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THE *COMMLAW* GROUP

FCC REGULATIONS GOVERNING TRANSFERS OF CONTROL

**FCC Regulations Governing Transfers of Control
and Asset Transfers Involving Telecom Services**

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Primer on FCC Regulations Governing Transfers of Control and Asset Transfers Involving Telecom Services

Through the years, both our law firm and its affiliated consulting arm, The Compliance Group, have assisted hundreds of telecommunications service providers with an assortment of regulatory compliance matters on a nationwide basis. Next to the Federal Communications Commission's ("FCC" or "the Commission") Universal Service Fund ("USF") program (which wins the prize as the most complex, rigid, and maddening regulatory regime impacting the telecommunications industry), the regulatory requirements that seem to give the industry the most heartburn are the FCC's rules governing transactions, mergers, asset sales, and transfers of control (to an equal extent, State Utility Commission rules covering transactions involving regulated entities, or their assets). For purposes of this Educational Advisory, we will refer to the entire body of these regulations as "Transfer of Control" rules.

Our law firm has represented numerous clients by assisting them in the navigation of both the FCC, and State Transfer of Control processes. All too often, we are alerted to such transactions only AFTER they have been consummated. With few exceptions, any time companies close a transaction involving regulated telecommunications assets without first obtaining FCC authorization, we must not only take corrective measures necessary to procure authorization, we must then contend with the resulting FCC Enforcement Bureau investigation.

The purpose of this Educational Advisory is to share our firm's collective experience representing clients before the FCC's Wireline Competition, International, Wireless, and Enforcement Bureaus in all forms of transactional matters.

We hope you find the following information both useful and informative.

I. Introduction to Transfer of Control Rules

Over the past year, transactions in the telecommunications services sector have started showing signs of life, following a long and deep slumber. In addition to the mega-mergers that everyone is keenly aware of due to national press coverage (e.g., Sprint's \$21.6 billion tie-up with Japan's SoftBank Corp., and Verizon's \$130 billion acquisition of British Vodafone Group Plc), there have been several dozen transactions involving small and mid-size providers throughout the country. Many of these transactions would go unnoticed if not for the public dissemination of Transfer of Control filings made with the FCC. Indeed, many more transactions go unnoticed until the FCC announces an investigation through a Notice of Apparent Liability for Forfeiture ("NAL"), or resolution of an investigation of alleged non-compliance through a Consent Decree.

Despite general awareness that the telecommunications industry is heavily regulated, we have recently witnessed a widespread lack of understanding of both state and federal regulations governing mergers and acquisitions among carriers. These burdensome regulations, coupled with a potentially lengthy and time-consuming regulatory approval processes – largely unchanged from the days of the monolithic telecommunications companies of the 20th Century – oftentimes throw sand in the gears of the otherwise fast-paced, highly-competitive telecommunications marketplace. Failing to take into account the "regulatory approval" requirements, processes, and timelines when contemplating a transaction involving regulated assets can result in many unexpected and unintended adverse consequences. Such outcomes may not only impact current business plans and growth initiatives, but future ones as well.

II. FCC Regulations

Section 214 telecommunications carriers seeking to transfer assets or corporate control must be aware of the Commission's rules regarding such transactions. The FCC distinguishes between "transfers of control", and "assignments of licenses" as forms of transactions involving telecommunications carriers. The FCC defines a transfer of control as "a transaction in which the FCC license or authorization remains held by the same entity, but there is a change in the entity or entities that control the authorization holder."¹ In contrast, an assignment of license is defined as "a transaction in which the authorization is assigned from one entity to another" so that "the authorization is held by an entity other than the one to which it was originally granted."² Furthermore, the FCC considers the sale of a carrier's customer base, or a portion thereof, to another carrier to be an assignment of license. Oftentimes, transactions involving telecommunications carriers involve a combination of transfers of control, and assignments of licenses depending on the transaction's level of complexity. However, transfers of control are subject to more complex regulations.

Specifically, the FCC defines a transfer of control as a transaction resulting in a change of an ownership share from less than 50 percent, to more than 50 percent. The reverse constitutes a transfer of control

as well.³ If these criteria are not met, the Commission evaluates those transactions on a case-by-case basis to determine whether or not the transaction is considered a transfer of control for the purposes of the FCC's evaluation, and ultimate approval of the deal.

