station on a wholesale basis pending the closing. Buyer provides the programming for the station and sells advertising. As in the case of the consulting agreement, the LMA must unequivocally reserve to the licensee/seller the unlimited right to suspend, cancel, or reject any programming furnished or recommended by the lessee/buyer. Additionally, the licensee remains responsible for the salaries of certain employees and other costs of the station’s operations, as well as for compliance with all regulatory requirements such as maintenance of the public inspection file and political file. In contrast to a consulting agreement, under the LMA, the broker/buyer customarily pays the licensee/seller for the lease of the airtime. These payments can also stand on their own or be treated as advances that will reduce the purchase price stated in the purchase agreement. In addition, an LMA between the seller and buyer of a station must be filed with the FCC as part of the FCC application. Some buyers are reluctant to enter into an LMA because: (a) the Media Bureau usually processes assignment and transfer applications in about 45 days and (b) a competitor of the station might file a petition to deny alleging that an unauthorized transfer of control has occurred.

Whether it is a consulting agreement or an LMA, a carefully drafted document should include a provision that “nothing in this Agreement shall be construed to prevent or hinder the licensee from retaining and exercising full and complete control over the station, including, but not limited to, control of its finances, personnel, and programming.” The wording of these agreements is critical in situations where the general manager is buying the station or a “workout team” plans to assume a managerial role. But words alone will not necessarily immunize the station from a determination by the FCC that an unauthorized transfer of control has occurred. The parties must maintain continuous oversight to ensure that the seller makes all key

21 The Federal Trade Commission regards the execution of a LMA as a reportable transaction under the Hart-Scott-Rodino Antitrust Improvements Act if the buying and selling companies meet the statutory tests.
management decisions, particularly those relating to station financing, programming and employment. A contemporaneous written record of each approval is recommended.

Yet another approach to the problem is to include a provision whereby the seller agrees “to allow Buyer an observer who will have full and free access to the Purchased Assets so that Buyer’s organization shall have an opportunity to study existing operations and prepare for a smooth transition to ownership.” Such an opportunity should also make clear that “the observer shall have no role in the operation of the Station prior to the Closing.” This provision, however, provides only a minimal amount of protection to the buyer. Where there is concern about the continuing viability of the station, a consulting contract might provide greater protection.

It is also important to guard against violating the FCC’s prohibition on an unauthorized transfer of control before signing bank or other financing agreements. Banks use a variety of techniques to place pressure on borrowers who are in default. In some instances, this pressure comes perilously close to violating the Communications Act by unduly restricting the discretion of the licensee of the station. For example, one bank was rumored to have ordered the owner of a group of radio stations to cut costs by firing each of the general managers and by having the sales manager at each station also act as general manager. Some banks also have tried to induce borrowers in default to execute a power of attorney giving the lender the authority to sign an application to assign the license of the station to a new buyer. One bank tried to include the following provision in a forbearance agreement: “Simultaneously upon the execution of this Agreement, the Borrower shall complete (but not date) and execute an FCC Form 314, Assignment of License, in blank and deliver the same to the Bank, such that the Bank shall possess an undated current and effective FCC Form 314 for the transfer of the Station’s FCC licenses at all times.” The FCC staff has taken the position that both a power of attorney of the kind just described and the signing of blank application forms clearly violate FCC policy and constitute an unauthorized transfer of control as of the date of the signing.

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23 See id.
Radio broadcasters should not, indeed may not, sign away their rights as licensees. Such action jeopardizes their licenses. Some broadcasters have taken the position that they will sign an assignment application in only two situations: either when an asset purchase agreement with a buyer of their choice has been executed, or if (and when) the bank secures a court order forcing them to sign an assignment application.

If the parties do decide to enter into an LMA, the seller must take particular pains to make sure that the buyer’s actions under the LMA do not result in a situation where seller is in technical breach of the purchase agreement because of buyer’s actions under the LMA. For example, many purchase agreements include a representation by the seller that the station is being operated in material compliance with the FCC’s rules and regulations. If the buyer provides programming under the scope of the LMA that the Commission deems to be indecent, however, the seller’s representation concerning the station’s compliance with the FCC’s rules and regulations will no longer be correct. This could lead to the anomalous situation wherein the buyer could terminate the purchase agreement because of the failure of that representation even though the buyer is the party that caused the representation, to no longer be true. To avoid precisely this kind of situation, the parties to a recent agreement included the following provision in their purchase agreement:

Notwithstanding anything contained herein to the contrary, the Seller shall not be deemed to have breached or otherwise failed to fulfill any of its representations, warranties, covenants or agreements contained herein or to have failed to satisfy any condition precedent to Purchaser’s obligation to perform under this Agreement (nor shall the Seller have any liability or responsibility to Purchaser in respect of any such representations, warranties, covenants, agreements or conditions precedent), in each case only to the extent that the breach of or failure to fulfill any such representation, warranty, covenant or agreement or the inability to satisfy any such condition precedent is due, directly or indirectly, to (i) any actions taken by or at the direction of Purchaser or its
Affiliates (or any of their respective officers, directors, employees, agents or representatives) in connection with the Purchaser’s performance of its obligations under the [LMA] or (ii) the failure of Purchaser to perform any of its obligations under the [LMA].

Although LMAs have been in use for nearly twenty years, there is always the possibility that the FCC could decide to forbid their use in the future or could rule that certain standard LMA provisions are not in the public interest. As a result, it is incumbent upon the parties to the LMA to make provision for either or both of these possibilities. For example, in one Local Programming and Marketing Agreement, the parties included a provision that stipulated that “[e]ither party to this Agreement may terminate this Agreement if the FCC’s policies or rules change in a manner that would require such termination by providing the other party with ten (10) days advance written notice.” Although this type of provision addresses the question of what is to happen in the event that the FCC forbids LMAs. It does not address the more likely scenario of the FCC adopting regulations that would require the parties to change their operations pursuant to the LMA. The following is a more comprehensive provision addressing this issue:

In the event of any order or decree of an administrative agency or court of competent jurisdiction, including without limitation any material change or clarification in FCC rules, policies, or precedent, that would cause this Agreement to be invalid or violate any applicable law, and such order or decree has become effective and has not been stayed, the parties will use their respective best efforts and negotiate in good faith to modify this Agreement to the minimum extent necessary so as to comply with such order or decree without material economic detriment to either party, and this Agreement, as so modified, shall then continue in full force and effect. In the event that the parties are unable to agree upon a modification of this Agreement so as to cause it to comply with such order or decree without material economic detriment to either party, then this Agreement shall be terminated. . . .
D. The Rule Against Reversion and Reservation of Time

Question 3 of Section II, the assignor’s portion of FCC Form 314, asks the seller of a station to certify that the purchase agreement and related agreements submitted to the Commission “embody the complete and final understanding between licensee/permittee and assignee... and [that they] comply fully with the Commission’s rules and policies.” As the instructions to the application observe, an applicant must consider “a broad range of issues” in order to make this certification. To help applicants navigate through these issues, the FCC has added a number of worksheets to Form 314.25

Worksheet #2 of Form 314 aids applicants in determining whether their agreements satisfy Commission requirements. Item 4 on the worksheet inquires whether the agreements provide in any way “for a reversion of the license(s) in the event of default or any right to reassignment of the license in the future[,]” The worksheet specifically notes that “[t]he response to [this question] must be ‘No’ in order to certify that the contractual documents comply fully with the Commission’s rules and policies. If ‘Yes,’ the applicant may not make the appropriate certification.”

Section 73.1150, which is the Commission’s “rule against reversion,” prohibits clauses in contracts (a) providing for reversion (i.e., reassignment of a license) or “reacquisition” of station control in the event of default by the purchaser and (b) reserving to the seller any rights to use the facilities of the station as a condition of the sale. In interpreting its prohibition against reversions, the Commission has consistently refused to grant transfer and assignment applications where the former owner retained the right to regain the status of licensee through reversion of stock control or reassignment of the license. FCC policy demands that the buyer be free to dispose of the control of the corporation or the station license without the former owner’s consent.

Where the deal contemplates a stock transaction, the exchange may involve either positive stock control (that is, a sale of a voting interest in the company exceeding 50 percent) or negative control (that

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is, a voting interest of exactly 50 percent that can act as a veto on actions by the shareholders holding the remaining 50 percent of the voting shares). Regardless whether the sale involves positive or negative control of a corporate licensee, however, the sale must be absolute, with no reversionary rights in the event of default. The voting rights to the stock must immediately be transferred to and remain with the buyer until other disposition is made of the stock with the prior consent of the Commission. The buyer may pledge the stock with a pledgee, including the seller, but, title to the stock and any related voting rights may not revert to the seller under any circumstances. However, provision may be made for allowing the stock to be sold at a public auction in the event of a default, or in a private sale to a buyer found after the default, at which time the seller could also be a bidder.

The Commission’s prohibition against reversionary interests most often comes into play in situations in which seller financing is used. A seller naturally wants to make sure that it will receive full consideration for the station and that it is protected in the event the buyer defaults on the note. The temptation will be to include in the purchase agreement, the security agreement or even in the note itself a provision whereby the seller will get the station back if the buyer were to default. This, however, is a classic example of a prohibited reversionary interest. The temptation to provide the seller with a reversionary interest in the event of a default on a note is so great that the Commission staff frequently will ask the parties to a transaction involving seller paper to confirm that the transaction does not give the seller the right to get the station back in the event that the buyer defaults on the note.

The rule against reversionary interests not only prohibits the blatant form of reversionary interest that would arise if the sales documentation simply stated that the station reverts back to the seller in the event of a default by the buyer. The rule also prohibits any reservation of rights to “use the facilities of the station for any period whatsoever.” This provision has been interpreted by the Commission staff to mean not just that a seller cannot retain the right to use the physical facilities of the station, but also that the seller may not enter into a local marketing agreement with the buyer that would permit seller to provide programming to the station. Although case precedent addressing the point is sparse, the Commission staff has stated that, in
the context of a television LMA, a provision whereby the seller would be able to provide programming over the station after closing “would appear to violate the plain language” of the reversionary rule to the extent that the LMA is “either a condition of, or consideration for, the proposed transaction.”

E. Hypothecation and Security Provisions

It is important to understand the distinction between the station’s license and the station’s non-licensed assets.

The FCC consistently has held that a broadcast license may not be encumbered by mortgage, lien, pledge, or lease. The rationale for this principle is that the license belongs to the government and such an encumbrance endangers the independence of the licensee who must be at all times responsible and accountable to the FCC. A licensee should also be free to assign the license of the station or transfer control to anyone of his or her choice without the consent of creditors or others (subject, of course, to the prior consent of the FCC).

Where the agreement specifies that Commission approval must be obtained prior to any assignment of voting control, the FCC has allowed loan agreements to require a pledge of the capital stock of the licensee corporation as security. The FCC also has allowed security provisions prohibiting the purchaser from making major expenditures not contemplated in the ordinary course of a broadcast operation without the lender’s approval. The FCC permits the loan documents to require the borrower, in the event of a default, to cooperate with the lender in the appointment of a receiver. Although neither a station’s license nor control of a licensee corporation may be the subject of a security agreement, a station’s physical assets may be foreclosed or sold without the prior consent of the Commission.

F. FCC Processing of Assignment and Transfer Applications

Because the Communications Act requires FCC approval of any change in the control of a licensee, an entity controlling a licensee, a sole proprietorship, or the holder of a majority voting interest,

27 Merkley, 94 F.C.C. 2d at 830 (1983).
28 Id. at 830–831.
assignments of license and transfers of control can take many forms. An assignment or transfer can be voluntary, as in the case of the consensual sale of a station between two parties, or involuntary, as where a corporate licensee becomes bankrupt or a sole proprietor licensee dies. Likewise, an assignment or transfer can involve a change in ultimate control of the licensee, or it can merely be pro forma, such as changing the ownership structure of a licensee without actually changing the party ultimately in control. Applications for FCC consent to involuntary or pro forma assignments or transfers of control follow “short form” procedures. That is, they utilize FCC Form 316 (the “short form”), are subject to less stringent public notice requirements, and are processed more quickly.

For the most part, the discussion in this article relates to voluntary assignments or transfers of control resulting in a de facto and a de jure change in the ownership and control of the license or the licensee. These types of deals are called “long form” transactions. That is, parties to such agreements must file a long form application—FCC Form 314 in the case of assignments, FCC Form 315 in the case of transfers of control—to seek FCC consent to the transaction. If the buyer proposes to employ five or more full-time employees, it must separately file a Model EEO Program Report on FCC Form 396-A. In considering such applications, the Commission does not permit the filing of competing applications for the station’s assigned frequency, but instead evaluates only the “basic” qualifications of the parties (especially the transferee or assignee) to dispose of and to acquire the license that is the subject matter of the application.

Although the discussion in this article focuses on voluntary assignments or transfers of control, there is one form of involuntary action about which every prospective seller or buyer needs to be aware. Specifically, the Commission treats any action whereby a federal or state court appoints a trustee, debtor-in-possession or a receiver as an “involuntary” assignment or transfer even if the licensee is a willing participant to the proceeding. Because such bankruptcy and receivership actions are treated as being “involuntary,” not voluntary, FCC consent can be obtained by filing for such consent on the “short

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30 See FCC, Form 316 Instructions for Consent to Assign Broadcast Station Construction Permit or License or Transfer of Control of Entity Holding Broadcast Station Construction Permit or License, at A9 (June 2008), http://www.fcc.gov/Forms/Form316/316.pdf.
form,” FCC Form 316. Short form applications are not subject to the statutory 30-day period for the filing of petitions to deny discussed below and it is not uncommon for the Commission staff to grant short-form applications within days of their being filed. Because the Commission need not observe the 30-day period for the filing of petitions to deny and because such applications are frequently acted on within days of filing, it is unusual for objections to be filed with respect to short-form applications. Simply put, the logistics are such that interested parties may be unable to get an objection on file before the FCC staff acts on the application.

In addition, it is customary for the short form application that is submitted in response to a bankruptcy or receivership proceeding to be filed after the court has appointed the debtor-in-possession, trustee or receiver. In fact, the normal procedure is to include a copy of the court order appointing the debtor-in-possession, trustee or receiver as part of the short form application. The court order can also serve as the signature of a recalcitrant licensee/assignor. In most cases, the FCC staff will defer to the decision of the court—unless that decision is at odds with the Communications Act or the Commission’s rules or policies.

Once a new buyer is found for the station through the bankruptcy or receivership process, another application seeking FCC consent must be filed. In this case, however, the Commission requires that a “long-form” application, namely an FCC Form 314 or an FCC Form 315, must be used. The long-form application is required in order to permit the Commission staff to examine the proposed licensee and its principals to ensure that their ownership of the station would be consistent with the Communications Act and the Commission’s rules and policies.

The Commission formerly required applications for consent to assignment of license or for transfer of control to be filed in hard copy and in triplicate. However, the Commission no longer accepts paper versions of FCC Forms 314, 315 and 316. Instead, these forms must be filed electronically.\(^{31}\) The application is subject to a filing fee.\(^{32}\)
After the seller and buyer file the application, and the filing fee is recorded, the Commission staff begins processing it. If the staff determines upon this initial review that the application is complete, within five to ten days after the filing, the FCC will issue a public notice announcing that the application has been accepted for filing.

Following the release of this initial public notice, a statutory 30-day period must elapse during which interested parties may file “petitions to deny” against the application. Challenges to the application may also be submitted at any time in the form of “informal objections.” Such objections do not carry the same procedural


32 The amount of the fee assessed for the application may be found in either the FCC Fee Filing Guide, or as specified in special electronic filing Public Notices. The filing fee for FCC Forms 314 and 315 is presently $940.00 per station for which consent is sought. Applicants must pay the FCC filing fee at the time their application is electronically filed or shortly thereafter. The Commission offers an electronic fee payment system, which allows immediate payment by credit card and facilitates faster processing of the application. Payment also may be made by check or money order sent to the FCC’s lockbox bank, U.S. Bank in St. Louis, Missouri. This will delay application processing by several days, however, and if there is an error in processing the check, the application may risk being dismissed for failure to pay the filing fee on time.

