

ALERT

Third Circuit Vacates Newspaper/Broadcast Cross-Ownership Rule and Upholds FCC's Retention of Other Media Ownership Rules

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On July 7, 2011, the United States Court of Appeals for the Third Circuit issued its opinion in *Prometheus Radio Project v. FCC* (*Prometheus II*), which is the latest in a series of cases challenging decisions of the Federal Communications Commission (FCC or Commission) in periodic reviews of its media ownership rules pursuant to Section 202(h) of the Telecommunications Act of 1996. In its decision, the Third Circuit vacated the modestly deregulatory changes that the Commission had made to the newspaper/broadcast cross-ownership (NBCO) rule in its *2008 Media Ownership Order* and upheld the FCC's retention of the remainder of its media ownership rules. In addition, the court vacated and remanded portions of the FCC's related *2008 Diversity Order*, finding that the Commission failed to provide a reasoned analysis supporting its definition of so-called "eligible entities," a definition which is relevant to several rules designed to promote broadcast ownership by women and minorities. The Third Circuit directed the FCC to consider the remanded issues within the context of its 2010 Quadrennial Review and indicated that the *Prometheus II* panel would retain jurisdiction over those issues.

Prometheus II has its origins in the FCC's 2002 media ownership proceeding, in which the Commission adopted a number of deregulatory changes to its media ownership rules. In *Prometheus I*, however, the Third Circuit remanded many of the new rules to the FCC, finding that the Commission had failed to adequately justify its deregulatory decisions. In the *2008 Media Ownership Order* under review in *Prometheus II*, which also concluded the agency's 2006 Quadrennial Review, the FCC responded to the Third Circuit's remand,

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in many instances reversing course and reinstating rules as they had existed before the 2002 proceeding.

As discussed in more detail below, *Prometheus II* rejected calls by the media industry to declare the individual restrictions on media ownership insufficiently deregulatory to satisfy Section 202(h) or the Administrative Procedure Act (APA). In addition, the court once again rejected constitutional challenges to the media ownership rules, refusing to revisit the so-called "scarcity rationale" which has historically been relied upon to justify subjecting broadcast regulation to a lower level of First Amendment scrutiny. Indeed, the court stated that the scarcity rationale may have even more force today than it did in 1975, despite the dramatic technological and marketplace changes that have occurred over the several decades since its inception. Relying almost entirely on a 1978 Supreme Court decision which had upheld the NBCO rule against constitutional challenge following its initial adoption, the Third Circuit held that all of the media ownership rules today still constitute "reasonable means of promoting" the government's "substantial" interests in promoting competition and viewpoint diversity. The court also rejected arguments that the NBCO rule unfairly singles out newspapers for differential treatment in violation of the Fifth Amendment's equal protection clause, again relying on the same 1978 Supreme Court ruling.

In the sections that follow, we provide greater analysis of the Third Circuit's decisions as to each of the media ownership rules addressed in the *2008 Media Ownership Order*, as well as the *2008 Diversity Order*.

Newspaper/Broadcast Cross-Ownership

In the *2008 Media Ownership Order*, the FCC revised the NBCO rule, which previously had imposed an outright ban on common ownership of newspapers and broadcast stations, to incorporate presumption-based waiver standards which varied depending on the size of the market involved and the number and market rank of the properties which an entity proposed to own in common. In *Prometheus II*, media industry parties challenged these waiver standards as insufficiently deregulatory, while the so-called "Citizen Petitioners" argued that they were adopted without adequate notice and comment and were, in any event, too deregulatory.

Rather than addressing the rule changes on their merits, the Third Circuit accepted the Citizen Petitioners' procedural challenge and held that the FCC had failed to comply with the APA's notice and comment requirements. The court found that the Further Notice of Proposed Rulemaking (FNPRM) underlying the *2008 Media Ownership Order* "did not contain enough information about what [the Commission] was planning to do, or the option it was considering, to provide the public with a meaningful opportunity to comment." (By contrast, the Third Circuit observed that the Notice of Inquiry issued in May 2010 as part of the 2010 Quadrennial Review "is much more specific and covers many other issues," offering potential insight into how it may view rules emanating from the now-pending 2010 Quadrennial Review.)

Although then-Chairman Kevin Martin had subsequently published an op-ed piece in the *New York Times* unveiling the details of the proposed rule changes in advance of their adoption and the agency issued a press release setting a 28-day deadline for public comment on his proposal, the court held that these actions did not satisfy the APA's notice and comment requirements either. While indicating that the proposal in the op-

ed and press release might have contained the requisite level of detail, the court termed the process that the Commission had employed "irregular" and found that it had fatal legal flaws: the proposal was not published in the Federal Register, it only represented the opinion of one commissioner, and it did not provide a sufficient comment period.

