FCC Liability Lurks for Unwary in Mergers and Acquisitions

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As the economy improves, merger and acquisition activity continues to surge.[1] Deadlines keep getting shorter as deals get more complicated. Due diligence efforts can easily overlook ancillary issues that can impact closing.

Non-telecommunications businesses increasingly rely on telecommunications technologies, many of which are subject to Federal Communications Commission ("FCC") licenses.[2] Energy companies, hospital systems, mining operations, transportation companies and warehousing facilities all depend on private wireless technology for voice and data communications (i.e., pagers and two-way radios). Companies utilize technology to control their business operations and production processes, protect worker and public safety and respond quickly to emergencies.

The FCC licenses associated with internal communications are easily overlooked in the process of merging or acquiring assets and businesses. Non-telecom businesses often apply, or ask a vendor to apply, for a license in conjunction with a new communications system. A license needs little attention over its 10-year term, and it is easy to lose track of it over time. Any merger or acquisition due diligence should include investigating any potential FCC licenses.

Ask the Right Questions

During the due diligence phase of a proposed transaction, asking the right questions and doing a little research will prevent significant future complications. It is not enough to ask if a company holds any FCC licenses. Many companies do not realize they utilize a license. We recommend due diligence include a description of internal communications systems; any two-way radio system is likely to involve an FCC license. Although seeking copies of all FCC licenses should be part of a due diligence inquiry, we also suggest an independent search of the public FCC license database to confirm that there are no active or expired licenses.[3]

An acquiring company should think critically and delve into the minutiae of what the company being acquired does on a daily basis. The FCC points out that many companies have foremen and security guards who carry radios. The company will likely have one or more FCC licenses for these radios. Other usage examples that should raise a red flag include transportation companies that track and communicate with trucks, boats and planes and railroad utilities that operate switches on the track. The technology that enables these services often utilizes an FCC license.

It is also critical that due diligence ascertain whether the company being acquired provides any communications services for a fee to any other entity. It is not unusual for excess capacity in a communications system to be sold to a third party. In that scenario, there are additional regulatory obligations that the acquiring party will face. It is preferable to address them as part of the negotiation, rather than be surprised post-closing with common carrier obligations.

FCC Must Grant Approval Prior to Closing

Section 310 of the Communications Act of 1934, as amended (the "Act") requires that all licensees, including private wireless service licensees, must seek and obtain FCC consent *before* assigning or transferring control of FCC-issued licenses or permits. Several events can trigger involuntary transfers, such as death or bankruptcy of the initial licensee, which require FCC notice to maintain the license. This means that prior to consummation of an assignment of license (such as in connection with a sale of assets) or a transfer of control of a license (such as in a corporate merger or reorganization), the parties must file

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the appropriate application(s) with the Commission. The FCC must grant the application(s) before consummation of the transaction may take place.[4]

There is an exception for private wireless applicants seeking assignments or transfers of control of licenses for one-way paging band (929-930 MHz).[5] The rules allow those applicants to operate under a conditional permit which may commence upon the filing of a properly completed application. One-way paging represents a small portion of private wireless licenses, so few applications will be eligible for the exception.

The parties to a transfer or assignment must file Form 603 with the FCC. Form 603 is primarily used by the FCC to identify the parties and ascertain their eligibility and qualifications for the licenses in question. Depending on the type of transfer or assignment, there are up to five additional Schedules that must be filed along with Form 603. Parties must also file a Notification of Consummation within 30 days of the actual closing of the underlying transaction.

Addressing Expired, But Active, Licenses

The Act and the FCC rules promulgated thereunder prohibit the use or operation of any FCC-regulated communication system without grant of authority from the FCC.[6] Section 503(b) of the Act provides that any person who willfully or repeatedly fails to comply substantially with the terms and conditions of any license, or willfully or repeatedly fails to comply with any of the provisions of the Act or of any rule or regulation, shall be liable for a forfeiture penalty. This is a low standard as, although "willful" requires a level of deliberate action, "repeated" merely requires that the act was committed or omitted more than once, or lasts for more than one day. As discussed below, FCC penalties accumulate quickly when a violation continues over time, which is not unusual for an expired license.

When performing due diligence on a proposed transaction, the acquiring party should obtain at least three years' worth of copies of any regulatory opinion letters issued, copies of any audit response letters given in the last three years, and payment confirmation of all regulatory fees owed. These documents can be used to verify against the FCC's Universal Licensing System ("ULS") to confirm whether licenses are current. The FCC will not allow the transfer or assignment of a license that has expired. The earlier a potential problem is identified, the more options are available to the parties to remedy the issue prior to closing.

