

ALERT

FCC Grants Pandora Relief from the Communications Act's 25% Foreign Ownership Limit

May 6, 2015

As we predicted last week, the Federal Communications Commission (FCC or Commission) has acted on the request by Internet streaming music provider Pandora for permission to exceed the 25% benchmark for foreign investment in broadcast licensee parent companies imposed by Section 310(b)(4) of the Communications Act. In the Pandora Ruling, the FCC authorized foreign investors to hold up to an aggregate 49.99% voting and/or equity interest in Pandora Media, the parent company of Pandora Radio, without additional Commission approval, provided that a majority of its Board of Directors remain United States citizens and subject to certain conditions.

The ruling arises in the context of Pandora Radio's request - first submitted nearly two years ago - for FCC approval of its acquisition of a South Dakota radio station. As we explained previously, Pandora Radio sought to obtain the station in part to qualify for lower copyright performance royalties in connection with its webcasting service. Its application drew opposition from the American Society of Composers, Authors, and Publishers (ASCAP), one of the major performance royalty organizations. Among other things, ASCAP contended that Pandora Radio's application failed adequately to demonstrate compliance with the FCC's foreign ownership limits.

When Pandora Radio initially submitted its application, the FCC had applied a *de facto* rule prohibiting investment in broadcast licensee parent companies in excess of 25%. Subsequently, however, the FCC issued a Declaratory Ruling clarifying that it would consider, on a case-by-case basis, requests to exceed the 25% limit in the broadcast

Authors

Wayne D. Johnsen
Partner
202.719.7303
wjohnsen@wiley.law

Kathleen A. Kirby
Partner
202.719.3360
kkirby@wiley.law

Gregory L. Masters
Partner
202.719.7370
gmasters@wiley.law

Eve Klindera Reed
Partner
202.719.7404
ereed@wiley.law

Practice Areas

Media
Telecom, Media & Technology

context. Pandora Radio thereafter submitted the Petition for Declaratory Ruling that gave rise to the FCC's recent ruling, which sought permission for Pandora Media to exceed the 25% benchmark under Section 310(b)(4). In its Pandora Ruling, the FCC found that acceptance of Pandora Radio's proposal would not contravene the public interest, subject to certain conditions the FCC imposed and in the specific situation presented by the proposed acquisition.

In particular, the FCC explained that "[n]either the Commission nor the Executive Branch agencies have identified harm to the public interest posed by Pandora Media's current level of unidentified but widely dispersed foreign ownership, where no single foreign individual or entity holds an attributable five percent or greater voting interest in Pandora's outstanding stock." The agency went on to identify two "safeguards" that will effectively prevent acquisition of significant influence over Pandora Media by foreign shareholders without prior Commission approval and without giving Pandora the opportunity to take preventative or remedial actions.

- First, the FCC noted that under SEC shareholder disclosure rules, "any interest in a publicly traded company above five percent of any class of registered equity securities must be timely reported to the SEC and the issuer of the securities,...and any voting interest of five percent or greater also generally makes the interest cognizable under the Commission's attribution rules."
- Second, the FCC noted that "the SEC also requires a shareholder to disclose promptly any plan to influence the management or operation of an issuing company."

Notwithstanding these "safeguards," the FCC imposed additional restrictions and conditions upon Pandora's ability to exceed the 25% foreign ownership benchmark. Under the Pandora Ruling, Pandora must obtain prior Commission approval for:

- Aggregate foreign equity and/or foreign voting interests in Pandora Media exceeding 49.99%;
- Any change in the Pandora Media Board of Directors that would result in a majority of foreign members; or
- Any individual foreign investor or "group" acquiring a greater than 5% voting or equity interest (or 10% for certain institutional investors) in Pandora Media.

The FCC also required Pandora Media to modify its organizational documents in a number of respects, to ensure that its Board of Directors has the power to implement the requirements of the Pandora Ruling. Specifically, the FCC identified certain "broadcast industry best practices," including providing the Board with the right "to request and obtain information regarding the citizenship of beneficial owners and those with voting rights and, if necessary to comply with Section 310(b)(4) or any requirement or condition of th[e] [Pandora] Ruling, the right to take any and all actions that the Board of Directors deems necessary to so comply or cure any noncompliance." The agency thus mandated that Pandora Media amend its organizational documents to include:

- The right to restrict the transfer of shares to aliens;

- The right to require disclosure when an alien acquires beneficial ownership of, or voting interest in, shares; and
- The right to compel the redemption of shares held by aliens.