The court faulted other aspects of the process which led to the *2008 Media Ownership Order* as well, including the circulation of a draft order two weeks before the comment period on Martin's proposal ended and the holding of a final vote within a week of the comment deadline. This, the Third Circuit found, was "not the agency engagement the APA contemplates." Accordingly, the court vacated the NBCO rule adopted in the *2008 Media Ownership Order* - an action which the Third Circuit made clear has the effect of reinstating the absolute ban on newspaper/broadcast cross-ownership which had previously existed - and remanded due to the agency's failure to provide adequate opportunity for notice and comment.

Dissenting from this aspect of the opinion, Chief Judge Scirica took issue with the majority's limited reading of the FNPRM, expressing the view that the parties understood that the notice was written in the context of *Prometheus I* and prior FCC actions, including a 2001 Notice of Proposed Rulemaking that had contained similar presumptions to those ultimately adopted in the *2008 Media Ownership Order*. His separate opinion also indicated that he would have upheld the NBCO rule as revised by the *2008 Media Ownership Order*.

The *2008 Media Ownership Order* also granted five permanent waivers of the NBCO rule, waivers which the Citizen Petitioners sought to challenge in *Prometheus II*. The Third Circuit found that it lacked jurisdiction to consider the waiver challenges because the arguments that the Citizen Petitioners were attempting to press before the court had not previously been presented to the FCC.

Radio/Television Cross-Ownership

In the *2008 Media Ownership Order*, the FCC restored the radio/television cross-ownership rule that it had first adopted in 1999. Under this rule, a party may: (1) own up to two television stations and six radio stations in a market with at least 20 independent media "voices;" (2) own up to two television stations and four radio stations in a market with at least 10 independent media "voices;" and (3) in all other markets own up to two television stations and one radio station (subject to further restriction in the local television and radio ownership rules).

In *Prometheus II*, media industry parties challenged the Commission's return to this rule, arguing that the FCC had failed to provide a reasoned explanation for why it is necessary to restrict radio/television cross-ownership when there are separate limits on local ownership of radio and television stations. The Third Circuit rejected this argument, instead accepting the Commission's rationale that cross-ownership rules serve its interest in diversity, while local ownership rules promote competition. The court also accepted, over the media industry parties' challenge, the FCC's findings that ownership can influence viewpoint diversity; that increased diversity and competition from new media do not warrant a modification of the rules given the importance of newspapers and broadcast stations as sources of local news; that the lines that it drew between markets of different sizes were reasonable; and that radio and television stations could rationally be treated differently

for some purposes but as equivalents for others.

Local Television Ownership

In the *2008 Media Ownership Order*, the FCC also restored its 1999 local television ownership rule. That rule (also referred to as the "duopoly" rule) permits an entity to own two television stations in the same DMA if (1) the Grade B contours of the stations do not overlap or (2) at least one of the stations is not ranked in the top four stations in the market and the market would maintain at least eight independently-owned full-power, non-commercial television stations after the combination. (The second part of this rule incorporates the so-called "top-four" restriction and the "eight-voices" test.) In *Prometheus II*, media industry parties challenged the Commission's decision on the local television ownership rule as too regulatory, while the Citizen Petitioners argued that the rule should have been tightened even further.

The court addressed the media industry parties' arguments first. Although recognizing that the *2008 Media Ownership Order* represented a reversal of the Commission's prior conclusion (reached in the order under review in *Prometheus I*) that the rule in its pre-2003 form was no longer necessary, the Third Circuit upheld the FCC's change of course as rational. In so doing, the court approved the Commission's decision to abandon its prior rationale for the rule - diversity - in favor of a new one - competition for viewers and in local television advertising markets. Meanwhile, the court refused to require the Commission even to address meaningfully whether to allow ownership of three stations (so-called "triopolies") in very large markets, finding that the FCC "need not address other solutions to the same problem."

The court also accepted the FCC's justification for limiting ownership of two stations (or "duopolies") to markets in which eight independent voices will remain and where the combined stations are not both in the top-four. Rejecting challenges to the eight-voices test, the Third Circuit approved the Commission's choice of eight voices as a reasonable exercise of agency line-drawing. In addition, although the D.C. Circuit had previously determined that preserving diversity of viewpoints does *not* sufficiently support excluding non-broadcast media from the number of voices in a market, the Third Circuit ruled that the agency had provided a new and permissible rationale for its decision to exclude such voices - the need to preserve competition in a limited "local television market." Similarly, the court rejected challenges to the top-four restriction, finding that the Commission reasonably relied on the dominant position of the four highest-ranked television stations in most markets in retaining it.