III. Substantial and Non-Substantial Transfers of Control

For evaluation purposes, the FCC distinguishes between "substantial", and "non-substantial" transfers of control. Whether a proposed transfer of control is considered substantial or non-substantial depends on whether the transaction results in a change in the ultimate ownership of a carrier's authorizations or lines of operation. The Commission determines the ultimate ownership, or "control," on a case-by-case basis according to the following factors: (1) power to constitute or appoint more than 50 percent of the board of directors or partnership management committee; (2) authority to appoint, promote, demote, or fire senior executives controlling the daily activities of the licensee; (3) ability to play an integral role in major management decisions of the licensee; (4) ability to receive monies or profits from the facilities' operations; and (5) unfettered use of all facilities and equipment.⁴

a. Substantial Transfers of Control

The FCC considers a transfer of control as "substantial" when there is a change in the ultimate ownership or control of a telecommunications carrier's lines or authorization to operate. When a transfer of control is considered substantial, the FCC requires carriers to receive Commission approval prior to consummation of the proposed transaction via application. The specific requirements depend on whether the telecommunications carrier is considered a domestic or international carrier under the Commission's rules.

Domestic: The majority of telecommunications carriers proposing a substantial transfer of control of domestic authorizations or lines of operation are given streamlined processing treatment.⁵ Thus, such applications normally result in an automatic approval within 31 days of the FCC's Public Notice listing the application as accepted for filing.⁶

However, the Chief of the FCC's Wireline Competition Bureau can revoke the streamlined processing status of domestic substantial transfer of control applications under certain circumstances. Such circumstances include the following: (1) the application is associated with a non-routine request for waiver of the Commission's rules; (2) the application facially violates a provision of the Commission's rules or the Communications Act; (3) a carrier fails to respond promptly to the Commission's inquiries; or (4) timely-filed comments on the application raise public interest concerns requiring further investigation.⁷ Ultimately, the FCC must act on such an application no later than 180 days after publication of the Public Notice listing the application as accepted for filing.

Applications for substantial transfer of control of domestic authorizations are subject to the following requirements under Part 63 of the Commission's rules. A carrier-applicant must provide the FCC:

- 1) contact information (e.g., name, address, and telephone number);
- 2) official corporate or partnership organization documentation;
- 3) contact information for the applicant's legal counsel;
- 4) the name, address, citizenship, and principal business of any person or entity that directly or indirectly owns at least ten percent of the equity of the applicant, and the percentage of equity owned by each of those entities;
- 5) certification that no party to the application is subject to a denial of Federal benefits pursuant to Section 5301 of the Anti-Drug Abuse Act of 1988⁸;
- 6) a description of the transaction;
- 7) the geographic areas and type of services that the transferor and transferee (and their affiliates) offer domestic telecommunications services;
- 8) a statement as to why the application deserves streamlined treatment;
- 9) list of all Commission applications related to the transaction;
- 10) request for special treatment due to impending bankruptcy;
- 11) list of any waiver requests sought in conjunction with the transaction; and
- 12) a statement showing how the transaction's consummation serves the public interest, convenience and necessity.⁹

International: Carriers proposing substantial transfers of control of international authorizations or lines of operation under Section 214 of the Communications Act are required to apply for FCC approval prior to consummation of the transaction.¹⁰ Streamlined review is possible. If the streamlined review requirements are satisfied, the Commission will approve substantial transfers of control of international authorizations within 14 days of publication of Public Notice of the application's filing with the FCC.

However, the Chief of the FCC's International Bureau may remove an application from streamlined processing if the applicant is a dominant carrier that is affiliated with a foreign carrier in a destination market, or an applicant has significant foreign ownership.¹¹ When the Chief of the International Bureau takes such action, the FCC will issue a Public Notice indicating that the application is ineligible for streamlined processing. However, the Commission normally takes action on such an application within 90 days of publication of the Public Notice. The Commission is free to repeatedly extend the 90-day review period for additional 90-day periods, until it reaches its decision on the application.¹² When an application is removed from streamlined processing, the application will likely be referred

to “Team Telecom” for review of the application for national security purposes. Generally speaking, Team Telecom will pull any application of a telecommunications carrier with foreign ownership for further review.

Applications for substantial transfer of control of international authorizations are subject to extensive requirements under Sections 63.18 and 63.24(e)(2) of the Commission’s rules. Notably, the carrier must disclose to the FCC that: (1) affiliation or ownership by foreign carriers or other entities; (2) the nature of their business in foreign countries; (3) the names of those countries; (4) and the nature of telecommunications and competition regulations in those countries.

b. Non-Substantial Transfers of Control

The FCC will consider a transfer of control to be “non-substantial”, or pro forma, when there is no change in the ultimate control of a telecommunications carrier’s lines or authorization to operate. Such transactions are subject to limited notification requirements with the Commission.¹³ There are roughly seven forms of transactions that the FCC deems presumptively non-substantial. They are transfers:

- 1) from an individual to individuals (including partnerships) or a corporation owned and controlled by such individuals/partnership without any substantial change in their relative interests;
- 2) by which certain stockholders retire and the interest transferred is not a controlling one;
- 3) from a corporation to its individual stockholders without effecting any substantial change in the disposition of their interests;
- 4) involving corporate reorganization where there is no substantial change in the ultimate ownership of the corporation (e.g., reincorporation in a different jurisdiction or change form of the business entity);
- 5) from a corporation to a wholly direct or indirect subsidiary thereof or vice versa;
- 6) from a corporation to a corporation owned and controlled by the assignor stockholders without substantial change in their interests; or
- 7) of a less than controlling interest in a partnership.¹⁴

As with substantial transactions, the specific requirements for non-substantial transactions depend on whether the carrier is considered a domestic or international carrier under the Commission’s rules.

Domestic: Carriers proposing a non-substantial transfer of control of a domestic authorization are generally not required to file a post-consummation notice of the transaction. However, this rule is

subject to the following exceptions when the transaction involves bankruptcy proceedings: (1) transfer is to a bankruptcy trustee under Chapter 7 of the Bankruptcy Code; (2) a debtor-in-possession under Chapter 11 of the Bankruptcy Code; or (3) any other party pursuant to an applicable chapter of the Bankruptcy Code. Under these circumstances, the transferee must notify the Commission within 30 days of consummation of the transaction.¹⁵

International: Carriers proposing a non-substantial transfer of control of a international authorization are required to notify the Commission of the transaction within 30 days of the consummation.¹⁶

Unauthorized Transfers of Control

Currently, the FCC is very aggressive in enforcing the transfer of control rules. In general, if a Section 214 telecommunications carrier applies for FCC authorization after the transaction has been consummated, the FCC's International Bureau will refer the matter to the FCC's Enforcement Bureau for investigation. Typically, the International Bureau will also delay approval of the transfer of control application until the Enforcement Bureau has completed its investigation. The Enforcement Bureau has the discretion of whether or not to investigate the matter, and issue a Notice of Apparent Liability, proposing forfeiture against the carrier for failure to obtain prior FCC approval for the transfer of control. Unfortunately, we cannot predict when the Enforcement Bureau will act on such a referral from the International Bureau.

If the Enforcement Bureau decides to proceed with an enforcement action against a carrier, the Bureau will likely propose a base forfeiture about of \$8,000.00. Typically, the Enforcement Bureau will propose only the base forfeiture amount unless specific factors suggest that either an upward or downward adjustment to the base amount is warranted.¹⁷ In determining whether to adjust the base forfeiture amount up or down, the Enforcement Bureau considers the following facts: "the nature, circumstances, extent, and gravity of the violations . . . and the degree of culpability, any history of prior offenses, the ability to pay, and such other matters as justice may require."¹⁸ Thus, it is difficult to predict how the Enforcement Bureau will handle a transfer of control application submitted after consummation of a transaction because the Bureau essentially determines the issue on a case-by-case basis.

Our firm has witnessed a number of enforcement actions in recent years. Most actions have proposed the base forfeiture amount of \$8,000.00 for each violation of the Commission's transfer of control rules. For example, the Enforcement Bureau recently settled with AccessLine Communications Corporation via consent decree for a total of \$16,000.00 for two violations of the transfer of control rules. The violations include: (1) \$8,000.00 for failure to obtain proper authorization for the transfer of control of an international Section 214 authority; (2) \$8,000.00 for failure to obtain to obtain proper authorization for the transfer of control of an domestic Section 214 authority.¹⁹ Furthermore, the consent decree required AccessLine to implement an internal mechanism to enforce Section 214

compliance. This case demonstrates the multiple ways in which the Enforcement Bureau can impose long-term penalties upon carriers for failure to obtain FCC approval prior to consummation of a transfer of control.

FCC Red Light Display System

The FCC adopted the Red Light Display System as part of the Commission's compliance with the Debt Collection Improvement Act of 1996.²⁰ If the carrier-applicant is delinquent on any non-tax debts owed to the Commission, the "Red Light Rule" requires the dismissal of all applications, including transfers of control. Such debts include, but are not limited to, the following: (1) unpaid, underpaid, or late regulatory fees subject to a 25 percent penalty fee; (2) unpaid or underpaid application fees; (3) delinquent installment agreements; (4) unpaid or underpaid Freedom of Information Act search and duplication fees; and (5) overdue Universal Service Fund, Telecommunications Relay Service, or North American Numbering Plan Administration payments. The FCC does not dismiss an application of carrier with a delinquent debt outright. Instead, the FCC notifies the carrier of the debt, and provides the carrier with 30 days to pay the debt in full or make other permissible arrangements (e.g., a payment installment agreement). If after 30 days the carrier takes no such action, the Commission will dismiss the application.