In addition, the FCC required Pandora Media to continue to monitor its foreign ownership over time and to certify that it continues to meet the conditions of the Pandora Ruling every two years, at the same time it files its Biennial Ownership Report. Again referring to "broadcast industry compliance practices," the FCC suggested that Pandora Media could satisfy its obligation to "diligently seek to identify the citizenship of beneficial owners and those with voting right in numbers sufficient to" support a certification of compliance in the following ways:

- Entering into the Depository Trust Corporation (DTC) SEG-100 or equivalent program that allows for the deposit of foreign-owned shares into a segregated account for monitoring of shares;
- Monitoring shares held by current or former officers and directors;
- Monitoring relevant SEC filings, such as Form 13F, Schedule 13D, Schedule 13G, and Form ADV;
- As to each investor or entity submitting such SEC filings, reviewing the reports, consulting other publicly available sources, and contacting the filer as necessary (consistent with SEC privacy regulations and the company's governing documents) to obtain additional citizenship information;
- Requesting that Broadridge Financial Services (or an equivalent company) provide Pandora with a non-objecting beneficial owner (NOBO) list (i.e., a list of beneficial owners that own shares through a broker or bank intermediary and that do not object to having their identifying information reported to the issuer), and seeking citizenship information from all NOBOs in connection with annual meeting proxy notices; and
- Committing to make reasonable efforts to secure the cooperation of the relevant financial intermediaries in obtaining citizenship information.

The FCC emphasized that it expects Pandora Media "to use sources other than shareholder mailing addresses or corporate headquarters locations," even though it permits reliance on such addresses and locations outside of the broadcast context.

Pandora must submit to the FCC a list of the steps it has taken or intends to take to ensure compliance with the Pandora Ruling, as well as a detailed description of the methodology that Pandora Media will use to make its biennial certification, within 90 days of the Pandora Ruling. The Media Bureau, acting on delegated authority, will review and approve Pandora's submissions, which will then become further conditions of the FCC's grant of the Pandora Ruling. The Bureau will not resume processing of Pandora's assignment application until a satisfactory submission has been received.

Commissioners Pai and O'Rielly issued concurring statements. Commissioner Pai pointed out the disparity between the Commission's treatment of other types of communications companies, in which foreign companies can own majority interests, and the treatment afforded to broadcasters under the Pandora Ruling. He noted, moreover, that the evidence in the record suggested that Pandora's foreign ownership fell below

the 25% benchmark, rendering the exercise of "deciding to decide" whether it could exceed that benchmark unnecessarily burdensome for the Commission and Pandora alike. Commissioner Pai stated that he was thus pleased that the FCC committed to examining in the near future whether to revise its methodology for assessing compliance with the 25% benchmark in the broadcast context, because the FCC's current "outdated methodology may simply discourage capital from flowing into the broadcast space - which undermines struggling broadcasters, particularly rural and minority-owned stations."

Commissioner O'Rielly similarly criticized the Pandora Ruling as imposing undue burdens on Pandora, and urged the Commission to go beyond the case-by-case approach to foreign investment in the broadcast context. He suggested, moreover, that further actions in this area "should not include the types of burdensome conditions set forth in this ruling, which have the potential to entrap any investment plan in a web of red tape for no value." Commissioner O'Rielly expressed appreciation for Chairman Wheeler's commitment to work towards "an overall liberalization of [the FCC's] broadcast-related foreign ownership rules," and thus the clarification that the actions taken in the Pandora Ruling are specific to the facts presented in this case.

The implications of the FCC's Pandora Ruling on other broadcasters seeking to exceed the 25% foreign ownership benchmark are unclear. The Commission took pains to emphasize the narrowness of its ruling, noting specifically that the actions it was taking were specific to Pandora and the facts presented in its Petition for Declaratory Ruling. The FCC stated, moreover, that it "intend[s] to examine in the near future whether it would be appropriate for the Commission to revise its methodology for assessing compliance with Section 310(b)(4) in the broadcast context."

In the meantime, a few things can be gleaned from the Pandora Ruling. As an initial matter, the FCC has confirmed (again) that broadcasters, unlike other communications companies, cannot rely on addresses of record to determine foreign ownership levels. In addition, the FCC has laid out provisions that broadcast companies should consider including in their organizational documents to permit them to ensure compliance with the foreign ownership benchmark. The ruling also provides some guidance regarding measures that broadcast companies may be able to employ to demonstrate compliance. Additional guidance can be expected to come through additional declaratory rulings on a case-by-case basis, or through the follow-on proceeding that the Pandora Ruling and concurring statements signal the agency may initiate.