An FCC Registration Number (“FRN”) is required for the filing of all FCC forms. Pursuant to the Debt Collection Improvement Act of 1995, the FCC is required to request this ten digit entity identifier from anyone doing business with the Commission. An FRN can be applied for and obtained from the FCC Commission Registration System (“CORES”), which is linked on the FCC’s homepage, http://fcc.gov. An FRN can also be applied for manually by submitting FCC Form 160.

An applicant submits its application via the on-line Consolidated Database System maintained by the FCC Media Bureau (“CDBS”). It provides a link to initiate the FCC Electronic Form 159 (“Remittance Advice”) system. The system will calculate the appropriate fee and provide for launching a browser for completion of the Electronic Form 159.

The applicant may print the completed Form 159 and send it to U.S. Bank by mail or courier, or may pay electronically. The Commission cautions that payment of the fee must be received by the bank within 14 calendar days of the date that the application is submitted. This deadline applies whether payment is submitted electronically or by a paper check. If payment is not received in time, the filed application will be considered to be not paid and the Media Bureau will not process it.

An applicant may elect to submit an application without immediately initiating the fee filing process. Applicants can submit their applications and then defer the submission of the fee. This arrangement can be useful if the applicant paying the filing does not have readily at hand all the information required to be included on the Form 159. The downside to this arrangement is that it increases the risk that the applicant will fail to timely submit the filing fee and risks dismissal of its application.
protections as formal petitions; however, objections that raise material concerns will often receive the careful attention of the Commission staff. If, at the end of the 30-day period, a petition to deny or other objection has been filed, the timing of final Commission action on the application becomes quite uncertain. Such filings can add several months, and in some cases even years, to the processing time for an application.

In the absence of any objection, an application becomes ripe for Commission action at the close of the 30-day period, and the parties can typically expect to receive a grant between five days and one month after the comment period. Customarily, the staff will make an action granting an application immediately effective although the public notice announcing the action will be issued about three business days after the grant.

Upon release of the public notice announcing the staff’s action on the application, another statutory 30-day period opens within which aggrieved parties (unsuccessful petitioners to deny or new third parties in the case of a granted application and the applicants themselves in the event of a denial) may petition the Commission staff to reconsider the decision if the grant is made pursuant to delegated authority. The Commission, for its part, has an additional 10 days (for a total of 40 days) within which it may review the staff’s action on its own motion. As with a petition to deny, the filing of a petition for reconsideration can make it very difficult to forecast accurately the timing of final action on the application. This is particularly true because the staff’s decision on reconsideration itself then becomes subject, potentially, to further review by the Commission or by the U.S. Court of Appeals. If no petitions for reconsideration are filed, and the Commission takes no action, a grant of the application is deemed to be “final” by operation of law and is no longer subject to legal challenge, on the 41st day after public notice of the grant.

G. Closing Before a Final Order

The grant of an assignment or transfer of control application is not “final” until after the disposition of all applications for review, petitions for reconsideration and judicial review and the passage of the 40-day period during which the Commission can revisit a staff grant of an application. Most contracts provide that the closing shall not take
place until the FCC’s grant of the transfer or assignment application has become a “final order.” However, there is no legal barrier to closing before finality. The FCC’s grant is effective immediately. The Commission has stated that parties that elect to close a transaction exercise their own business judgment and proceed at their own risk with the full understanding that they may ultimately be required to undo the transaction.\textsuperscript{33}

Many parties accept the risk and close before a grant becomes final. How can the seller and the buyer protect themselves if they close before a final order and the FCC subsequently rescinds the grant? One way of handling this rare occurrence is for the parties to include an “unwind” or rescission provision in the asset purchase agreement. The following is an example of such a provision:

If the Closing occurs prior to a Final FCC Consent, and prior to becoming Final, the FCC Consent is reversed or otherwise set aside, and there is a Final order of the FCC (or court of competent jurisdiction) requiring the re-assignment of the FCC Authorizations to Seller, then Seller and Buyer agree that the purchase and sale of the Station Assets shall be rescinded. In such event, Buyer shall re-convey to Seller the Station Assets, and Seller shall repay to Buyer the Purchase Price and re-assume the Seller Contracts assigned and assumed by Buyer at Closing. Any such rescission shall be consummated on a mutually agreeable date within thirty (30) calendar days of such Final order (or, if earlier, within the time required by such order). In connection therewith, Buyer and Seller shall each execute such documents (including execution by Buyer of instruments of assumption of the Seller Contracts assigned and assumed at Closing) and make such payments (including repayment by Seller to Buyer of the Purchase Price) as are necessary to give effect to such rescission. Seller’s and Buyer’s obligations under this section shall survive the Closing.

\textsuperscript{33} Washington Ass’n for Television and Children v. FCC, 665 F. 2d 1264 (D.C. Cir. 1981) (holding that parties who consummate a sale transaction before its approval becomes final assume the risk that the sale may later be set aside by the Commission or the courts).
In some transactions where the parties dispense with the requirement for a final order as a condition to closing, they enter into a rescission agreement (also called an “unwind” agreement) at the closing which sets forth the procedures and ramifications in the event that the FCC were to rescind the grant. Such agreements normally provide for the return to the status quo ante in the event of a later FCC or court order vacating the FCC consent.

V. How to Avoid Seller’s Remorse: Selling Without Selling Out

To use Charles Dickens’ often quoted phrase, selling a radio station can be “the best of times” if the seller finds the right buyer who is willing to pay the best price at optimal and secure terms in a transaction structured to maximize the after-tax benefits to the seller. But it can be “the worst of times” if there are strategic mistakes in the pricing or presentation of the station, if administrative snafus prevent the transaction from moving forward in a timely manner, or if important details are left undone. This section discusses some of the business considerations that a seller should address before placing a station on the market and suggests some contractual provisions to protect the seller’s interests. Although this section is written from a seller’s perspective, prospective buyers who would like insights on how to deal with the party on the other side of the bargaining table will also find it valuable.

A. Overall Business Strategy

Time spent planning and preparing for the sale of a radio station is time well spent for the seller. The first important decision any seller has to make concerns timing. If you can avoid it, don’t attempt to sell in the midst of an economic downturn. Make sure that prospective buyers understand your station’s current economic value as well as its future growth potential. Another important threshold step is determining the method you will use to find the right buyer. Do you want to use confidential bids? An open auction? Selecting an aggressive and creative media broker and/or investment banker is another key preliminary task.
B. Contract Provisions Protecting the Seller’s Interest

Typically the buyer’s counsel prepares the initial draft of the definitive acquisition agreement. The following is a listing of the negotiating approaches often taken by counsel for the seller in responding to the buyer’s initial draft:

- diluting the strength of the seller’s representations and warranties by adding phrases such as “to seller’s knowledge” or “to the best of seller’s knowledge” and including materiality exceptions (e.g., phrases such as “in all material respects”); the addition of “knowledge” qualifications to the representations and warranties can significantly limit the buyer’s post-closing indemnification rights by shifting to the buyer the economic risks of unknown facts;
- placing a “basket” (the dollar losses that must be suffered by the buyer before the buyer’s claims for indemnification are asserted and then whether all damages may be recovered or just those in excess of the agreed amount), a “ceiling” or “cap” on the seller’s liability for indemnification (the total amount of damages for which the seller may be liable) and the type of damages to which the buyer is entitled (whether consequential or punitive damages are excluded or modified in some ways);
- avoiding the inclusion of overly broad provisions which enable the buyer to terminate the agreement or its obligations to close in the event of a minor breach by the seller or its failure to fulfill a minor condition;
- limiting the period of time for the survival of the seller’s representations and warranties;
- negotiating against the inclusion of a “material adverse change” clause;
- limiting the type of conditions to the buyer’s obligations to close beyond those that are “normal and customary;”
- not allowing the buyer to terminate the acquisition agreement without a penalty (e.g., loss of earnest money deposit) as a result of its failure to obtain financing or approval of its governing board or shareholders; and
- insisting on the assumption of all contracts by the buyer so that the seller is not burdened with paying off any agreements.
The remainder of this section provides specific examples of provisions in the acquisition agreement that are designed to protect the seller’s interests.

1. Assuring that the Buyer Is Financially Qualified

The seller’s primary concern is whether the proposed buyer will have the funds available at the closing to purchase the station. Thus, sales contracts typically contain a provision such as “Buyer represents that it is, and at the closing shall be, legally and financially qualified under rules, regulations and policies established by the Commission to be the licensee of Radio Station.”

The seller should not allow the buyer to include a provision in the acquisition agreement that permits it to “walk away” from the purchase if it is unable to obtain financing. In some transactions, the seller negotiates for a provision that renders the buyer’s failure to close because of the lack of funds a breach of contract. For instance, one asset purchase agreement stated that “Buyer intends to finance a portion of the purchase price through borrowing of funds from one or more third parties, [and] Buyer knows of no reason why such third parties should not fund the loan to Buyer.” The agreement also provided that:

Any failure of the Buyer’s lenders to fund the loan to acquire the assets to be conveyed hereunder shall be treated as a breach by Buyer of its obligations hereunder, regardless of what cause may in such event be stated by Buyer’s lenders or Buyer, including the quality of the Personal Tangible Assets or Seller’s corporation.

2. Making Sure of the Buyer’s Legal Qualifications

FCC approval of a transaction might be delayed or even denied if the buyer does not possess the requisite legal qualifications to be a licensee of a radio station or is deemed to have excessive concentration of media interests in the market. A broadly worded provision such as the following covers the various legal qualifications required by the FCC:

The Purchaser is legally and financially qualified under the Communications Act to
enter into this Agreement and the Purchaser Documents, and to consummate the transactions contemplated hereby and thereby. It is not necessary for the Purchaser or any Affiliate of the Purchaser (or any person in which the Purchaser or any Affiliate of the Purchaser has an attributable interest under the Communications Act) to seek or obtain any waiver from the FCC, dispose of any interest in any media or communications property or interest, terminate any venture or arrangement, or effectuate any changes or restructuring of its ownership, including, without limitation, the withdrawal or removal of officers or directors or the conversion or repurchase of equity securities of the Purchaser or any Affiliate of the Purchaser or owned by the Purchaser or any Affiliate of the Purchaser (or any person in which Purchaser or any Affiliate of the Purchaser has any attributable interest under the Communications Act). The Purchaser is able to certify on an FCC Form 314 that it is financially qualified.

In a similar vein, a sales agreement provided as follows:

Buyer is legally, financially and otherwise qualified to acquire and own the Station and operate the Station’s Business under all applicable federal, state and local laws, rules and regulations, including the Communications Act. The filing of the Assignment Application will not require any waiver of the FCC’s rules, regulations and policies, with respect to Buyer or any Person having an attributable interest in Buyer pursuant to the Communications Act or the rules, regulations and policies of the FCC. To Buyer’s Knowledge, no fact or circumstance exists relating to the FCC qualifications of Buyer that (a) could reasonably be expected to prevent or delay the FCC from granting the Assignment Application or (b) would otherwise disqualify Buyer as the licensee, owner, operator or assignee of the Station.
3. Selling Assets But Obtaining the Benefits of a Stock Sale

In some situations and especially for tax reasons, the seller of a radio station might insist on a sale of stock (rather than assets). Buyers generally prefer to purchase assets rather than to risk assuming hidden liabilities by acquiring stock and in order to get the tax benefits of a stepped-up-basis of the assets. One seller devised an unusual and creative solution by persuading the buyer to agree to the following provision:

The Purchase Price will be increased by an amount equal to the amount by which, all else being equal, the income taxes of the Stockholders resulting from this sale of assets exceeds the income taxes of the Stockholders which would have been payable upon a sale of stock of the Seller, as reasonably determined by Seller’s accountants, plus $10,000.00 to compensate Seller for additional attorney’s and accounting fees, provided that Seller, Seller’s accountants and the Stockholders will make available to Buyer such information as Buyer shall reasonably request for purposes of verifying the determination of Seller’s accounts, including income tax returns if needed.

4. Limiting Personnel and Promotional Obligations

Most asset purchase agreements require the seller to use its best efforts to retain existing employees and to maintain the same levels of expenditure for advertising and promotion. However, one seller negotiated the inclusion of the following provision:

Except for the level of Sales Department employees (which Seller intends to reduce shortly after execution of this Agreement), Seller will use its best efforts to maintain its staff levels; however, Seller shall be under no obligation to hire employees to replace any employees who may voluntarily resign between the period from execution of the Final Sale Agreement and the Closing.

The Agreement also provided that “Seller shall be under no obligation to maintain the same levels of expenditures for advertising
and promotional efforts as expended prior to execution of this Agreement.”

In another asset purchase agreement the seller obtained the following provision: “It is understood and agreed that the defection of any of the Stations’ present employees following the execution of this Agreement and prior to the Closing Date shall not constitute a material adverse change in the business of Seller.”

5. Easing the Pain of the Buyer’s Default

How can the seller be protected if the buyer “walks” from the deal? Most agreements provide for the collection of liquidated damages by the seller (usually, the total amount of the escrow deposit) in the event of a breach of any material representation, warranty, covenant, or condition. Typically, the liquidated damages provision makes clear that the seller has no other remedies in the event of a breach. For example, one asset purchase agreement stated that “[r]ecovery of liquidated damages from the Escrow Account shall be the sole and exclusive remedy of Seller against Buyer for failing to consummate this Agreement on the Closing Date and shall be applicable regardless of the actual amount of damages sustained.”

In some situations, sellers have been able to negotiate a provision which gives them the option of collecting the escrow deposit as liquidated damages or going to court to collect compensatory damages. For example, an asset purchase agreement provided that in the event of a material breach by the buyer of any of its representations and warranties, the seller had the option of treating the escrow deposit as liquidated damages or, at seller’s option, waiving the right to liquidated damages and bringing “an action at law or in equity to cover its actual compensatory damages, if any, sustained as a result of such default.”

6. Selling the Equipment “As Is”

Sometimes the seller of a station tries to obtain a provision that, in effect, states that the buyer is acquiring the equipment and the buildings on an “as is” basis. One asset purchase agreement provided that “Buyer and Seller agree that Seller expressly disclaims any warranties of merchantability or fitness for a particular purpose, and that Buyer has obtained the advice of independent engineers employed by Buyer as to the usefulness or fitness of the personal tangible assets for Buyer’s purposes.”
7. Turning Adversity into a Tax Deduction: A Charitable Donation

Are there any alternatives to bankruptcy for a deficit ridden radio station that cannot attract buyers? One alternative carrying potential tax benefits for the owner is for the licensee to donate the assets of the station to a qualified Section 501(c)(3) charitable corporation. For example, a licensee donated the assets of the station to a local college. One agreement provided that the donor intended that “the transfer of STATION to COLLEGE shall be a contribution to enhance COLLEGE’s public educational services” and stated that the “Donor values the equipment, facilities and other elements of this donation of STATION to COLLEGE at [specified sum].” One cautionary note: the Internal Revenue Service requires an appraisal that documents the value attributed to the assets of the station.

8. Profiting From a Material Positive Change: The Flip Side of Material Adverse Change

A “material adverse change” provision is included in some contracts to protect the buyer in the event that the station performs poorly between the date of the execution of the acquisition agreement and the closing. Generally, sellers take the position that a “material adverse change” provision is not appropriate if a LMA is entered into on the ground that the LMA shifts the operating risk to the buyer.

By contrast, some agreements provide for an upward adjustment of the purchase price for the seller in the event the station performs significantly better than anticipated. For example in one asset purchase agreement the parties agreed that the cash payment to be paid by the buyer to the seller at the closing would be increased on a dollar for dollar basis, by the increase in working capital during the term of the time brokerage agreement into which the parties were entering contemporaneously with the execution and delivery of the purchase agreement. Conversely, the parties also agreed that the cash payment to be paid by the buyer would be decreased, on a dollar for dollar basis, in an amount equal to any decrease in working capital that occurred during the term of the time brokerage agreement.

