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## 2007 Outlook for Telecom and Media

**Summary:** The legislative outlook for the telecommunications and media sectors has changed significantly post-midterm elections, with both houses of Congress returning to an experienced Democratic leadership but a Republican majority remaining at the FCC. The 110<sup>th</sup> Congress, which convenes in January 2007, will confront familiar residual issues but will certainly reorder priorities. Investors should **expect much more oversight** with serial hearings on hot-button issues such as “net neutrality,” Universal Service reform, and media ownership caps taking priority. Despite the dramatic ramp-up in oversight of both substantive issues and the regulatory process at the FCC, I believe it is **highly unlikely that Congress will adopt a comprehensive rewrite of the Telecommunications Act** for the investable future. Accordingly, I provide this 2007 Outlook as a guide to where the battles lines will form, around what issues, who will lead the charges, and what will be the likely outcomes.

**Reordered Stand-Alone Priorities among Residual Issues.** Soon to be former Commerce Committee Chairman Stevens all but ensured failure of his massive ten-part Telecommunications Act rewrite by stating that it would all pass or fail together. Stevens would not address issues individually. I believe that the Democrats have learned from their strategy of picking apart the omnibus package to successfully block the Republican leadership’s efforts to pass comprehensive “reform”. Therefore, the incoming Democrats’ strategy will address stand-alone issues responsive to their relatively more pro-consumer, pro-federal, pro-union, pro-broadcast media constituents.

**Experienced Leadership Increases Oversight.** More apparent than the re-ordering of substantive issues will be the significant increase in FCC oversight. Senator Dan Inouye (incoming Chairman of the Senate Commerce Committee) and M.C. John Dingell (returning Chairman of the House Commerce Committee) are experienced Chairmen who take their oversight responsibilities seriously, wield their regulatory and budgetary powers with relish, and intend to make their ascension felt at the FCC. **Senate Outlook.** Senator Inouye is low key and will likely return the favor of his long-time WWII Senatorial colleague, out-going Republican Senator Stevens, by considering him a “Co-Chairman” and letting him share the oversight responsibilities. Together they constitute a formidable team that will likely schedule seriatim hearings on all aspects of FCC rulemaking and budgeting. Expect

Chairman Inouye to focus on net neutrality, where he parted company with Co-Chairman Stevens, uncharacteristically complained publicly about Democrats being shut out of the omnibus process, sought to turn the FCC’s guidelines into enforceable statutory requirements, and ultimately killed the omnibus bill. **House of Representatives Outlook.** Within the Beltway, the re-emergent House Chairman’s “Dinglegrams” are legendary. Chairman Dingell is not shy about giving the FCC Chairman advice about what would be Congressionally preferred and sustainable decision-making. Indeed, it is rumored that “Big John” Dingell has already “invited” FCC Chairman Martin up to The Hill to “chat” about how the FCC has failed to regulate effectively and fostered untimely and ill considered consolidation in both the telecom and media sectors. Chairman Dingell has already weighed in (with his considerable political heft) on the pending MaBell/Baby Bell reintegration, but with contradictory signals that **likely kick resolution of the ATT/BellSouth merger into 1Q07**. It will take an astute politician to weather the on-coming oversight onslaught. Fortunately, Kevin Martin has not shown himself to be a policy purist but a pragmatic deal-maker who will negotiate with his opponents.

### **Ranking the Issues and Predicting Outcomes.**

**(1) Net Neutrality.** The key stumbling block to telecom and media reform has been net neutrality, which divided the Democrats from the Republicans and pitted new-media digital content suppliers (e.g., Amazon, Google, Yahoo) against traditional network providers (e.g., ATT, Verizon, Comcast) in providing broadband access and transmission to consumers and businesses. Investors should expect the hyperbole to increase in a succession of hearings in both chambers but these fulminations are likely to remain staged events without new laws enacted. I believe that it is **only 40% likely that the FCC’s voluntary net neutrality “guidelines” will become law.**

**(2) Media Ownership Reform.** The rules regulating which company gets to own what combination of broadcast and print media in any market(s) are perhaps the most sensitive issues for politicians because they go to the heart of how politicians communicate with and appear to their constituents. They shape the parameters of what has become the “permanent campaign”. Additionally, these rules are traditional “fault line” issues between the Republicans and the Democrats wrapped up in the increasingly divisive partisan rhetoric of re-defining “localism” “diversity,” and “effective competition”.