If a company discovers that any of its active licenses have expired, it must take immediate action. Depending on the type of license involved and the amount of time that has elapsed since the license expired, the company may be allowed to renew the license and pay an administrative fine for a late renewal by filing a waiver request in conjunction with its renewal. However, a license that expired multiple months or years ago could require an entirely new license application, and could also open the company up to liability for operating without a license.[7]

Forfeitures for Companies That Do Not Comply

Failing to obtain prior approval for a transfer of control or an assignment of an FCC license can trigger significant liability. For example, in 2014 the FCC imposed a $64,000 forfeiture penalty against Associated Telecommunications Management Services, LLC ("ATMS") for failing to obtain prior Commission approval.[8] ATMS was found to have engaged in eight unauthorized transfers to eight of its subsidiaries. The FCC did not reduce the penalty even though ATMS self-disclosed four of the unauthorized transfers. In 2010 the FCC and Delta settled for $35,000 after Delta failed to obtain prior consent when it merged with Northwest Airlines; Northwest held its radio licenses in a separate entity, and Delta failed to obtain prior approval for the transfer from this subsidiary.[9]

It is important to note that even a corporate reorganization may trigger FCC licensing issues. The FCC requires prior approval if there is a change in the controlling ownership interest of the licensee.[10] If a company reorganizes by transferring ownership of the licenses from a parent company to a new wholly owned subsidiary, this would be deemed a *pro forma* transfer and no prior consent would be required. However, if there is a change in the controlling ownership of the ultimate parent company, prior consent would be required.

As with most federal agencies that have authority to enforce their rules, the FCC has a penalty policy in place that delineates potential violations and their potential fines ("FCC Forfeiture Policy"). Of particular relevance to a company's circumstances are the following potential violations and their base penalty amounts:

- Operation without an instrument of authorization: (e.g., a license): $10,000
- Interference: $7,000
- Failing to file renewal: $3,000

Each of these penalty amounts may be adjusted upward or downward based on specific factors. Penalties may be adjusted upward if the misconduct is particularly egregious, is intentional, causes substantial harm, results in substantial economic gain of the violator, is a repeated or continuous violation, or the violator has a prior record of violations. Penalties may be adjusted downward if the violation is relatively minor, the violator has acted in good faith or voluntarily disclosed, or the violator has a history of overall compliance. The FCC will also consider more general factors such as the nature, circumstances, extent and gravity of the violations and any other matters as justice may require. From our experience and review of past enforcement actions, the FCC is generally more likely to adjust penalties upward, even in the circumstance of voluntary disclosure of a violation.

Post-closing, the required FCC files should be obtained from the acquired company to comply with FCC recordkeeping rules.[11]

Conclusion

It can be very easy to overlook FCC license issues in the mergers and acquisitions environment. It is imperative that counsel understand the breadth of licensing from the FCC so that their clients do not inadvertently expose themselves to fines for non-compliance. Proper due diligence will ensure that all issues are identified before they lead to potential liability.

1. *See* Alexa Davis, "No Slow Down in Sight for 2014's M&A Frenzy," *Forbes* (June 24, 2014), http://www.forbes.com/sites/alexadavis/2014/06/24/no-slowdown-in-sight-f... ("Mid-year levels haven't been this high since 2007, the year before the financial crisis sent the economy into a tailspin, according to Dealogic.")

2. For additional information on FCC licensing obligations, *see* http://wireless.fcc.gov/services/index.htm?job=service_home&id=private_land_radio.

3. Expired licenses are a red flag that frequencies may be used and were not renewed.

4. If a proposed transaction fails to close after FCC approval, notice to the FCC will nullify the transfer of control or assignment.

5. *See* 47 C.F.R. § 1.931(b)(11).

6. There is unlicensed spectrum available to all, but using it creates significant risk of interference. *See* Federal Communications Commission Blog, *Accessing Spectrum*, http://www.fcc.gov/encyclopedia/accessing-spectrum.

7. In our experience, there is little upside to self-disclosure of non-compliant licenses. The FCC imposes the same or even more significant fines when disclosure is voluntary.

8. *In the Matter of Associated Telecommunications Management Services, LLC, et al.*, DA 14-1642, Forfeiture Order, (rel. Dec. 1, 2014).

9. *In the Matter of Delta Air Lines, Inc., Licensee of Various Authorizations in the Wireless Radio Services*, DA 10-2047, Consent Decree, 25 FCC. Rcd. 16721 (rel. Dec. 13, 2010).

10. The FCC has a Q&A that contains several illustrative examples of various types of transfers that qualify for *pro forma* treatment. *See* http://transition.fcc.gov/eb/factsheets/sec310d.html.

11. Recordkeeping requirements vary depending on license. *See, e.g.*, 47 C.F.R. § 73.1840(a).

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