A “material positive change” clause can be very useful for a seller when there is clear reason to expect that the station will increase in value following the closing. For example, say you’re the licensee of a
small market radio station and you have a construction permit application on file with the FCC to relocate the station closer to a major metropolitan center. You’ve decided to sell the facility before completing the upgrade, but you would still like to realize an upside from the increased value the upgrade is likely to deliver. How do you achieve that objective?

One approach to this problem can be found in an asset purchase agreement in which the parties established a base purchase price for the station of $7 million, which was subject to upward adjustment if the buyer, within three years of acquiring the station, successfully completed the upgrade and sold the station to a third party for a net profit in excess of $10 million. The specific amount of the adjustment depended on the amount of the net profits from the resale. Specifically, in the event that the net profits on the resale of the station were between $10 million and $30 million, the seller, was to receive a 10% share of the net profits in addition to the base price. If the net profits exceeded $30 million, the seller, would be entitled to 25% of the net profits over that figure.

To effectuate these provisions, the agreement required the buyer to notify the seller in writing within five days of entering an agreement for the sale of the upgraded station to a third party. The notice was required to include the amount of the purchase price adjustment to which the seller was entitled. Moreover, because the agreement provided that the net profits were to consist of the buyer’s net proceeds for the resale minus all of its direct costs related thereto (including, e.g., legal and engineering fees, filing fees, build out costs, and any costs associated with the third party purchase agreement or any channel change agreements), the buyer was also required to furnish an itemized breakdown of the costs used to calculate net profits, which breakdown was subject to audit by the seller. Finally, the agreement directed the buyer to instruct the third party purchaser to distribute the purchase price adjustment directly to the seller at the time of the closing of the resale of the station. The caveat to the seller in this kind of arrangement is that the buyer may either wait to sell the station until after the negotiated period of time or may never sell the station.

9. Using Warrants

The use of warrants also enables the seller of a station to reap some benefit from an increase in the value of the property after the
station is sold. For example, in one transaction, the purchase price for the stations was one million dollars. The letter-agreement for the purchase of the stations provided that the buyer would deliver to seller “a warrant for five percent (5%) of the accretion in the stations above the $1,000,000 price.” The warrant was made exercisable when the stations were sold to an independent third party or at the maturity of the bank loan taken out by buyer (namely, five years from the closing). In the event that the stations were not sold prior to the maturity of the loan, the parties agreed to engage an appraiser to determine the stations’ value. The letter agreement provided that in the event of a disagreement between the appraisers, they would choose a mutually acceptable third appraiser whose opinion would be binding.

10. Obtaining Added Value for Seller Paper

“Seller paper” (a purchase money mortgage) can be used as a means of financing the purchase if mezzanine financing or subordinated debt is difficult to obtain. Seller paper is usually subordinated to senior bank debt and often takes the form of a loan at two to three times cash flow for a five-year period at a fixed interest rate at or below prime. Some agreements give warrants to the seller to provide the seller with the benefit of the possible upside of a transaction. In other transactions, all or some seller paper takes the form of a covenant not to compete. In some deals, the seller is given stock in the acquiring company as well as a promissory note.

In one transaction, the seller agreed to take a promissory note in the amount of $400,000 with the following terms: (a) the entire principal balance (including any deferred interest accrued during the first year), but would not be due until five years after the closing, and (b) the note would be deemed paid in full if on or before a fixed date, the buyer paid the seller $250,000 plus all accrued interest. This promissory note reflects a negotiated discount for early payment, which provides a significant benefit for both the buyer and the seller.

In addition, the buyer agreed to deliver another promissory note with a principal balance equal to the lesser of the face amount of all of the accounts receivable or $150,000. The asset purchase agreement provided that prior to full payment, the seller could put the note to the buyer in exchange for a 5% stock interest in another broadcast station.
owned by the buyer “plus the payment of all accrued interest, including any deferred interests accrued during the first year.”

To protect the seller, payment of both promissory notes was secured by a security interest in the tangible and intangible personal property used in the operation of the station. To benefit the buyer, the agreement provided that the buyer’s obligations were subordinate and junior with regard to its obligations (including any refinancing) to one or more institutional lenders up to a maximum principal balance of $2,500,000. Also, to make sure that the seller helped the buyer obtain financing, the asset purchase agreement provided that:

Seller agrees to cooperate with Buyer, Buyer’s underwriters, lenders, and their respective agents and representatives in connection with Buyer’s financing arrangements, including without limitation providing such information and documents as Buyer may reasonably request for the purpose of obtaining the funds required to consummate the transaction.

This transaction illustrates how the seller can accommodate the buyer by, in effect, providing working capital, by creating an incentive for early payment of a note, and by making it easier for the buyer to obtain financing. In turn, the buyer provides the seller with a subordinated secured interest in the physical assets of the station and an option to purchase stock in another broadcast licensee.

11. Securing Protection for Seller Paper

If the seller provides the buyer with seller paper, what protection can the seller obtain to make sure that the station will be operated properly and that financial and other information will be provided on a timely basis after the closing? One seller sold the station assets for $4,000,000 and received the buyer’s promissory note in the amount of $3,200,000. Since the seller paper accounted for the lion’s share of the sales price, the seller wanted protection in addition to a security agreement (accompanied by a UCC-1 filing), a trust deed on the real estate, and a pledge agreement from the three individuals who provided personal guarantees.

The asset purchase agreement provided for a series of “post closing covenants” by the buyer concerning the operation of the station in accordance with all laws and regulations, payment of all
taxes, maintenance of the assets in good condition and repair, and keeping the assets free of liens and encumbrances. These covenants echo those that the seller provided for the period between execution of the contract and the closing. Also, the buyer was required to keep the assets fully insured against fire, theft or vandalism and to name the seller as an additional insured under the policy and to “insure the life of one of the principals of the buyer” in an amount equal to the unpaid balance of the Note with the Seller named as beneficiary.” The buyer was also obligated to provide the seller with quarterly financial statements. The seller or an agent of the seller was given “the right at reasonable times during Buyer’s normal business hours to inspect the assets and to inspect, audit and copy any books and records of Buyer relating to the Assets.”

Although it would seem logical that the seller should be able to protect itself by providing that the station will revert to the seller in the event that the buyer defaults on the seller paper, this type of reversionary interest is prohibited by the FCC’s rules. Section 73.1150 of the Commission’s rules is broadly worded. It provides that, in assigning a broadcast license, the licensee “may retain no right of reversion of the license, no right to reassignment of the license in the future, and may not reserve the right to use the facilities of the station for any period whatsoever.” Moreover, the Commission staff takes the position that such a reversionary interest cannot be salvaged by including a requirement that FCC approval be obtained before the station is reassigned to the seller.

Section 73.1150 can also be read to prevent a seller from holding rights to provide programming over the station once the closing occurs. In an agreement for the sale of a noncommercial educational radio station, the parties included a provision whereby the seller would hold a right of first refusal to “prepare, produce, present on-air, and sell course materials for” college level courses to be aired on the station if the buyer ever proposed to offer such college-level courses as programming on the station. The FCC staff objected to this provision and the parties found it necessary to file an amendment to the purchase agreement that struck this provision. According to the amendment, the parties agreed to strike the provision because the FCC

34 47 C.F.R § 73.1150 (2010).
staff had advised counsel for the parties that the provision “must be deleted to bring the Agreement into compliance with FCC rules and policy.”

12. Building a Margin of Error in Financial Statements

One of the most important provisions of a contract is the representation and warranty concerning the accuracy of the financial statements furnished by the seller. The seller should review its financials with its accountant(s) and other experts to identify problems. The wording is often the subject of intense negotiations. In some exceptional situations, the seller is able to negotiate a contract that contains no representations or warranties concerning financials, but the seller should beware. In a stock transaction, SEC Rule 10b-5 prohibits “...mak[ing] any untrue statement of a material fact or... omit[ting] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.”

While most contracts provide that financial statements are prepared in accordance with “generally accepted accounting principles,” sellers try to include a provision, which allows for a margin of error. For example, in one asset purchase agreement, the sellers negotiated the following provision:

The financial statements are not audited but are prepared substantially in accordance with accepted accounting principles consistently applied, are correct in all substantial and material respects and present fairly, the operating income and financial condition of the stations as of their respective dates and results of operations for the period then ended.

13. Providing Incentives for the Seller and the Seller’s Key Executive

How do you provide an incentive to the hands-on executive of the seller who will be responsible for making or breaking the success of the acquired station? In one asset purchase agreement, an executive of the seller was given a lucrative compensation arrangement whereby he would have a substantial personal stake in the operation. First, he was given an opportunity to purchase stock in the corporation at a
sweetheart rate and on sweetheart terms—while the price for the stock was specified as $100,000, the buyer agreed to loan the executive $66,667 of the $100,000, payable over a three-year period. Second, the executive was given options to purchase an additional 15% of the stock: 5% at closing, 5% one year later and 5% in two years for one dollar each purchase. Third, if the stations were to be sold for more than $50 million, the executive would receive, as a bonus, 20% of the net proceeds; if sold between $47.5 million and $50 million, a proportionate percentage.\(^\text{35}\)

The asset purchase agreement also contained a creative way of assuring that the station would have sufficient funds to operate prior to the closing and giving the seller a piece of the action if the station was very profitable the first year after it was sold. The buyer agreed to loan the seller $200,000 which would be credited against the sale price at closing. If the deal were to fall through, the buyer would take back $200,000 with interest plus $10,000 “to compensate Purchaser for its costs and expenses in making the loan.” The contract provided for “an incentive profit payment” of $500,000 to the seller if the gross revenues during the first year after closing were greater than or equal to $4 million. The payment is a creative way of giving the seller a share of the profits without having to give away a stock interest.

14. Obtaining Benefits Through FCC Rulemaking

Diligent broadcasters remain perpetually attuned to application and rulemaking activity at the FCC that could potentially affect their ability to seek an improvement in station facilities such as: increasing the station’s power or moving the antenna closer to a larger market. A rulemaking might lead to a significant improvement in coverage. Generally, these types of facilities improvements take a lot of time. Months and, frequently, years may be devoted to the upgrade project. Having invested substantial time, effort and money in the upgrade project, the seller does not want the buyer to reap the benefits of the project without rewarding the seller for its efforts. The buyer does not want to pay the seller for those efforts unless they produce results. Of course, at the time that the application is filed, the parties cannot be sure that the FCC will grant the application or the rulemaking that will

\(^{35}\) A cautionary note: any executive compensation plan must comply with the strict requirements contained in Section 409A of the Internal Revenue Code.
lead to the improvement of the station’s coverage or even that the improved facilities authorized by the FCC will receive local zoning approvals.

The compromise usually achieved in such cases is to include a provision whereby the buyer will make a payment to the seller above and beyond the purchase price if the upgrade project is successful. The difficulty in such cases is in reaching agreement as to what constitutes successful completion of the project. An initial grant by the FCC staff is subject to further review and consideration, so the issuance of a favorable staff decision is usually not a satisfactory point at which to consider the project complete. Even when the staff decision is final, other obstacles may arise that would prevent the station from ever achieving the facilities upgrade that had been contemplated by the parties. Zoning authorities may deny permission to build the new facility. The tower site may prove to be unsuitable for construction. The construction permit application filed in response to the successful rulemaking may not be granted.

As each milestone in the process of upgrading the facility is reached, the risk that the project may fail decreases, but the length of time that the impatient seller must wait before it receives its payment increases. The seller may be forced to trade dollars for a more immediate payment. Whatever compromise ultimately is reached by the parties, it is vitally important that the payment be tied to a clear, demonstrable event, such as a final FCC decision, a final zoning board decision or the FCC’s final grant of a covering license application for the facilities. The use of a well-defined triggering event helps to avoid disputes as to the timetable for payment.

In deciding which event will trigger the payment obligation, the parties may be tempted to use the final grant of the covering license application inasmuch as the issuance of that grant removes virtually all uncertainty as to whether the upgrade will become a reality. Sellers, nevertheless, would be well advised to take care in doing so. Processing of covering license applications has a very low priority at the FCC and as a result, it is not uncommon for many months to elapse before the covering license is granted. In the meantime, buyer is able to make use of the upgraded facilities while seller continues to wait for its payment. From a seller’s perspective, that is an unhappy situation. One alternative triggering event that could be used is the FCC’s grant of Program Test Authority ("PTA"). Stations routinely operate under the
terms of PTA during the time the covering license application is pending. Although grant of PTA does not signal an absolute certainty that the license will be granted, it reduces the risk of non-grant to nearly zero.

VI. How to Make the Closing Look Easy

The closing brings to a successful conclusion the long and sometimes ulcerous process of deciding to sell or purchase a radio station, finding a buyer (or seller), valuing the business, conducting due diligence and negotiating agreements reflecting the interests and intent of the parties. At the closing, the consideration (cash, notes or stock) is exchanged for the property. And if all has gone well, the buyer and seller walk away convinced that each got a good deal, and the lawyers finally smile with a sense of accomplishment, collect the papers and quietly leave the scene to the sweepers and shredders.

We can offer some general guidance to those contemplating a closing. Do not lose sight of the fact that, for the most part, once the deal has been struck, the buyer and seller share the same general objective: to close the deal. No one—not the buyer, the seller, nor their lawyers—relishes surprises at the closing. Taking into account the differing interests of the buyer and seller, try to keep all parties informed as your preparations progress and be ready to solve problems, not just identify them.

On that note, a comprehensive document checklist can give you the memory of an elephant. First, analyze the requirements for the closing and then develop checklists describing the tasks to be accomplished, the documents to be prepared and signed, the persons responsible for each task or document, and the status of preparations and delivery. Second, circulate checklists to all parties early in the preparation period so that they may use them as the vehicle for coordinating the actions and preparations of the buyer, seller, their counsel and their other representatives.

The devil is in the details. The details for the closing are set forth in the acquisition agreement, and a typical agreement will contain sections that usually are titled “Conditions to Closing” or “Deliveries at Closing.” One of the key conditions to closing the purchase and sale of a radio station in most agreements is the issuance of a final, non-appealable order by the FCC consenting to the transaction (the Final
Order). This might be an assignment of the seller’s license to the buyer in an asset transaction or a transfer of control stemming from the buyer’s purchase of a controlling interest in the company which is the licensee of the station. The grant of an assignment or transfer application by the Media Bureau will become a final order by operation of law 40 days after the issuance of a public notice by the FCC announcing the grant, provided that no petitions for reconsideration or applications for review are filed and that the Commission does not rescind the Bureau’s action on its own motion.

In addition, under certain conditions the buyer and seller must make certain notice filings with the Department of Justice and the Federal Trade Commission pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (e.g., the purchase price is more than $63.4 million and certain other thresholds concerning the size of the buyer and seller are met.) Once the buyer and seller have received notification that the prescribed 30-day waiting period following the filing has been terminated or expired, the parties may proceed to closing.

It is now common practice for the buyer and seller to close without waiting for finality of the FCC grant. Where a lender is involved, the parties sometimes close prior to finality by placing into escrow the funds furnished by the lender and providing for the release of such funds to the seller (with any interest earned thereon) when the FCC grant of the assignment or transfer application becomes a Final Order.

Checklists will help but the heavy lifting usually takes the form of coordinating your actions and documents among all parties, spotting problems in advance, and developing, coordinating and implementing solutions to those problems. Also, consider holding a “pre-closing” at least one day prior to the closing, so that documents may be revised prior to the scheduled date of the closing and the closing can consist only of wiring the money at the opening of business on the closing day. Since wiring sometimes takes longer than expected, the earlier the funds are wired, the better.