At the same time, the Third Circuit rejected the Citizen Petitioners' argument that the local television ownership rule should have been tightened in light of television broadcasters' digital multicasting capabilities. Although the court relied in part on the fact that the *2008 Media Ownership Order* was issued before the digital transition was complete, it offered potential guidance to the Commission for its 2010 Quadrennial Review, observing that because the existing rule did not harm competition, "the FCC did not need to promulgate a more restrictive rule just because entities may gain similar economies of scale and generate new revenue by multicasting."

Local Radio Ownership

In the *2008 Media Ownership Order*, the FCC retained the existing local radio ownership rule, including the overall numerical limits and the AM/FM subcaps, intact. Media industry parties challenged this decision as insufficiently deregulatory, but, here again, the Third Circuit rejected their challenges.

Affirming the retention of the overall numerical limits, the court accepted the Commission's "balancing" rationale, under which it had found that allowing greater consolidation might undermine its interest in ensuring sufficient diversity and competition, while tightening the rule would fail to recognize that certain efficiencies flow from common ownership. The Third Circuit rejected arguments that the FCC failed to adequately explain why it disregarded a study which found that consolidation had no impact on advertising prices, instead accepting the Commission's reliance on a conflicting study that reached the opposite conclusion. The court also found that the FCC was free to rely on evidence of consolidation at the *national* level, even though the rules concern consolidation only at the *local* level. In addition, the Third Circuit dismissed arguments that the FCC should have considered allowing greater levels of common ownership in the nation's very largest markets, stating that the agency was not required to demonstrate that its rule was superior to alternative proposals, but only that the rule it retained was based on reasoned analysis supported by evidence.

As to the AM/FM subcaps, the court first addressed the validity of the AM subcap. It accepted the FCC's finding that there are technical and marketplace differences between AM and FM stations, and that although many of those differences might justify an FM-only subcap, the competitive viability of some AM stations justified retaining the subcaps on both services. In addition, the Third Circuit rejected contentions that the transition to digital radio has obviated the need for the subcaps. The court noted that the transition is in its initial stages and cited approvingly to the Commission's finding that, at least at present, the transition may exacerbate the technical differences between AM and FM stations because FM stations have rights to greater spectrum and are farther along in the transition. At the same time, the Third Circuit acknowledged that "the digital transition may ultimately have a significant effect on the technological and economic advantages of FM stations."

Dual Network Rule

In the *2008 Media Ownership Order*, the FCC retained intact the dual network rule, which prohibits a single entity from owning more than one of the top four networks. In *Prometheus II*, the Third Circuit upheld this decision against a challenge from the media industry. In rejecting arguments that the rule is unnecessary, the court accepted the Commission's arguments that the top four networks are unique for their vertical integration, operation as a strategic group, and broad appeal (as opposed to the "more specialized, niche" appeal of emerging networks). Given the "unique role" of the top four networks, the court agreed with the FCC's finding that the harm to competition from mergers of those networks justifies the preservation of the rule.

2008 Diversity Order

In its *Prometheus I* decision, the Third Circuit criticized the FCC's attempts to address broadcast ownership by minorities and women and ordered the Commission to consider certain related matters on remand. In the *2008 Diversity Order*, the FCC addressed the Third Circuit's remand and, among other things, adopted a number of rule changes designed to promote minority and female broadcast ownership as well as a definition of "eligible entities" to be used to determine those entitled to take advantage of certain of those rule changes. The Commission modeled its "eligible entity" definition on standards employed by the Small Business Administration (SBA), which are based on revenue rather than race, ethnicity, or gender. In support of its revenue-based approach, the FCC relied on the shortcomings in its data regarding minority and female ownership and on the Supreme Court's decision in *Adarand Constructors, Inc. v. Peña*, which applied strict scrutiny to certain government classifications based on race.

Citizen Petitioners challenged the FCC's reliance on a revenue-based definition, claiming that the Commission failed to provide adequate explanation or evidence that the definition would advance its stated goal of advancing minority and female broadcast ownership. The Third Circuit agreed, noting that minorities constitute almost the same percentage of small business broadcasters as they do general commercial broadcasters. The court also took the Commission to task for its lack of data on minority and female ownership, a problem which the agency itself had acknowledged. Noting that the FCC had already opened a rulemaking designed to collect such data, the Third Circuit expressed hope that the new proceeding would "lay necessary groundwork for the Commission's actions on remand." As a result of the analytical failings that it identified with respect to the "eligible entity" definition, the court vacated the aspects of the *2008 Diversity Order* which relied on it.

The Commission will now have to determine how to address the Third Circuit's *Prometheus II* decision in the context of its pending 2010 Quadrennial Review, in which we expect a Notice of Proposed Rulemaking to be issued in the near future. In addition, parties to the case may elect to request rehearing or rehearing *en banc* by the Third Circuit, and/or to petition for a writ of *certiorari* before the Supreme Court of the United States.