Prior to filing a transfer of control application, carriers should check to ensure that they do not have any delinquent debts with the Commission. Carriers can do this by visiting the FCC's Red Light Display System at: <https://apps.fcc.gov/redlight/login.cfm>. A status of "Green" means that the carrier has no delinquent debts restricting them from conducting business with the FCC, and thus is free to file a transfer of control application. However, a status of "Red" indicates that the carrier has delinquent debts that must be satisfied before the FCC will review their transfer of control application. The Red Light Display System provides carriers with a method of online payment by credit card. However, in some instances, debts listed in the Red Light Display System must be paid directly to the U.S. Treasury via regular mail. Carriers facing payment of delinquent debts to the Commission should check with counsel before making such payments.

Team Telecom

The FCC refers substantial transfer of control applications to "Team Telecom" for review where the transferee has a 10 percent or more of a foreign ownership share. Once the application has been referred, Team Telecom will often ask for ownership information down to the 5 percent level. Team Telecom is comprised of representatives from the U.S. Department of Homeland Security, U.S. Department of Justice (including the Federal Bureau of Investigations), U.S. Department of Commerce, U.S. Department of Defense, U.S. Department of State, U.S. Department of Treasury, and the Office of the U.S. Trade Representative. The committee is responsible for reviewing mergers and acquisitions involving telecommunications carriers for possible national security issues.

Based on its review, Team Telecom may have no issue with a transfer of control application referred to them by the FCC. On the other hand, Team Telecom may request that the FCC condition their grant of an application with assurances made by the carrier in either an exchange of letters, or a formal security agreement. The FCC will not act on an application until Team Telecom has completed their review of the application. The duration of Team Telecom's review varies from case to case, and is dependent on the carrier's unique circumstances (e.g., the carrier's past history, or country of origin). Generally, their review takes between six to eleven months to complete. A carrier's lack of full disclosure on the questions presented by Team Telecom to the carrier can also extend the duration of a review. It is important to remember that the foreign ownership of the company means that the company cannot provide telecommunications service within the United States without Section 214 authorization. Otherwise, the company will be fined.

State Regulations

Unlike at the federal level, state approvals of transfers of control among telecommunications carriers vary greatly state to state. Some states require a full application for consent to the transfer with the state regulatory authority, while some states require a simple notification. On average, it takes about two to six months to receive state approval of the transaction. Some states require notice prior to the transaction, while other states require notice after the transaction is consummated. When the transaction involves a transfer of state certificates of public convenience and necessity, state approval or notice may be required before the transaction occurs. Due to the multiple variations in state regulation of mergers and acquisitions involving the telecommunications industry, carriers should consult with counsel prior to initiating a transaction to ensure that all state requirements are properly satisfied.

If you are contemplating a transaction that may entail a Transfer of Control or acquisition of regulated telecommunications services assets, contact The CommLaw Group today.

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¹ 147 C.F.R. § 63.24(c).

² *Id.* at § 63.24(b).

³ *See* §§ 63.04(d), 63.24(c).

⁴ *See* §§ 63.04(d), 63.24(d).

⁵ § 63.03(b).

⁶ See *id.* at § 63.03(a).

⁷ See *id.* at § 63.03(c).

⁸ See 21 U.S.C. § 853.

⁹ See 47 C.F.R. § 63.03(a) *et al.*

¹⁰ *Id.* at § 63.12(a).

¹¹ *Id.* at § 63.12(c).

¹² See *id.* § 63.12(d).

¹³ §§ 63.04(d), 63.24(d).

¹⁴ §§ 63.04(d), 63.24(d).

¹⁵ See § 63.03(d)(2).

¹⁶ § 63.24(f)(2).

¹⁷ See § 1.80(b)(6); *In The Matter Of The Commission's Forfeiture Policy Statement And Amendment Of Section 1.80 Of The Rules To Incorporate The Forfeiture Guidelines*, Report and Order, CI Docket No. 95-6, 12 FCC Rcd. 17087, 17113 (1997).

¹⁸ 47 U.S.C. § 503(b)(2)(E); *see also* 47 C.F.R. § 1.80(b)(6).

¹⁹ See *In the Matter of AccessLine Communications Corporation*, File No. EB-13-IH-0280, Consent Decree, DA 13-1556 (rel. Jul. 17, 2013).

²⁰ See 47 C.F.R. §§ 1.1901-1.1953.