But the preparation and effort are worth it. When the work is complete, the buyer, the seller and their counsel will have shepherded the transaction to its intended conclusion.
VII. A Closing Word

The path of a broadcast station acquisition and sale is a long and sometimes rocky road, from the initial letter of intent to the closing (and through the relevant post-closing period). This article attempted to assist both seller and buyer in identifying and avoiding the potholes and pitfalls in between. Today’s broadcast marketplace presents special challenges to buyers and sellers, as to economic outlook and the rise of competing media outlets. These challenges compel the parties in a station transaction to be well briefed and adequately prepared to accomplish their mutual objectives without risking delay, dissatisfaction, and disillusionment in the acquisition process. It has been our goal in this article to assist the reader in minimizing the inevitability of mistakes in the radio station acquisition process, so that seller and buyer make a mutual success of their joint endeavor.
THE ECONOMIC IMPACT OF
FREE CONFERENCE CALLING SERVICES

Alan Pearce
W. Brian Barrett

Free conference calling services have added a new dimension to the long-distance telecommunications marketplace in the United States and abroad. Accompanying the introduction of these services, there are a variety of business and public policy issues that have been raised here in the United States. These issues include access service charges imposed on Interexchange Carriers (“IXCs”), profits made or lost by IXCs and Local Exchange Carriers (“LECs”), fees paid by LECs to free conference calling companies, benefits accruing to the general public through the ability to efficiently collaborate and engage in business, political and religious activities, and the resulting positive byproducts: an expansion in economic growth; an increase in employment growth; and an increase in the availability of services such as broadband in these often underserved areas. This report will examine and evaluate the accuracy of the unsubstantiated economic and policy attacks, propagated by dominant IXCs that have been leveled at the free conference calling industry.

To date, most of the debate has focused on the Federal Communications Commission’s (“FCC”) access charge regime and the charges levied by LECs on IXCs for originating and terminating long-distance telecommunications services. Under the current regulatory framework in the United States, the costs for these access charges are necessarily imputed into the costs that IXCs incur while enabling their long-distance customers to make long-distance calls. Accordingly, the law requires IXCs to bill and collect from their customers and then pay

* A prior version of this article is available at http://www.freeconferencecall.com/factreport.asp.
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LEC\textsuperscript{s} for the use of their network in transiting these long-distance calls. This report will examine this regulatory framework and the economics of LEC\textsuperscript{s} billing IXCs for terminating access charges associated with free conference calling services.

The report also includes a discussion of the economic structure of the long-distance telecommunication market and the implications of that structure on natural (market-based) pricing and level of telecommunications service. This is followed by data and analysis that demonstrates that long-distance calls to free conferencing services are profitable for the IXCs, despite their claims to the contrary.

The IXCs’ position as to the profitability of calls made to free conference calling services necessarily implies that there is another motive behind the IXCs’ attacks on free conference calling services. This report searches for and uncovers the IXCs’ hidden motive, which stems from the fact that many IXCs have had to reduce the price of their own conference calling services and have had to develop and introduce new services in response to new entrants in the market. Generally, this is exactly how the competitive market should work; new entrants launch new, more innovative services in what has been an entrenched market dominated by a few large companies, thereby spurring competition and driving down prices. In the end consumers win, so long as dominant firms are not able to use their market power along with regulatory and public policy mechanisms to eliminate the emerging competitors. Finally, what is often left unsaid by those who attack the new entrants is that they actually fulfill the FCC’s underlying public policy goal of providing advanced services to rural America, while simultaneously stimulating competition and creating employment opportunities.

I. Free Conference Calling Companies

A. The Role of Free Conferencing Companies

Free conferencing companies are third party service providers that provide LEC\textsuperscript{s}, both rural and non-rural, with innovative services. By subscribing to local exchange services offered by LEC\textsuperscript{s}, free conferencing companies allow competitive carriers to diversify their revenue streams and remain viable in the face of technological advancements and changing consumer preferences that have resulted
in decreased demand for traditional wire-line services.\(^1\) Free conferencing companies have been the necessary catalyst that has allowed the affiliated LECs to build human capital, re-invest capital in operations, and provide more and better service to local customers. Farmers Telephone Company of Riceville, Iowa (“Omnitel”) is an example of a LEC that did business with a free conferencing company from 2005 until 2007. Because of changing consumer preferences, Omnitel did not have much of a future before working with a free conferencing operation.\(^2\) Today Omnitel is able to offer its rural customers a wide array of services, including high-speed Internet, toll-free numbers, a variety of long-distance plans, teleconferencing, cable TV, wireless and more.\(^3\) Similar outcomes are possible for other rural LECs and are completely consistent with the FCC’s vision for vibrant competition in rural America.

1. Broadband Expansion on American Reservations

Like rural Competitive Local Exchange Carriers (“CLECs”), American Indian tribes have also become increasingly interested in supporting the provision of free conferencing services as a way to diversify income streams and provide their nations with economic development opportunities, including the deployment of broadband and other modern telecommunication services. These reservations are located in some of the country’s most remote areas, and until now, business models that respect the tribe’s autonomy, while effectively providing those who reside in these remote areas with modern telecommunications and Internet service, have consistently failed. These failures have stemmed from a misunderstanding or lack of appreciation for the tribe’s history and culture, excessive infrastructure costs, and lack of financial resources necessary to secure “luxuries” such as broadband Internet access. The result, as FCC Commissioner Michael Copps has noted, is a level of broadband access on Indian

\(^1\) Morgan Stanley, Telecom Services 5 (2009).
reservations that is “shockingly low” and “a national disgrace.”⁴ Free conferencing services are already helping to turn this tide.

Tribes are now discovering that they can establish their own telephone companies and sell local exchange service to free conferencing companies and applications to the Federal Government. In doing so, the American Indian people can finance their own infrastructure build-out and internet libraries, and provide telecommunications and broadband services to all reservation residents, subsidized by American Indian-owned businesses and not by the United States Federal Government. They have discovered that their ability to operate viable telecommunications businesses provide them with the opportunity for economic growth and independence.

By way of example, the Crow Creek Indian Reservation of South Dakota was one of the most economically disadvantaged places to live within the United States boarders. The Crow Creek Indians now have their own phone company, Native American Telecom Enterprise LLC, that provides for broadband services, modern telecommunications services, and an internet library. They now have an impetus for economic expansion and personal pride. Jobs are being created, and a source of income for the Tribe has been created that will be used for further economic growth and the general welfare of their people. Without the ability to provide access service to other companies and realize the revenues, the American Indian owned telephone company business model would not be viable.

This business model is now being adopted in other remote locations, such as the Pine Ridge Indian Reservation, and many others have shown interest. This example helps to highlight the fact that the application of the rural exemption for other rural locations is a valuable stimulus to economic growth in rural areas, true to the FCC’s intention.

B. Access Charges, Long-distance Plans and Conference Call Pricing—Tracking the Cash Flow

This section outlines the costs and pricing structures involved in the initiation of a telephone call to a conference call bridge. It includes the pricing of unlimited long-distance calling plans, because it is this aspect of conference calling that is most often misunderstood and misinterpreted by those who oppose free conference calling.

Figure 1: Free Conference Calling Traffic and Cash Flow

Conference call companies provide free conference calling services to consumers by entering into marketing agreements with the LECs whereby the conference call provider receives a marketing fee in return for generating conference call traffic. The free conference service model, shown in Figure 1, illustrates the typical cash flow scenario: (1) a call participant, who has already purchased a long-distance calling plan from an IXC, dials a long-distance number; (2) the IXC pays the call participant’s originating LEC an originating access service payment for each minute of the call; (3) the IXC pays the terminating LEC that provides local exchange service to the conference call provider a per minute terminating access fee; and (4) the Host, terminating, LEC pays the conference call provider a marketing fee in a manner determined by contract between the terminating LEC and the conference call provider. This cash flow

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5 For clarity and ease of reference, the LEC that provides local exchange service to the conference call provider will be referred to as the “Host LEC.”
scenario is repeated for each call participant under the free conferencing service model.

The model in Figure 1 is modified in situations where there is an intermediate carrier between the IXC and the terminating LEC. Such a carrier is known as a transport company or centralized equal access tandem/transport provider and serves to aggregate and route traffic between the IXCs and smaller LECs. Transport companies often charge a large mark-up, explaining some of the arguments made that rural locations are high-cost. By way of example, Google recently defended its practice of blocking certain access to certain rural areas for its Google Voice service by stating that it would have to pay between 12 cents and 39 cents per minute to these locations. Google contends that it blocks calls to these areas because they are cost prohibitive. However, the LECs from which most of the free conferencing companies receive service, and where Google blocks calls, have tariffs that are only about 5 cents. The difference is the mark-up charged by the intermediate carrier. It is noteworthy that these intermediate carriers, and not the free conferencing companies, are the beneficiaries of these high transport fees.

The traffic and cash flow diagram is also modified slightly if any of the call participants are also customers of an originating LEC that is owned by, or affiliated with, the customer’s long-distance provider. In this instance, illustrated in Figure 2, the IXC would effectively retain the originating access charges collected from the customer.

Finally, it should be noted that another type of traffic and cash flow analysis results if the caller initiates its call to a conference bridge using a wireless phone or VoIP service. The imposition of access

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7 See Id.


9 Recently, alternative intermediate carriers in these “high-cost” areas have sprung up to offer competition in these markets, transporting this same traffic at a rate around 2 cents per minute, making the free conference calls affordable to the IXCs and other companies like Google, and negating the “high-cost” reason to block calls and/or use other methods of IXC self-help. See generally WideVoice Commc’ns, Inc., http://www.widevoice.com/services.html (last visited July 28, 2010).
charges on these calls remains an unsettled issue on the regulatory landscape and is largely beyond the scope of this analysis.\footnote{See Ex Parte Letter and Presentation from Brian Benison, AT&T to Marlene Dortch, Sec'y, FCC (Aug. 5, 2008) in FCC CC Dockets 01-92, 96-45 & WC Dockets 05-337, 99-68, & 07-135, available at http://fjallfoss.fcc.gov/ecfs/document/view.action?id=6520036878. This is not to suggest that wireless and internet-protocol phone service is not a significant component of the market, but rather that the dispute regarding payment of access charges for conference calling services is predominantly discussed within the context of landlines. These dynamics are likely to continue to change as AT&T and others argue that the FCC should consider eliminating the Plain Old Telephone System (“POTS”) in favor of an Internet Protocol based system.}

![Diagram](image)

**Figure 2: Modified Free Conference calling Traffic and Cash Flow**

C. *Hosted vs. Free Conference Calling: Comparing the Economic Alternatives*

The pricing of access charges, long-distance calling plans and conference calling services are, in some ways, intertwined and the interplay between these various services needs to be explained fully, fairly, and completely. A primary objective of this report, therefore, is to explain and analyze the interplay, and the often complex and confusing characteristics of these telecommunication services.

There are generally three types of business arrangements for provisioning conference calling services in the United States: (1) large and often dominant IXCs that generally provide conference calling services in partnership with one or more nationwide conference call service companies (e.g., Genesys, a partner of Qwest), and that have traditionally utilized a host-pay system whereby all callers dial a toll
free (1-8XX) number to access the call; (2) Incumbent or Competitive LECS that own their own conference bridges and may provide a combination of host-pay and free conferencing services; and (3) small independent conference call companies that secure local exchange service from ILECs, CLECs, and/or rural CLECs that generally, though not exclusively, provide a free conferencing service where each caller dials a long-distance number and incurs long-distance charges to participate in the conference call.

1. All Conference Calls Involve Access Charges

Despite the differences in business models, an important attribute unifies this complex set of business arrangements. That is, each conference calling model incorporates a long-distance charge, which necessarily includes originating and terminating access charges for the use of the LECS’ network, is assessed. These originating and terminating access charges apply to all conference calls. For calls made to 1-8XX numbers, the access charges for all participants will be paid by the call’s host. For free conferencing services, each participant will pay its own long-distance charge in order to access the call (i.e., each individual caller pays for the long-distance call individually as part of his/her monthly local and long-distance telephone bill).

2. Free Conferencing Services Provide Consumers with More Choices

On the other hand, the free conferencing services are unique in providing a greater level of consumer choice. By way of example, those consumers using the free conferencing services have the option of: (1) dialing into a conference call bridge using a direct-dial phone number and their existing long-distance plan; (2) utilizing a 10-10 XXX “dial-around” number to select a specific IXC while dialing; (3) using a pre-paid long-distance calling card; (4) implementing a wireless device (e.g., a cell phone); or (5) utilizing a Voice-Over-Internet Protocol (“VoIP”) service. These free conferencing services do not require a host to pay all of the costs but rather allow each participant to pay their own share of the call’s cost. Hosted conference calls, on the other hand, are more expensive to the host and can be cost-prohibitive. This is an important distinction, because free conferencing services provide an additional economic alternative for would-be conference hosts, an alternative
that is an efficient, cost-effective method of mass communication, the absence of which would leave many with no viable alternative.

II. The Effect of Regulatory Pricing Decisions

A. The Current Policy Issues

The current policy issue before IXCs, the FCC, various state utility commissions, and Congress is whether IXCs should be required to pay tariffed terminating access charges to rural LECs that pay marketing fees to their customers that market, promote, and provide free conferencing services. Major IXCs, such as AT&T, Qwest Communications, Sprint, and Verizon, which are often vertically integrated with LECs and offer their own competitive conferencing services, have repeatedly claimed that terminating rural CLECs are charging too much for termination, or are “pumping” excessive volumes of traffic through these rural areas in order to take undue advantage of the existing regulatory framework that permits rural CLECs to operate under and receive higher tariffs than metro locations.\(^\text{11}\) It is important to note that this is a result that the FCC contemplated and ultimately decided is acceptable and even desirable.\(^\text{12}\)

B. Pricing Discretion is Under the Complete Control of the IXCs

As this report explains, the rural tariff rates present no profitability problem for IXCs resulting from long-distance calls to free conference calling services. To the extent that IXCs may not make a profit on any given customer or any particular call as a result of the IXCs’ unlimited long-distance plans, that is not an issue for the FCC or Congress, but is a direct effect of the IXCs’ own business plans and pricing, a matter within their complete discretion. A problem of their own making, the IXCs cannot be heard to complain when they have

\(^{11}\) In the case of Free Conferencing Corporation, the terminating access charges levied by the LECs are all less than or equal to the National Exchange Carrier Association’s rate allowed under the FCC’s “rural exemption.” See Access Charge Reform, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 9923, para. 65-73 (Apr. 26, 2001) [hereinafter Seventh Report and Order].

\(^{12}\) AT&T admits that the CLECs they are challenging are charging around the NECA band 8 rates. See Ex Parte Letter and Presentation from Brian Benison, AT&T to Marlene Dortch, Sec’y, FCC (Dec. 3, 2009) in FCC Docket WC 07-135, available at http://fjallfoss.fcc.gov/ecfs/document/view?id=7020350996.
knowingly and intentionally adopted a business model whereby they sell unlimited long-distance plans for a fixed monthly charge, without regard to the volume or destination of the telephone calls placed by consumers.

C. Shifting of Resources

Under any regulatory pricing plan, the final prices are often arbitrary and subject to compromise and change over time. The regulator must weigh the costs and benefits of setting the price at any given level. At current levels, all service providers are profitable. Nevertheless, AT&T and others have suggested that the FCC should lower rural CLEC access rates, at least for the purpose of conference calling services.

A change in access rates will have little practical effect on the demand for free conference call services. As long as the new rate is sufficient to keep all current service providers profitable (although at different levels), and thus in business, then the only economic effect would be a transfer of wealth from one service provider to another. In this instance, the shift would transfer wealth from the smaller, less competitive companies to the larger, more dominant ones (the IXCs). This will produce negative results on future competition and product development. Therefore, the appropriate line of inquiry is a policy one: does the policy analysis underlying the rural exemption remain valid and does the FCC intend to continue to ensure that rural America has ubiquitous access to wire-line and emerging services (e.g., broadband)?