The Democrats have promised a “full and searching” review of the FCC’s past and current actions on media and telecom consolidation. Tellingly, the ATT/Bell South merger has already become the first friction point between the FCC and the incoming Congress. I expect this developing schism between the majority Democrats in Congress and the Republican majority at the FCC to spill over into broadcast media consolidation. Commissioners Adelstein and Capps, the FCC Democrats, have already successfully used the threat of media consolidation to rally their traditional allies, the self-denominated consumer advocates. Resolution of multiple ownership issues is further complicated by conflicting precedents from the Courts of Appeal. The DC Court of Appeals has twice determined that the FCC did not justify retention of the restrictive rules while the Third Circuit held that the FCC went too far in liberalizing the rules and found their “diversity index” methodology statutorily inadequate. Given the multiple layers of uncertainty, the lack of an analytical formula, and heightened political sensitivities, I believe that it is **highly unlikely (~20% likely) that the FCC will complete its very broad media ownership notice of inquiry (in all but name) in 2007**. The on-going lack of media ownership clarity is likely to continue to hamper Gannett and Tribune in particular and spur asset sales or privatizations such as those being pursued by Tribune and Clear Channel.

**(3) Universal Service and Reciprocal Compensation.** These are long-standing MEGO (“my eyes glaze over”) issues for legislators but they are critically important to the small rural telecom providers and wireless new entrants. Politically, we have no urban Senators in this country; all 100 Senators view themselves as friends of rural interests. These issues will likely be played out in a sustained letter writing campaign from The Hill to the FCC. Complicating matters for the FCC is the existence of a “Missoula Plan” proposed by state regulators that has received only lukewarm reception in D.C. Commissioner Tate, in particular, has a depth of knowledge on these arcane issues but the FCC has been notably absent in bringing them forward so I **expect these Universal Service and reciprocal compensation issues to languish** despite likely hearings on The Hill. Investors should watch for some tinkering of the accounting rules, which could forestall more problematic changes for small rural operators, but **overall USF reform is unlikely in 2007**.

**(4) Video Franchising.** The advent of a Democrat-controlled Congress signals the likely **withering away of federal consideration of nationwide video franchises** and other national laws regulating telephone entry into video distribution. The incoming Democratic leadership in both chambers and the two Democratic FCC commissioners still consider telephone companies to be dominant monopolies that were improperly freed of federal regulation during the pursuit of the inter-modal competition philosophy of the Republican era. Accordingly, telcos are likely to lose out to cablecos as they are forced to slog through state and municipal legislation, a time and money consuming process.

**(5) Minority Media Ownership.** Increasing minority ownership of media is a legislative project that remains from the Democrats’ last time in power. Although set-asides have been found to be Constitutionally suspect, I believe that a **serious effort will be made to re-authorize minority tax certificates** to assist minorities and women in purchasing the stations that are beginning to come onto the market with the demise of liberalized ownership rules and the counter-consolidation trends discussed above.

**(6) Spectrum Management.** Reforming management of the nation’s airwaves was a priority for *previous* Republican FCC Chairman Powell and was encouraged by Hill Republicans for its *beneficial budgetary effects*. (All auction proceeds are deposited in the Treasury for disbursement by Congress.) Chairman Martin, however, disbanded the FCC Spectrum Review Task Force, dispersed the highly skilled technical personnel throughout the agency, and failed to even appoint a permanent Chief of the Wireless Bureau. The last minute changes made to the auction rules for Advanced Wireless Spectrum (AWS), including “blind bidding” and increased spectrum holding terms, are currently under judicial review. However the Appeals Court decides the administrative law-based challenge to the AWS rules, will have little effect on future spectrum auctions. I believe that the auction rules are always customized for the particular auction to get the desired budgetary outcome. The next significant amount of spectrum to come onto the market will be in 2008 when the FCC auctions 700 MHz analog channels returned as part of the DTV transition for which Congress set a hard date of February 2009. This spectrum is valuable due to strong propagation and penetration characteristics which lower deployment costs. Accordingly, I **expect the cablecos and DBS satellite providers to bid actively in the 2008 700 MHz auction** despite their hesitant participation in the AWS auction.

**(7) Straggler Issues.** I expect a great deal of legislative activity but no statutory changes on the following perennial issues and highlight one “meteor issue” that is likely to draw partisan investigation. **(a) DTV Transition.** The **February 2009 DTV transition date will stick** because it was a bi-partisan compromise. The focus will shift to the coupon program at NTIA. **(b) Indecency.** Indecency will continue to be used as a political bully pulpit and **FCC enforcement is likely to continue to be ad hoc and contextual without clear standards**, regardless of the outcome of the Janet Jackson Super Bowl case currently pending before the appeals court. **(c) Politicizing Delegations.** This under-the-radar issue is likely to break open in the new Congress because it parallels the “K Street Project” which infuriated Democrats. There have been rumblings that representatives of NGOs (non-governmental organizations) that attend international conferences such as International Telecommunications Union (ITU) and CITEL (pan-American technical group) have been denied travel credentials based on political party involvement.