The FCC’s intent is to stimulate the businesses of the rural LECs (both ILECS and CLECs) to invest in their markets and provide better and possibly cheaper, more imaginative and innovative services to customers, because these areas are generally underserved by the major and dominant nationwide companies. This ideally translates into more and better jobs, lower local telephone bills, and improved local and national telecommunications services. This is precisely what the rural LECs sponsoring free conferencing are doing. In general, they serve a relatively small number of customers and offer full local telephone service, VoIP, high-speed Internet, digital TV, and long-distance telecommunications.  

13 See Yorkgitis, supra note 3.
Meanwhile the large former Regional Bell Operating Companies ("RBOCs")—AT&T, Verizon, and Qwest—are assiduously divesting themselves of their small and rural ILECs.\footnote{Brian Osborne, Verizon Sells Rural Local Wireline Assets to Frontier, Geek.com (May 14, 2009), http://www.geek.com/articles/mobile/verizon-sells-rural-local-wireline-assets-to-frontier-20090514/ .} This is evidence that the major IXCs are not interested in serving many rural markets in America.

D. The Effect of Unlimited Calling Plans

The strategic business issue concerning unlimited local and long-distance calling plans will now be explained and analyzed in more detail in order to understand the effects these plans are having on conference calling services. The overall profitability of long-distance services is also analyzed in detail.\footnote{See infra Section IV.} This analysis concludes that because unlimited long-distance plans must be analyzed based on \textit{average} costs and \textit{average} revenue, the plans yield significant profits for IXCs, even when consumers utilize a relatively large quantity of free conference calling services.

E. Average Cost Should Not Be Confused With Marginal Cost

The IXCs' tendency to conflate \textit{marginal} and \textit{average} cost is not trivial, and has, in fact, resulted in significant misperceptions regarding the free conference calling service industry. Indeed, ILECs are required to base their prices and profit calculations on average costs, rather than marginal costs. It is understood that less profitable service offerings, generally in rural America, must be subsidized by earnings from the more profitable densely populated areas (where call volume is high and costs low) in order to foster the FCC's mandate of ubiquitous services.\footnote{See Seventh Report and Order, supra note 11.} This is a critical business and policy matter as large ILECs are actively divesting themselves of their rural properties in an effort to lower their average costs and then concentrate their business strategies on the high-density, high-volume, low-cost, high-profit areas. Indeed, this exact scenario was one of the underpinnings that resulted in the FCC's creation of the rural exemption for CLECs.

The introduction of unlimited long-distance calling plans, successfully launched by the ILEC-IXC combinations, has become a
major aspect of conference calling that is frequently misunderstood and misinterpreted by those who oppose free conference calling. With these increasingly popular unlimited plans, where both local and long-distance services are bundled into a fixed monthly rate, the IXCs and LECs/IXCs (e.g., AT&T and Verizon) may lose money on any given marginal call that is placed by one of their customers to any long-distance number. Indeed, this is true of any fixed price service, where those who choose to use more of the “unlimited” services gain, but this does not mean that free conference calling has made IXCs, generally, or unlimited long-distance plans, specifically, unprofitable. In other words, it is the average profit per user multiplied by the number of users that determines the IXCs’ profit, and free conference calling services may have the tendency to impact both of these factors differently.

It is important to note that the LECs that work and collaborate with free conferencing companies charge less, on average, for termination access than most rural ILECs. Indeed, many of the LECs that work with free conferencing companies have commercial agreements, with some of the same IXCs that have been so vocal in the debate, at rates substantially lower than the tariff rates for those areas.\(^\text{17}\) The implication raised by the adoption of these commercial agreements is that natural market forces self-regulate the industry, and that additional regulation by the FCC or Congress is unnecessary. If an IXC claims that it is losing money due to terminating access charges, then it can only be due to a faulty analysis used to determine the pricing of unlimited calling plans. Notably, despite continued claims that free conferencing services are ruining the profitability of unlimited long-distance plans, the IXCs have continuously refused to produce data to backup these claims. And anecdotal evidence would suggest that the contrary is true. Indeed, AT&T, Verizon, Sprint and Qwest, the four dominant IXCs, continue to aggressively promote their unlimited long-distance plans, which are increasingly popular with consumers.\(^\text{18}\) The profitability related to the use of unlimited calling plans is discussed in detail in Section IV.

\(^{17}\) David Erickson states that alternative rates are frequently available below the tariff rates. See supra note 8.

\(^{18}\) Unlimited plans come with many of AT&T’s U-Verse plans, Verizon’s FIOS, and virtually all cell phone plans.
III. Pricing Models for Long-Distance Calls

A. Marginal versus Average Cost

There has been some confusion between average cost and marginal cost in arguments and disputes before the FCC, the courts, and Congress.\(^\text{19}\) AT&T in particular has made a claim that the marginal costs of switching an additional call for rural CLECs is close to $0, and therefore a rural exemption to charge higher tariffs is unnecessary.\(^\text{20}\) Marginal costs are irrelevant, however. As has been outlined and demonstrated above, only average cost is relevant.

AT&T’s conclusion that marginal cost is close to zero assumes that there is unlimited capacity in each switch. If indeed the number of calls is growing, as the evidence suggests, then LECs providing local exchange service to conference call providers must therefore continue to upgrade and improve the quality of their switching equipment in order to meet the increased demand. This has been the case for many LECs. For example, Omnitel used its profits from offering free services, including free conferencing, to upgrade and improve services for all of its rural customers.

To further illustrate the critical relationship of marginal cost to average cost, consider a hypothetical switch that costs $1,000,000. As long as the switch is below capacity, it has zero marginal cost. In other words, the LEC would incur no additional cost to add an additional call to the switch. Further assume that the switch can handle 100,000 calls at any given time. As the call volume increases over time, the short-run average cost falls as the volume increases. Now suppose that the call volume is, on average, 99,000 calls at any given time. In this scenario, the marginal and average cost per call is extremely low, because the switch is near capacity. However, as soon as call volumes get at or near the 100,000 call volume limit, the LEC will be required to buy an additional switch in order to accept the next call. Assuming this additional switch also costs $1,000,000, the marginal cost for accepting that next call will be $1,000,000. With the purchase of the additional switch completed, however, the marginal cost per call will return to near $0.00, while the short-run average cost for all calls will remain


\(^{20}\) See Benison, supra note 12.
somewhat high, decreasing again as the volume of traffic increases, until such time as both switches are near capacity and the purchase of a third switch is required. If this cost is averaged over a longer period of time, it is possible to measure the company’s long-run average cost, which is certainly not $0.00, as the IXCs imply.

Arguments that the cost of switching additional calls for LECs is equal to $0.00 are clearly and obviously a marginal cost argument. Since the switching equipment is expensive, the long-run average cost is not falling quickly with each new call. Indeed, the same arguments can be applied to the IXCs. IXCs have an expensive network of switches, transmission lines, and transmitters. They too have (close to) zero marginal cost for each additional call. Would they argue, however, that there is no additional cost for a call, such that their rates to consumers should be approaching zero, given the significant volume of calls that they carry on their network? If this logic is followed by regulators, one or more interested parties would suggest that the IXCs should be required to sell their services to consumers for a fraction of a cent per minute if they have almost zero marginal cost. Clearly, this argument is flawed, and thus has no relevance to the issue of free conferencing services. How then can the IXCs justify their demand that rural LECs sell access to their networks for a fraction of a cent per minute merely because the volume of calls to these networks has increased?

If the long-distance callers do not have an unlimited long-distance plan but rather are paying a per-minute rate, then even on a marginal cost basis the IXC will make a profit for each and every call. It is known that these calls make a profit because IXCs pay access charges for every call, not just those that connect to free services, so the IXCs must price long-distance services to make a profit. More evidence of their rates and profitability is given below.

If, on the other hand, the caller uses an unlimited calling plan to connect to a free conferencing service, then the IXC will incur the same marginal cost (i.e., the terminating access charge), but will have no marginal revenue (i.e., increased revenue from its customer). This does not mean, however, that there is no profit, since the profit is determined by average cost and average revenue. Accordingly, if there is a problem with profitability associated with free conference calls, it has nothing to do with the cost, which remains constant, but rather the
problem is on the revenue side, and therefore in the pricing of the long-distance plans. It is also true that not only are the IXCs earning a profit on average, but their profits have actually been growing since free conference calling and unlimited long-distance plans have become popular with consumers, as is explicitly and graphically demonstrated in Figure 4.

Furthermore, terminating access charges paid by the IXCs to the Host LEC participating in free conferencing services plays only a minor role in the overall business operations of AT&T, Verizon, Sprint and Qwest. In principle, any LEC could purchase a conferencing bridge and thereby increase the volume of minutes and thus costs to the IXCs. This only becomes a “problem” for the IXC if it charges a flat monthly rate for unlimited long-distance and local calling. Otherwise, if the IXC charged its customer per minute of use, the business incentives would immediately change and the IXC would have every incentive to encourage its customer to make lengthy calls to the conference calling bridge.

Nevertheless, the IXCs might still complain, since profits would be larger if they paid lower access charges, but the same is true of any access costs. The same is also true if IXCs reduced labor costs by withholding pay from employees or reduced infrastructure cost by refusing to pay vendors that provide switches or other infrastructure. These activities would be unlawful methods of increasing profits, just as the IXCs’ refusal to pay switched access charges is an unlawful method by which the IXCs increase profits and eradicate competition.21 Despite their claims, the IXCs are not “losing” money. In fact the IXCs are actually experiencing increased profits as these new services bring new unlimited long-distance customers to the IXCs, thereby enlarging the overall market, to use, and pay for, more IXC services.

B. Profit Maximizing Pricing by IXCs

The IXCs offer services with a number of pricing plans and various types of bundling with other products. Furthermore, this happens at both the residential and commercial level. Though individuals generally pay the same price for any given bundle, larger

21 See 47 U.S.C. § 201(b) (2006) (“All charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful. . .”).
businesses buy bulk minutes at a discount, more like a wholesale rate, and are also offered bundled services. Therefore rates vary depending on minutes bought and by the ability of a consumer to negotiate lower rates. For an IXC to be profitable, average prices overall must be above the IXC’s long-run average costs.

1. Why do IXCs Choose Different Pricing Philosophies for Voice and Data?

A signal of IXCs’ pricing problem is that AT&T is reconsidering its pricing for unlimited data on cell phones. AT&T has discovered that 40% of its data traffic is coming from 3% of AT&T Mobility’s Smartphone users.\(^{22}\) According to AT&T’s use of the term, one might expect the company to accuse its customers of “traffic pumping.” AT&T is considering tiered pricing plans that will resemble the traditional voice plans, that were in place before the proliferation of unlimited calling plans; a customer pays for a certain amount of minutes and then pays a per minute rate once that limit is exceeded.\(^{23}\) AT&T and other IXCs could similarly modify their unlimited long-distance plans to charge a premium to those long-distance customers that, in the IXCs’ opinions, consume excessive quantities of unlimited long-distance services.

2. Fixed Pricing for Unlimited Service has a Preconceived Business Purpose

A fixed price for unlimited service is not an unusual situation for many businesses. The following analogy may shed further light on the fallacy of the IXCs’ arguments. Consider, for example, tire stores, which frequently offer free balancing and rotation for the life of the tires if you buy a complete set of four tires for your car. Does that mean that the tire store loses money each time a customer comes in to balance and rotate the tires? What if the stores are owned independently and franchise the tires from a major national supplier?

Further assume that tires must sell for the same price everywhere, but the national supplier must compensate stores with higher rent and labor costs to help them cover the costs associated with this service.


\(^{23}\) Id.
What if the customer chooses to balance and rotate at the downtown store instead of the suburban store? Does that mean the customer is ruining the profitability of the national chain? Surely the chain will account for this in their pricing model and charge sufficiently for the original tires to cover their costs.

What if the downtown tire store only sells tires, but a small company contracts to do the balance and rotation services at its neighboring downtown location? The supplier may prefer customers go to the suburban store since providing service through the contractor costs more, but does that mean they are losing money? Can the tire store simply refuse to pay the contractor, because too many customers use the contractor’s services?

How many new customers will the tire store draw in because it offers this balance and rotation service as part of the bundle that consumers buy with their new tires? This draws more revenue to the store but also to the chain by attracting more customers away from competing tire brands—and they are likely to be loyal, satisfied customers that purchase other products and services from the tire store. If the supplier felt the services were being abused, they could limit the number of free balances and rotations or impose a small incremental service fee on the work done in the downtown store. Just like the tire store, the major IXCs have tremendous flexibility to offer consumers a variety of plans with varying terms. For example, per minute long-distance rate plans from the major IXCs range between $5.00 flat fee per month, plus 5 cents a minute at AT&T, to $1.99 flat fee per month, plus 15 cents a minute at Qwest. Verizon’s rates are $6.00 per month, 5 cents per minute, with a $9.99 minimum per month. Sprint no longer advertises residential long-distance (anyone who is interested must call an 800 number to ask for pricing information), but, according to SaveOnPhone.com, Sprint is charging 5 cents per minute plus $8.95 per month and MCI (now a part of Verizon) offers 4 cents per minute plus $6.99 per month.²⁴

3. IXCs Have the Market Power to Implement Various Pricing Plans

Some companies also have started introducing hybrid plans, similar to wireless plans, where consumers pay a flat fee for a certain volume of minutes and then pay for each minute by which they exceed the predetermined volume. MCI, for example, offers 200 minutes of long-distance for $12.99 plus 5 cents per minute for minutes used over the initial 200.

Each IXC also offers “unlimited” plans as well. For example, Qwest and AT&T both advertise $25 per month for unlimited plans. Similarly, the major IXCs offer bundled services tied to various home services offered by their captive ILECs. With bundled services, the price of each additional service, like unlimited long-distance, is even less depending on what else a customer buys. This is another example of averaging used in pricing models.  

4. Unlimited Calling Plans Lure Consumers

Another inquiry that is relevant to the profitability of IXCs is how many customers with per minute long-distance bills (for example, averaging, between $10–$30 month, but varying across months) switched to unlimited plans (for say $25 per month) just to substitute a higher expected, but predictable bill, in exchange for eliminating the risk that they might have an occasional extremely high monthly bill that results in “sticker shock.” In these circumstances, the major IXCs are increasing profits by having people switch from per minute plans to monthly plans.

It is likely that many customers who were on per-minute plans switched to unlimited plans because they saw the availability of free conferencing, and other free telecommunications services and wanted

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25 The “price” that is produced by the necessary average cost method is a form of hybrid, or aggregate, pricing. Aggregate pricing can also create problems for the IXCs because it tends to skew economic incentives and natural market forces, as we have noted with the “unlimited” pricing model that desensitizes consumers to the actual costs of using the service and may even encourage additional usage that serves to drive up the average costs to the IXCs.

to have worry-free access to them. Granted, many of these customers may not use the free services, or use them to a lesser degree, if they had to pay per minute rates, but that does not mean that the IXCs are negatively affected merely because a consumer wants to use some free services in conjunction with their unlimited long-distance plans. In fact, the record demonstrates that customers use only 21 minutes of free conferencing services per month, on average.\(^{27}\)

5. Why are the IXCs Complaining?

Taking another look at this, Figure 3 demonstrates, according to FCC and Bureau of Labor Statistics (“BLS”) data, that the average revenue per minute for long-distance telephone calls is currently about 7 cents, plus or minus 1 cent.\(^{28}\) This suggests that the IXCs are earning between 4 cents and 6½ cents per minute on every call made to a free conferencing service, or 24 cents per minute in the case of the customer in Exhibit B. Even at 3 cents per minute for access charges, which is at the high end, and accepting the lowest possible estimate for profit, the IXCs are making 4 cents per minute of increased conference traffic, which is an extremely generous profit on these calls.

This, then, begs the question: Why are the IXCs fighting against the free conferencing companies? Is the real intention to eliminate competition and then take advantage of a business niche created by the free conferencing companies?

One theme becomes clear. The claims about “losing money” on calls made to free conferences are bogus. Of course, the IXCs would prefer lower access charges, but then they would like lower taxes and lower labor costs as well. In short, this argument is merely another way for these powerful economic interests to get a larger share of the market.


More evidence can be derived from the rates of return for the IXCs. Figure 4 shows that the rate of return for the interstate services business has been increasing to high levels since at least 2003. This fact is supported by the 10Qs filed with the Securities and Exchange Commission (“SEC”) that also point out higher profit margins with unlimited plans. In fact, the complaints from the IXCs about “traffic pumping” that are the subject of several ongoing legal battles have given the IXCs cover to raise rates, because they continually claim—and complain—to the FCC, the state regulators, and to Congress that their asserted lack of profits compel them to raise prices. Since, in fact, there is no evidence to support a lack of profit, this argument is baseless, as demonstrated by the increasing rates of return for the major IXCs.

The claims that the IXCs are “losing money” on long-distance are false. It is raised merely as an argument designed to distract regulators from the IXCs’ efforts to quash competition stemming from new entrants to the conference calling market.

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F. Competition from New Market Entrants

A. New Competitors and New Markets

Conspicuously absent in the complaints filed by the IXCs is the fact that services offered by free conferencing companies are effectively competing with services offered by the IXCs. Until 2005 the only teleconferencing service offered by the big telecoms was a host-pay toll-free dial-in service. This service was prohibitively expensive for many consumers that desired to use conference calls to collaborate on entrepreneurial ventures (i.e., small business), for philanthropic or religious purposes (i.e., nonprofits), or to deal with the government. Free calling services were pioneered as a response to this market failure.

Indeed, starting in 2006, many IXCs were forced to adopt a consumer-friendly model similar to free conferencing, that is, participant-paid conferencing. Though many still charge the host per minute, per caller, these new offers are significantly cheaper than the traditional host-pay toll-free services. Over the intervening years, the price for these service offerings have continually declined from 25
cents per minute in March 2007 (AT&T) to 8½ cents per minute, as of November 2009.\textsuperscript{30}

B. \textit{IXCs are Engaged in Unfair Competition}

The IXCs’ complaints and refusals to pay for access charges associated with free conference call services, is an example of unfair competition whereby IXCs leverage their nationwide market power and corporate strength to control, and perhaps eliminate, emerging and increasingly vibrant competition, much as the “Robber Barons” did in order to build and assert their monopoly power in the late 19\textsuperscript{th} and early 20\textsuperscript{th} centuries.

Another issue appears to underpin the complaints of the IXCs': the fundamental shift of consumers away from traditional landlines to wireless and VoIP services. According to an analysis by \textit{Cable and Satellite}:

\begin{quote}
While wireline voice continues to lose customers to wireless, the loss was slightly less this quarter. The telcos saw a 7\% decline in y/y losses as fewer people moved given difficulties in the housing market (also partially caused by a relatively easy comp from 2Q08). Cable saw an accelerated slowdown in phone additions for the 5th consecutive quarter.\textsuperscript{31}
\end{quote}

The shifting preferences of consumers, raises three further issues that must be explored to fully understand the economic impact of free conference calling services. First, what is the purpose of the FCC’s policy that allows rural CLECs to charge more for access services than urban ILECs? Second, what has been the effect of the implementation of these rules? Finally, what is the effect on the LECs, the IXCs, and consumers, particularly rural telecommunications consumers? These issues will be explored in detail.


C. FCC Regulations and Statements: IXCs use “TRAFFIC PUMPING” in Order to Mislead Legislators

Rules relating to access charges collected by LECs are enumerated in the FCC’s Seventh Report and Order and further Notice of Proposed Rulemaking, adopted on April 26, 2001. In that document, the FCC clearly and unequivocally concluded that LECs serving exclusively rural areas are entitled to tariff access charges at rates generally exceeding those of ILECs. In reaching that decision, the FCC articulated several reasons for this rural LEC exemption:

... to encourage the deployment to rural areas of the infrastructure necessary to support advanced telecommunications services and of the services themselves. ... [rural CLECs] experience much higher costs, particularly loop costs, when serving a rural area with a diffuse customer base ... the exemption we adopt today is not properly viewed as an implicit subsidy of rural CLEC operations. Instead it merely deprives IXCs of the implicit subsidy for access to certain rural customers that has arisen from the fact that non-rural ILECs average their access rates across their state-wide study areas.

As a result of the Seventh Report and Order, rural CLECs must follow one of two pricing rules: (1) if the CLEC competes with a non-rural ILEC, then it may tariff at the highest NECA rate, or (2) if the CLEC competes with a rural ILEC, then its tariff rate is limited to the maximum of the competing rural ILEC (which may also be the highest NECA rate).

The IXCs’ complaints wrongly allege that free conference calling services violate the FCC’s intent in setting rural access charges. Their arguments either fail to address the actual intent of the FCC in their entirety, or to analyze the FCC’s intent in light of current market realities and the positive impact that conference calling services can have on other aspects of the rural CLECs’ business operations.

32 See Seventh Report and Order, supra note 11.
33 Id. at para. 65–67.
34 See id. at para. 73.
35 See id. at para. 79.
Since the FCC was specific in its intent in adopting the rural exemption, failing to address all of the factors enumerated by the FCC, while focusing exclusively on only one variable, reveals little about whether a specific rural LEC is or is not violating the spirit of the FCC’s policy and its intent. For example, rural ILECs often have outdated switches. The ILECs involved with free conferencing services purchased soft switches capable of handing off VoIP traffic. Furthermore, AT&T has submitted that the FCC should eliminate circuit switches entirely in favor of wirepods. This will only put more pressure on the rural LECs, especially ILECs. Without revenue sources to pay for the new switches, how can the rural LECs continue to provide universal service?

D. The Economic Impact of the IXCs’ Refusal to Pay for Access Services

In a variety of complaints before the FCC, rural CLECs and free conferencing service providers have alleged that large IXCs, with dominant market power (e.g., AT&T, Verizon, Qwest, and Sprint) are committing various anti-competitive practices against small, non-dominant LECs and related service providers. These practices include, but are not limited to, not paying for access charges, routing calls through low quality or exhausted lines, or outright call blocking. At the same time, the relative size and financial strength of large IXCs, such as AT&T, Verizon, and Qwest, provide an enormous advantage over the small firms.

E. IXCs’ Abuse of Market Power

To illustrate, AT&T is worth approximately $152 billion, which is more than half of the Standard & Poor’s market capitalization for the entire Telecommunications Sector. Furthermore, they have increased their dividend each year since 2004, and continued that

trend by raising it again in January of 2010. Small LECs, on the other hand, are worth less than 1% of AT&T’s value. Further, rural LECs, like IXCs, are experiencing shifting consumer demands and thus are expected by UBS analysts to experience continued revenue declines. 37

To continue to provide a sustained or improved quality of service to rural consumers, rural CLECS must diversify their service offerings and revenue streams. Many are beginning to offer wireless service, while others are providing facilities to conference call providers. Regardless of their business strategies, the business reality remains the same: rural CLEC’s are in increasing jeopardy as consumer preferences shift toward more modern services with the concomitant higher costs. Consequently, the FCC’s goal of ubiquitous access services is similarly jeopardized when rural CLEC’s are the victims of unfair competitive practices.

Similarly, free conferencing companies are also significantly smaller than any of the IXCs, serving a small percentage of the total conference call market. Accordingly, the IXCs’ practice of withholding access payments, thereby forcing LECs and conference call providers to expend considerable sums on litigation expenses, has a proportionally greater negative effect on these much smaller competitors of the dominant IXCs. Stated differently, a small, start up conference call provider places far greater value on $100,000 than does an AT&T, a Qwest, a Verizon, or a Sprint.

F. Consumers Ultimately Pay the Price for Abuse of Market Power

Moreover, as rural CLEC’s and conference call providers are harmed by the refusal of IXCs to pay access charges, so too are consumers. Notably, IXCs generally refuse to pay for both traditional call traffic and conference call related traffic. Consumers will ultimately be the biggest losers, as the availability of innovative services is diminished for rural consumers and as competitive conference call service providers are choked off by the IXCs. In the end, consumers will experience higher prices and less choice, as the dominant firms in this oligopolistic market push pricing to suit their urban and high-density markets.

G. Conclusions

This leads to some straightforward observations:

- Conference calling services are currently provided by an array of entities ranging from the very large, (e.g., AT&T, Verizon, Qwest, Sprint, et al.), to the very small, (e.g., rural telephone companies and small competitive local exchange carriers).
- Broadly speaking, there are two major types of conference calling. First, host-paid conference calling where the calling-in party pays nothing because the host pays all of the telecommunications expenses. Host conference calling arrangements were developed, and are still dominated by, the giants of the industry. Second, in free conferencing services the conference attendee pays for the long-distance call. These conference calling arrangements are generally used by charities, small and large businesses, and political organizations, where the calls are generally terminated in a rural area.
- When the dominant ILECs/IXCs complain to the FCC about “traffic pumping,” “access stimulation,” and refuse to pay terminating access charges, there is a hidden motive and agenda on their part, namely to frustrate and weaken the competitive positions of the small, non-dominant companies that offer conferencing services competing with the dominant companies.
- Despite claims to the contrary, the dominant IXCs are not confronting either a loss of business opportunities or profit as a result of the free conferencing competition. If they are suffering at all, it stems from their unlimited long-distance pricing models, which they are free to modify.
- Conference calling competition introduced and promoted by the free conferencing companies has resulted in lower prices for all conferencing services. As a result, all customers of these services have benefitted, along with the companies that provide them.
- Free conference calling services have expanded the market for unlimited long-distance plans.
- The average revenue per minute and rate of return for the IXCs’ long-distance services have been increasing, not decreasing.
- The evidence supports a conclusion that unlimited long-distance plans are, on average, profitable for the IXCs. Thus, it can be
concluded that free conference calling services have, on average, resulted in increased profits for the IXC.

- FCC regulations and statements have consistently and categorically concluded that the policy goal for rural America should encourage the deployment of the infrastructure necessary to support advanced telecommunications services. In order to support that laudable and widely supported goal, the access charges for originating and terminating long-distance traffic in rural areas can be higher than the nationwide average. Referred to as “the rural exemption,” this policy is designed to overcome the technological and capital costs of providing advanced services in rural America—services that if they were withheld would result in severe economic and employment suffering.

- If the FCC eliminates the rural exemption or places regulatory constraints that result in tariffs that are simply too low, the action would have a negative impact on future competition and product development, thus eviscerating the FCC’s policy underlying the rural exemption while impeding the provision of available and affordable broadband services.

- The dominant IXC is assiduously divesting themselves of their own rural ILECs, adding further evidence that these major, profitable companies are no longer interested in serving rural American markets.

- Some rural communities are being so poorly served by incumbent telephone service providers that they are forming their own CLECs because they cannot get service from existing IXC/ILECs. Perhaps the least served communities in the nation are those on Native American Reservations. In fact, a number of them have formed CLECs and offer up-to-date telecommunications-information services at affordable rates. This trend should be encouraged by the FCC.
FINANCING FILM THROUGH AGGRESSIVE TAX INCENTIVES—A LOSING PROPOSITION FOR THE STATES?

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“Runaway production” is not new. The exodus of production from the Hollywood studio lot has been afoot for decades, and usually occurs for two distinct, but not totally separate, reasons: (1) “artistic flight”;¹ and (2) “economic flight.”² Because the former is primarily fueled by creative decisions it is not the focus of this paper.

To combat economic flight abroad, Congress passed, and President Bush signed, a bill with the goal of keeping production and filming in the U.S.³ However, some states, taking a page out of

¹ Artistic flight is a result of a director’s creative vision which requires filming away from the studio lot to give the film an “authentic” feel. While any decision has some economic aspects—and the venues often capitalize on the opportunity by lowering costs to make the decision easier—artistic flight is fueled primarily by artistic vision. Prime examples of this kind of flight are location shoots in New York City or Paris, which offer an atmosphere that is often impossible to replicate on a studio lot.

² Economic flight is only incidentally artistic (requiring only that one location resemble another closely enough to justify the artistic compromise). An example of successful flight in past decades included Vancouver and Toronto, Canada, where tax incentives and cheap labor attracted big (and small) movie producers to shoot “on location” (which could stand for the Midwest or New York City). In fact, between 1996 and 2006, more than 1,500 film and television productions were “outsourced” to Canada (not including the “scores” of made for TV movies produced there). See Kelly Nestruck, Set in the US, Filmed in Canada, Fed Up in Hollywood, Guardian.co.uk (Nov. 1, 2007 10:50 GMT), http://www.guardian.co.uk/film/filmblog/2007/nov/01/kellynestruckthursampic; Edward Jay Epstein, Northern Expenditure: Why are so many movies still being shot in Canada?, Slate (Feb. 13, 2006), http://www.slate.com/id/2136064.

³ See American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 181, 118 Stat. 1418, 1445 (codified as amended in 26 U.S.C. § 181 (2006)). Two of the industry’s largest unions, the Directors Guild of America (“DGA”) and the Screen Actors’ Guild (“SAG”), argued (and the Commerce Department agreed) that runaway production cost the United States $10.3 billion in lost revenue in 1999 alone. To offset this and jump start domestic production, the Act, which had a December 31, 2009 sunset provision, included provisions that allowed for (1) an immediate tax write-off of production expenditures for domestic film and TV production under $15 million (or $20 million for production located in certain “low income” communities), and (2) a 9% deduction from net income for qualifying domestic film production.
Canada’s playbook, introduced their own, often generous, tax incentives to attract production. The result for California, and to a lesser extent New York (with its own established film and television industries), was a war on two fronts: international flight on the one, and intranational flight—financed by both federal and state tax dollars—on the other. These new entrants, however, were not immune from the same effects, with late comers introducing even more generous incentives.

Over the years the number of state programs exploded, with at least forty-two states now participating in some capacity. Two interrelated policy considerations result from this rapid growth: (1) over-saturation of the marketplace, and (2) a “race to the bottom” with the generosity of the incentives. In the process the states may forego valuable opportunity costs that could produce a greater return on their investment.

State incentives come in various forms—such as tax forbearances, free use of locations, an inexpensive labor force and even loan guarantees. Governments seek to recover these investments in different ways. Under the most basic economic model, a state benefits if the rebates and credits it provides are less than the taxes it otherwise collects from the production. However, governments also count the creation of production-related jobs, tourism, the infusion of revenue to low-income areas and the building of valuable infrastructure as indirect benefits (which may even justify losses under

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5 Over-saturation of the marketplace occurs when each state’s return on investment declines as more states adopt aggressive subsidies.
6 A “race to the bottom” occurs when states compete with each other, gradually ramping up incentives to attract production, and in the process decreasing their own return on investment.
the basic model).\textsuperscript{8} Louisiana’s film tax credit law exemplifies these considerations.\textsuperscript{9}

It is undeniable that big studio productions can infuse large sums of money into a local economy. Two examples are Louisiana and New Mexico, both aggressive early adopters, which established their programs two years before the national response in 2004:

- In 2008, New Orleans, Louisiana was home to twenty productions, with budgets totaling $275 million. The City estimates that at least half of that amount (almost $138 million) was spent locally and therefore benefitted local businesses and production workers. In fact, according to the Office of Entertainment Industry Development (“OEID”),\textsuperscript{10} it is

\begin{itemize}
  \item \textsuperscript{8}Id. See also Dan Glickman, Stand Up for Creative Jobs, HUFFINGTON POST (Mar. 19, 2009), http://www.huffingtonpost.com/dan-glickman/stand-up-for-creative-jobs_b_177137.html (“Tax incentives, built responsibly, can serve a critical role in economic stimulus. To do so, they must achieve three objectives: create jobs, increase commerce and generate a positive return on taxpayer’s investment.”).
  \item \textsuperscript{9}The introduction of § 6007, the Motion Picture Investor Tax Credit, provides that:

The primary objective of this Section is to encourage development in Louisiana of a strong capital and infrastructure base for motion picture film, videotape, digital, and television program productions in order to achieve an independent, self supporting industry. The objective is divided into immediate and long-term objectives as follows:

(1) Immediate objectives are to:

(a) Attract private investment for the production of motion pictures, videotape productions, and television programs in Louisiana.

(b) Develop a tax and capital infrastructure which encourages private investment. This infrastructure will provide for state participation in the form of tax credits to encourage investment in state-certified productions and infrastructure projects.

(c) Develop a tax infrastructure utilizing tax credits which encourage investments in multiple state-certified production and infrastructure projects.

(2) Long-term objectives are to:

(a) Encourage increased employment opportunities within this sector and increased global competition with other states in fully developing economic development options within the film and video industry.

(b) Encourage new education curricula in order to provide a labor force trained in all aspects of film and digital production.

(c) Encourage development of a Louisiana film, video, television, and digital production and post-production infrastructure with state-of-the-art facilities.


OEID is a department of Louisiana’s Department of Economic Development.
estimated that total production in Louisiana increased from $20 million in 2002 to nearly $700 million in 2007.\footnote{W. Thomas Angers et al., No Rules, No Problem, 55 La. B. J. 428 (2008).}

- New Mexico’s “Film Incentive Program,” boasting a $276 million fund earmarked for film and television investment and production,\footnote{N.M. State Inv. Council, Film Investment Program Outstanding Loans Since Inception Through July 31, 2007, http://www.sic.state.nm.us/PDF%20files/NM_Film_Investment_Program_7.31.07_Final.pdf.} was home to twenty-two productions, generating $130 million of revenue for the state.\footnote{See Streib, supra note 7.}

While both programs are aggressive,\footnote{Louisiana, which has a 4% state sales tax, grants a 25% investor tax credit based upon the total in-state expenditures of a motion picture production. An additional 10% labor tax credit is given for the hiring of Louisiana residents. The tax credits are fully transferable. Louisiana also offers a 40% infrastructure tax credit for the building/establishment of state-of-the-art facilities. The tax credits have no cap. See La. Rev. Stat. Ann. § 47:6007 (2010); New Orleans Office of Film and Video, http://www.filmneworleans.org (last visited Sept. 12, 2010).} neither is as generous as Michigan’s, a relative newcomer hoping to build its own film industry by providing public support of up to 42% of a production’s costs.\footnote{Mich. Comp. Laws § 208.1455 (2010); see Michael Cieply, States Underwrite Films, Some in Narrowest Release, N.Y. Times, Mar. 19, 2009 at C1. Michigan has to rely on the generosity of its program to attract production because a six year lag allowed states like Louisiana and New Mexico to establish infrastructure which Michigan lacks. Additionally, the physical proximity of New Mexico to Hollywood, and Louisiana’s unique topography (the bayou) provide advantages Michigan has to overcome.}

According to a study commissioned by Michigan, the program (launched in April 2008) created 1,102 “full time” jobs, thereby generating $53.8 million in new employment income.\footnote{Steven R. Miller and Abdul Abdulkardi, Mich. State Univ., The Economic Impact of Michigan’s Motion Picture Production Industry and the Michigan Motion Picture Production Credit (2009), http://www.michiganfilmoffice.org/cm/The-Film-Office/MSU_Economic_Impact_Study_269263_7%5B1%5D.pdf.} However, in the same time period the program cost taxpayers about $48 million in tax forbearance. Assuming the figures are accurate, a back of the envelope analysis indicates that for every $1, the tax incentives generate only $1.2 in revenue.
The reason why these tax incentives are so attractive to businesses is laid out in Schulyer M. Moore’s article. Put simply, most films lose money, but nevertheless hundreds of films are produced each year—almost in defiance of the laws of supply and demand. One important catalyst for the prominence of the tax credits is a shift in the world of film finance. In the past, as much as one hundred percent of a film’s budget was raised through “pre sales” at film markets (more euphemistically known as “festivals”). That amount has shrunk to about 70% today. The state and federal tax credits provide an important lubricating function to the wheels of production by providing “free money” to bridge the gap, in essence making the state a financial backer of the film. However, while this dynamic is attractive to producers, it does not always lead to desirable results for the states.

For example, in 2009 the Wisconsin Department of Commerce issued a harsh report on the cost of film tax credits. Wisconsin

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18 Moore proposed two rationales for this: (1) the “sex-appeal” of being in the business; and (2) the chance for a big payoff (while 600 to 700 movies are produced each year, only 200 movies may obtain a theatrical release; of these two hundred, a handful see a profit; but rare “blockbusters” produce exponential returns, and may offset the loss suffered by dozens of films.) As he points out, this is gambling in its purest form, tax-credits, therefore, would be analogous to playing with the house’s money. Id.
19 This led to layered finance models in which gap loans made up most of the difference, but required completion guarantees and did not cover pre-production expenses, which in turn required bridge lenders, who were willing to make loans to fund preproduction expenses with no completion guarantees in place. Analogizing this to a housing loan, these lenders would come in third in seniority, after both the primary mortgage and the secondary mortgage on the film. Naturally, these kinds of loans carry a hefty premium (sometimes reaching 1% per week). Id. at 28.
20 This “free money” comes in two flavors: assignable and non-assignable tax credits. Assignable tax credits can be readily sold to third parties, and an entire cottage industry has developed around their brokerage. Competition increased the value of assignable tax credits from 70 cents to 82 cents on the dollar. Non-assignable tax credits are not as liquid; they are analogous to the securitization in the mortgage market—the company must obtain a loan secured by the tax incentives for the lender to obtain direct payment of the tax refund. Id.
21 See Wis. Dep’t of Commerce, Cost Benefit Analysis of Wisconsin Film Tax Credit Program (2009), http://www.senate.michigan.gov/gop/senators/cassis/Wisconsin%20Film%20Tax%20Analysis.pdf; see also Tom Still, Lights! Camera! Inaction? State film tax credits stir debate, Wisconsin Technology Network News (Apr. 16, 2009),
Commerce Deputy Secretary Aaron Olver characterized the tax credit as “the least effective” tool in the agency’s arsenal of economic development, saying that a tax credit for manufacturers costs the state a little more than $3 for every hour of labor it creates, while the film tax credit costs twenty times as much ($60, or 3x20) for the same hour of labor. In other words, if we had to choose, we could get one full-time job on a film for one year or we could get twenty factory jobs that might last for twenty years. Even in successful states like Louisiana, that very scenario may cost the state’s taxpayers more than $20 million. The specific question in Michigan with its decimated manufacturing base and an unemployed skilled work force, is whether film tax credits are a responsible investment in the future, or are the opportunity costs foregone in pursuit of those industries too steep?

If a traditional investment in manufacturing jobs would yield a greater return, as Olver suggests, the state foregoes that opportunity by pursuing the far “sexier” field of film production. As mentioned supra, states look at both the hard numbers (the return on investment) and some indirect benefits, such as job creation, infrastructure, and tourism

http://wistechnology.com/articles/5943/. The Department believes that the tax credits cost more than they are worth in economic benefits to the state. The report called the program “really expensive,” because it is not a typical tax credit program—capped at a percentage of taxes paid—but a refundable tax credit program, making it akin to a blank check, if the tax credit exceeds the recipient’s actual tax bill, the state will write a check for the difference.

22 See Wisconsin Film Incentives, Film Wisconsin, http://www.filmwisconsin.net/Incentives/WhatTheyAre.asp (last visited Aug. 31, 2010). The Wisconsin program has an investment tax credit of 25% that can be claimed for investing in Wisconsin based productions; a comprehensive sales and use tax exemption for machinery, equipment and services used in production and post-production and 0% tax for all film and television services contracted by out of state production companies; a refundable tax credit of 25% of direct production expenditures for feature films, television movies, episodic and mini-series television, video games and broadcast advertising production; a 15% state income tax credit for film, television and electronic game production businesses who make a capital investment by starting a business in Wisconsin, with further incentives available on a city-by-city basis. It is not nearly as ambitious and costly as the Louisiana and Michigan programs.

23 See Still, supra note 21 (citing the Johnny Depp film “Public Enemies” which was shot in Wisconsin) (“The film generated spending of $18.5 million but all but $5 million of that spending took place outside the state. ‘Even making favorable assumptions about indirect economic impact, “Public Enemies” only returned $1.70 for every $1 invested,’ the Commerce report concluded.”).

24 Id.
to decide if the cost is worth it.\textsuperscript{25} Some of these assumptions, however, may not be well grounded in fact. To wit:

- While a producer is concerned with the long term goal of turning a profit, the state is interested in the job creation—and business related expenses by the production—in the average 18-month period of the production. To sustain employment, a state needs a steady flow of new productions in the pipeline, however, a factor often outside its control. While the generosity of the tax credit is a part of the studio’s decision, it is but one part of the calculus.\textsuperscript{26}

- Arguably the most important secondary benefits—long term infrastructure building and the post-production jobs in it—have an important caveat closely related to the above point. The numbers of jobs are finite, and while more than 600 films are produced each year, only the handful of big-ticket productions, undertaken by major studios, would produce the desirable effects in a state. Simply put, there are not enough of those to go around for each of the forty-two states currently in the business of financing film to sustain long term production job growth.\textsuperscript{27}

- Even more precarious is the tourism justification. Even if a film is spectacularly successful, tourism to the state is not guaranteed, because a producer concerned with the bottom line may choose a location based in part on the economic incentives

\textsuperscript{25} These benefits are the “economic multipliers” effects on which legislatures rely to support the passage of the tax credits. See Miller, supra note 16; see also Ernst & Young, Economic and Fiscal Impact of the New Mexico Film Production Tax Credit; Prepared for the New Mexico State Film Office and State Investment Council (2009), http://www.nmfilm.com/locals/downloads/nmfilmCreditImpactAnalysis.pdf.

\textsuperscript{26} Incidentally, some states have legislation, such as Louisiana, that profess a long term goal of providing “new education curricula in order to provide a labor force trained in all aspects of film and digital production,” therefore committing further resources to the enterprise. See La. Rev. Stat. Ann. § 47:6023 (A)(2)(b) (2010). But if these trainees act in their own best interests, the best result the majority of states can actually hope for is that trainees will find jobs in the field, most likely in already established film markets such as California and New York—thereby transferring all of the benefits accrued to another state.

\textsuperscript{27} This appears axiomatic, but it does not stop states from passing subsidies in hopes of attracting these productions, and further assuming that they can reproduce that result year after year to justify the infrastructure and job growth assumptions made in passing the tax credits.
the state offers, thereby setting a story in a totally different state, with no tourism benefit flowing to the incentivizing state.\footnote{Consider two examples: First is the film \textit{Annapolis}, originally set to film “on location” in Maryland, but was lured at the last moment to Pennsylvania by a $10M incentive. Clearly, Pennsylvania would get no tourism boost from this successful movie if one was inspired by the movie to visit the naval academy. The second example is \textit{Runaway Jury}, set in Mississippi, but filmed in Louisiana for similar reasons. It would stand to reason that Louisiana did not benefit from a tourism boost based on a movie set in Mississippi. \textit{Tax Me If You Can}, \textit{Wall St. J.}, Mar. 14, 2009 at A8.}

An important implication of the scarcity of these projects is that interstate competition is producing a “race to the bottom,” which only has intensified as more and more states became aggressive in pursuing film projects. While pioneers in the field—first New York, and more recently New Mexico and Louisiana—only needed to compete with a handful of states, recent arrivals, such as Michigan and Georgia, have to create a place for themselves at the table by competing on the generosity of their tax incentives.\footnote{See \textit{State Film Incentives}, supra note 7; see also \textit{Economic Research Associates, Project Report: Louisiana Motion Picture, Sound Recording, and Digital Media Industries} (2009), \url{http://louisianaentertainment.gov/film/files/ERA20report.pdf}. For example, while Louisiana had an exemplary year in 2007, with an estimated $763M in economic benefits—up from $576 in 2006, and $421M in 2005—it’s 25% production credit is not nearly as generous as some of its newest competitors in Georgia and Michigan, with 30% and 42% credits respectively.} Because Georgia and Michigan cannot yet compete with incentives like a trained workforce or sound stages, they are left with attracting film production using bigger tax incentives. This is, of course, detrimental to all states involved. Just as Michigan is left with the unenviable position of returning almost nothing on its investment for the next 3–5 years, Louisiana—and, to a lesser extent, New Mexico, thanks to its geographical proximity to Hollywood—are in danger of losing productions and having their trained workforce, and infrastructure, unengaged in the business they worked to build.

Because the interests of the producers and the states are diametrically opposed—the former vying for bigger incentives and the latter for greater returns on their investment—aggressive competition among the states favors the producers to the detriment of the states. If competition persists (or increases) it may even become a challenge to hold on to the gains already made, let alone successfully build entirely new industries. States must recognize that such competition is
economically detrimental to them, and that while big productions can infuse large sums of money into a local economy, better uses for state funds, which may produce greater returns on their investment, may exist.
BROADCAST v. BROADBAND?
A SURVEY OF THE REALLOCATION OF BROADCAST SPECTRUM FOR WIRELESS BROADBAND

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“America’s future competitiveness and global technology leadership depend, in part, upon the availability of additional spectrum. The world is going wireless, and we must not fall behind. . . . We are now beginning the next transformation in information technology: the wireless broadband revolution.”¹ On June 28, 2010, President Obama issued an Executive Memorandum which committed the Federal government to nearly double the amount of commercial spectrum available over the next ten years, in order to unleash the innovative potential of wireless broadband.

The contribution of wireless services to overall gross domestic product in the U.S. grew over 16% annually from 1992–2007, compared with less than 3% annual growth for the remainder of the economy.² The demand for mobile broadband services is increasing with the introduction of new devices, as well as the availability of 3G and the emergence of 4G networks. The mobile broadband industry is expected to “drive innovation, job growth and investment through the next decade,” while both usage rates and revenues in broadcast television have declined significantly over the past decade.³ An inventory and possible repurposing of some television broadcast

³ Id. at 89.
spectrum for wireless broadband is therefore a logical strategy to insure efficient utilization of the scarce resource.

Section I of this paper defines spectrum. Section II provides an historical context for spectrum scarcity and regulation. Section III discusses the solution to spectrum scarcity proposed by the National Broadband Plan. Section IV addresses broadcasters’ responses.

I. What is Spectrum?

The term spectrum, originally used in reference to light, refers to a range of frequencies at which information can be transmitted through the air. Frequency is measured in hertz ("Hz") or cycles per second. The different propagation characteristics of various frequencies make certain bands more suitable for specific uses. High frequency waves can carry information, but not through walls, trees or across long distances. Low frequency bands are considered the very best, because those frequencies can carry signals through walls, trees and across long distances in rural areas. The lower bands, which are used for broadcast, are also most suitable for wireless broadband. These bands are considered the most valuable or the “beachfront” property. Television broadcast bands comprise about 30% of spectrum between 225 MHz and 1 GHz.

High usage and/or the presence of more than one service on a particular band are significant considerations for spectrum planning purposes. Two parties, for example, cannot broadcast on the same frequency at the same time in the same area, without causing interference to the other party. In addition, some types of service may be more likely to cause interference on neighboring bands than others. This problem occurred in the 800 MHz band, when police, firefighters and first responders transmitted radio dispatch messages on the same

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4 Spectrum is sometimes referred to as capacity or bandwidth.
8 Benjamin et al., supra note 5, at 31.
band that Nextel used for its mobile services. If the first responders’
radio transmission was made at 850 MHz near a Nextel cell tower
broadcasting at 851 MHz, the result was interference which rendered
the first responders’ broadcast inaudible. The Federal
Communications Commission (“FCC” or “Commission”) resolved the
problem by relocating the mobile service to a different band.\textsuperscript{9}

An additional consideration is the amount of bandwidth
required for a particular use. The requisite amount of bandwidth
depends upon the amount and type of information that needs to be
carried. For example, an analog transmission will require more
bandwidth than a digital one, because digital transmission compresses
content.\textsuperscript{10} Following the transition from analog to digital television
(“DTV”), broadcasters now can offer multiple channels of digital
programming simultaneously, using the same amount of spectrum as
one analog program.\textsuperscript{11}

\section*{II. Spectrum Scarcity and Regulation}

Spectrum is a finite resource and subject to interference;
therefore, in the public interest, commercial spectrum is regulated by
the FCC under the authority granted by the Communications Act of
1934.\textsuperscript{12} The Supreme Court reiterated the importance of regulation by
the agency in the seminal \textit{Red Lion Broadcasting v. FCC} case:

\begin{itemize}
\item[\textsuperscript{9}] Associated Press, \textit{FCC, Nextel Agree to End Cell Phone Interference}, FoxNews.com
(Feb. 7, 2005), http://www.foxnews.com/story/0,2933,146645,00.html (last visited
Sept. 5, 2010).
\item[\textsuperscript{10}] BENJAMIN ET AL., supra note 5, at 8.
\item[\textsuperscript{11}] \textit{What is DTV?}, FCC, http://www.dtv.gov/whatisdtv.html (last visited Sept. 9, 2010).
\item[\textsuperscript{12}] Communications Act of 1934, 47 U.S.C. § 151 (2006). The FCC has statutory authority
to grant, transfer, renew and terminate broadcast licenses. Historically, under the
\textit{Ashbacker} Doctrine, the Commission held comparative hearings for bona fide competing
parties before one party was granted a license to the exclusion of another. Ashbacker
Radio Corp. v. FCC, 326 U.S. 327, 333 (1945). Subsequently, the Commission developed
“comparative criteria” for the comparative hearings, see Policy Statement on Comparative
Hearings, 1 FCC 2d 393 (1965). However, following the DC Circuit decision in \textit{Bechtel v.
FCC}, 10 F.3d 875 (D.C. Cir. 1993) (holding that some of the “qualitative factors” in the
comparative criteria were “arbitrary and capricious”), the Commission ceased comparative
hearings until the issues raised in \textit{Bechtel} could be resolved. In 1997, a Congressional
amendment to 47 U.S.C. § 309 granted the Commission the authority to conduct
competitive bidding procedures to resolve mutually exclusive applications for commercial
broadcast stations. Unless filed before July 1, 1997, the Commission does not currently
resolve disputes for competing applications by comparative hearing, reasoning that it is
generally “fairer and more expeditious” to grant mutually exclusive licenses by competitive
The rapidity with which technological advances succeed one another to create more efficient use of spectrum space on the one hand, and to create new uses for that space by ever growing numbers of people on the other, makes it unwise to speculate on the future allocation of that space. It is enough to say that the resource is one of considerable and growing importance whose scarcity impelled its regulation by an agency authorized by Congress.\textsuperscript{13}

However, government regulation was not viewed as the best solution by everyone. Nobel Prize-winning economist, Ronald Coase, proposed to the Commission in 1959 that the licensing process arbitrarily enriched private operators, that spectrum should be treated similarly to traditional property rights, and that the market would correct itself.\textsuperscript{14} Nonetheless, Coase still recognized that some form of government regulation was necessary in order to prevent the interference caused by multiple parties transmitting simultaneously on the same spectrum.\textsuperscript{15} Furthermore, because spectrum is a public good, the policymakers determined that a market solution by economic pressures in buying and selling frequencies was not appropriate.\textsuperscript{16}

More recently, in 1993, Congress authorized spectrum auctions. From 1994 through 2009 there have been 75 spectrum auctions which have yielded more than $52.6 billion for the federal government.\textsuperscript{17} In addition, the DTV transition in 2009 freed up 108 MHz of spectrum, 52 MHz of which was sold through the FCC’s 700 MHz auction,

\textsuperscript{14} Ronald Coase, Why Not Use The Pricing System in the Broadcast Industry?, Testimony before the FCC (Dec. 1959), reprinted in Benjamin et al., supra note 5, at 34 (theorizing that between two stations in competition for use of the same band, the station which uses the spectrum most efficiently (with the greatest “monetary measure of cost and benefit”), will ultimately pay the most for the spectrum and retain ownership).
\textsuperscript{16} Benjamin et al., supra note 5, at 46 (citing Ronald Coase, Comment on Thomas W. Hazlett: Assigning Property Rights to Radio Spectrum Users: Why Did FCC License Auctions Take 67 Years?, 41 J.L. & Econ. 577, 580 (1998)).
generating almost $20 billion in federal revenues. If broadcasters are permitted to reap the economic benefits, spectrum auctions could potentially provide some economic incentive to broadcasters as well, thereby encouraging efficient use of spectrum and the auctioning of unutilized spectrum.

III. National Broadband Plan

Mobile broadband use in America is growing at an exponential rate, and analysts predict that within five years more users will connect to the Internet via mobile devices than desktop computers. The sales figures for new devices, such as the iPad, may be an indicator of a shift in consumers’ preferences. Apple sold nearly 3.3 million iPads during the quarter following its launch in April 2010, and is predicted to sell 16 million iPads by first quarter 2011. As users increase and the technology becomes more sophisticated, applications will require even greater amounts of bandwidth to operate, further compounding a spectrum scarcity concern. Among the recommendations to remedy a possible spectrum shortage, the National Broadband Plan (“NBP” or “Plan”) proposes a reallocation of broadcast spectrum for wireless broadband.

According to the Plan, the process for revising spectrum allocations has historically taken between six and thirteen years, and therefore the reallocation must occur now, in order to make spectrum available to meet consumers’ future demand for wireless broadband. The NBP recommends that the Commission initiate a rulemaking proceeding to reallocate 120 MHz from the broadcast television bands for wireless broadband use. The Plan further recommends the establishment of a licensing framework allowing two or more stations to share a 6 MHz channel assignment, as well as rules for the auction of broadcast spectrum reclaimed through repacking and voluntary channel sharing.

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18 Id.
19 National Broadband Plan, supra note 2, at 75.
22 National Broadband Plan, supra note 2, at 79.
23 Id. at 88.
Recommendation 5.8 proposes that the FCC should make available an additional 500 MHz within the next ten years, 300 of which should be between 225 MHz and 3.7 GHz and available for mobile flexible use within the next five years.\(^{24}\) In the bands below 3.7 GHz, 547 MHz is licensed as flexible use spectrum that can be used for mobile broadband. Currently, 170 MHz is being used by cellular and PCS bands, and the majority of the remaining 377 MHz is just now becoming available for mobile broadband use. Wireless providers estimate future needs will range from 40 to 150 MHz per operator.\(^{25}\)

The NBP also recommends that Congress should consider granting the FCC and the National Telecommunications and Information Association the authority to impose fees on spectrum that is not licensed for flexible use.\(^{26}\) If implemented, the U.S. would not be the first country to impose such license fees. The United Kingdom has a user fee system in place called Administrative Incentive Pricing (“AIP”) for commercial and government spectrum. A recent review of the program has conclusively found that the AIP program is indeed meeting the objective of incentivizing users “to make optimal use of their spectrum.”\(^{27}\)

IV. Broadcasters’ Response

Broadcasters are concerned about preserving their ability to provide consumers with broadcast content and distribution, particularly after undertaking significant effort and expense to upgrade facilities in connection with the DTV transition.\(^{28}\) Broadcasters also are working to develop “Mobile DTV” service, which would operate on the broadcasters’ current 6 MHz spectrum alongside their other broadcast service. The National Association of Broadcasters (“NAB”)

\(^{24}\) Id. at 84.
\(^{25}\) Id.
\(^{26}\) Id. at 82.
\(^{27}\) Id. at 83.
asserts that any reduction in that spectrum allocation would hinder broadcasters’ ability to roll out this new technology. 29

Maximum Service Television, Inc. (“MSTV”) and the NAB are proposing that to the extent that more spectrum is needed for broadband uses, the Commission should not assume that broadcast spectrum is the best place to find it. 30 The comments also emphasize four ideas: (1) broadcasting and broadband are not “either/or” propositions; (2) local television broadcasting offers social benefits which are not replaceable by other services; (3) by both policy and directive, the FCC should provide universal communications for all communities as well as local service; and (4) consumers have spent approximately $109 billion in HD receiving equipment in the DTV transition relying on the broadcasting services which cannot be duplicated or replaced by wireless broadband, cable, or satellite services. 31 The comments further suggest that consumer demand for mobile video is focused on the content that broadcasters offer, including local news programming. 32

On the other hand, according to a study by The Brattle Group, “the over-the-air portion of broadcasting is becoming less economically relevant to broadcasters.” 33 Furthermore, CTIA – The Wireless Association (“CTIA”) asserts that the benefits of over-the-air (“OTA”) broadcast services can be enjoyed without the use of broadcast spectrum, as the majority of Americans do through their cable service. CTIA’s comments further state that the number of consumers who use OTA broadcast services has decreased by 56% over the past ten years, whereas the number of people using smartphones has grown 690%

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31 Id. at 4–6.

32 Id. at 6.

over the past four years. According to a survey by the Pew Internet and American Life Project, 61% of Americans get at least some of their news online, and just over a quarter now read their news on a cell phone. More than 80% of those surveyed receive news from emailed links.

A. Emergency Services

The NAB and musicFirst, a recording industry trade group, propose that Congress mandate that every mobile phone sold in the United States contain a chip to enable FM radio reception. They argue that having the tuner in the device would offer news and guidance in emergency situations.

While an FM chip in a smartphone might give a user access to approximately 30 local stations, a smartphone user streaming on an internet radio application has hundreds, or even thousands, of stations available online. Moreover, wireless broadband applications can improve public safety services. Location-based services can offer faster location and recovery of missing persons and stolen property through a Commercial Mobile Alert System (“CMAS”). CMAS will enable emergency operations centers to reach targeted audiences with emergency alerts on the device that most people almost always have with them.

B. Morality and Community Concerns

In the NAB State of the Industry Address, the Association President and CEO Gordon Smith suggests that because broadcasters

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37 Id.
40 Id.
41 OBI TECHNICAL PAPER, supra note 7, at 12.
are required by statute to “observe community standards” and the Internet is rampant with lewd material, any move which favors broadband therefore supports the distribution of obscene material. He argues that “if broadcasting loses spectrum and grandma’s new HDTV is rendered useless, at least she will have the consolation of knowing her grandson can get lewd material on his cell phone.”42 Even if this scenario were plausible, the fact is that broadcasting is not devoid of indecent content either. The ongoing issue of fleeting profanity in broadcast programming was recently argued in the Second Circuit by broadcasters in Fox v. FCC (holding that the FCC’s policy banning fleeting expletives violates the First Amendment).43

As for other public policy concerns, the FCC continues to support the policy goals of localism and diversity of views in broadcast television.44 It should be noted, however, that localism and diversity can be supported by mobile broadband as well. For example, mobile broadband devices have enabled innovation in journalism. In 2009, the images of democratic protests in Iran were captured and transmitted to social networking websites via mobile devices,45 which has expanded First Amendment expression to diverse viewpoints and to communities which were previously excluded from conventional forms of media.46

C. Efficient Spectrum Use

In his testimony before the U.S. Senate Small Business and Entrepreneurship Committee, Gordon Smith asserted that because broadcast is one-to-everyone, it is indeed the most efficient use of

43 Fox Television Stations, Inc. v. FCC, 613 F.3d 317 (2d Cir. 2010). On August 25, 2010, the FCC filed a Petition for Rehearing En Banc in the Second Circuit, asserting that the decision went too far in overruling the indecency regime and that the decision should have focused on the longstanding context-based approach to indecency enforcement that was sanctioned in FCC v. Pacifica Foundation, 438 U.S. 726 (1978). Brief for Respondents, Fox Television Stations, Inc. v. FCC, 613 F.3d 317 (2010) (No. 06-1760-ag(L), 06-2750-ag, 06-5358-ag), 2010 WL 3463628.
44 OBI Technical Paper, supra note 7, at 12.
46 OBI Technical Paper, supra note 7, at 12.
spectrum, whereas broadband, which is one-to-one, is “spectrum hogging.” Smith refers to the type of wireless broadband architecture in which each user has his or her own path in the cellular network.

However, the development of mobile ad hoc networks could change this traditional cellular architecture. In a mobile ad hoc network, each device in the network acts as both a sender and a receiver, as well as a relay point for other devices. Ad hoc network technology has been in development for more than three decades, but the large amount of battery power required for mobile operation has prohibited implementation of this technology for mobile commercial use. Recently, researchers at Stanford University announced a breakthrough in the development of a lithium-sulfur battery, which will have 80% more capacity and ten times the power density of lithium-ion technology. If the new battery type can be integrated into the next generation of smartphones, mobile ad hoc networks could be commercially available in the near future. Mobile ad hoc network technology would not replace all cellular infrastructure, but it could vastly improve efficiency, as it would rely on fewer cellular towers.

Additionally, there have been great advancements in the area of digital data compression. By employing techniques which reduce the wireless bandwidth required to send data such as photos, email, text and flash content, wireless broadband technology remains efficient in its optimization of available spectrum.

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50 Id.


52 Effros, supra note 49.

53 See generally Accelerated Broadband, Propel, http://www.propel.com/propel_direct/learn/broadband_propel.html (last visited Sept. 12, 2010); Solutions: Technology, Venturi Wireless,
Whether the usage is one-to-one, one-to-everyone, or anything in between, any inefficient use of spectrum can be viewed as wasteful or “hogging.” To further carry out the objective of ensuring that “our nation’s spectrum is put to its highest and best use,” Chairman Genochowski recently announced the launch of the Spectrum Task Force, whose purpose is to carry out the NBP’s roadmap for creating greater spectrum efficiency.

In addition, the FCC has conducted extensive modeling and analysis to determine the best spectrum repacking solutions. The spectrum analysis in Options for Broadcast Spectrum, OBI Technical Paper No. 3 explains that “through channel sharing, the FCC may be able to repack channel assignments more efficiently to fit current stations with existing 6 MHz licenses into fewer total channels, thus freeing spectrum for reallocation to broadband use.”

For the first time, the FCC has launched a “spectrum dashboard” which allows the public to view spectrum usage in the bands from 225 MHz to 3.7 GHz. The dashboard allows for greater transparency, showing how spectrum is being used, who owns the licenses and what spectrum is available. The NAB notes that the dashboard does not currently cover all bands, and believes that a comprehensive inventory of spectrum allocation, including that spectrum allocated for Federal government use, would be in the public interest.


55 The Spectrum Task Force will be co-chaired by Julius Knapp, Chief of the Office of Engineering Technology, and Ruth Milkman, Chief of the Wireless Telecommunications Bureau and “will play a critical role in the execution of the spectrum recommendations in the National Broadband Plan, including long-term spectrum planning.” Id.

56 “‘Channel sharing’ involves two or more stations combining their transmissions to share a single six-megahertz channel.” OBI Technical Paper, supra note 7, at 14.


59 Id. at 10.
V. Conclusion

Efficient spectrum use is not a zero-sum situation. Consumers do not want to choose between broadcasting and broadband. As spectrum management policies are developed for the public good, a collaborative spirit will serve both broadcasters and wireless carriers alike in reaching maximum efficiency. To this end, Sprint Nextel recently announced that it cleared 35 MHz of broadcast auxiliary service spectrum to free more spectrum for mobile broadband use.60 The project involved replacing 100,000 pieces of television broadcasting equipment at more than 1,000 television broadcast stations nationwide. This work is an example of cross-industry collaboration, and was lauded as such by David Donovan, president of MSTV. The NAB and the Society of Broadcast Engineers also worked closely with Sprint Nextel on the project and are pleased with the result achieved.61

The wireless broadband revolution is upon us. As we move forward, the industry players and regulators must continue to work together to create balanced policies to support consumers’ ever increasing demand for wireless broadband while protecting the community’s interest in broadcast distribution and content.

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61 See id.