



May 2008

FCC Finds Enforcement Of Format-Based Non-Compete Violates Communications Act

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This is the story of a station transaction gone bad, done in by a non-compete agreement that was, apparently, too well-crafted. The FCC's recent resolution suggests a change – or at least a substantial re-emphasis – in the agency's treatment of non-competition agreements. That change may necessitate re-evaluation of non-competes by parties who might otherwise have seen such provisions as advisable for one reason or another.

The facts here are a bit complicated, so bear with us. A few years ago, one Mr. Burns (Gary, not Montgomery) sold a station to Centennial Broadcasting LLC. The station in question apparently featured some form of news/talk format, and as part of the Burns/Centennial deal, Burns agreed to a five-year format-based non-compete. That is, for five years following the Burns/Centennial deal Burns would be contractually prohibited from owning another station in the same market with substantially the same format as the station he sold to Centennial. In return, Burns received \$25,000 from Centennial (in addition to the station's purchase price).

Less than a year into that five-year period, Burns (through a company he controlled) bought another station in the market and promptly converted it to news/talk (with a few hours of music a day). Centennial, understandably miffed at that turn of events, went to court seeking specific performance in the form of an injunction prohibiting Burns from using the news/talk format. The trial court agreed with Centennial that Burns's new format was a violation (a "blatant" violation at that) of the terms of the non-compete, so the court granted the injunction. An appeals court upheld that ruling.

This, of course, should have been music to the ears of Centennial. Centennial had, after all, bargained for a non-compete, and the resulting contractual provision was so well-crafted that the courts ordered that it be enforced. This is precisely the way things are supposed to work on Planet Contract Guy.

But Burns counterattacked at the FCC. He initially filed a complaint with the Enforcement Bureau, alleging that Centennial was improperly trying to assert control

over the programming of Burns's new station. The Enforcement folks apparently did little or nothing in response – but at least they did not reject the complaint. So when Centennial filed an application to acquire a number of stations from an unrelated third party in a deal which had virtually nothing to do with Burns at all, Burns essentially re-filed his complaint with the Media Bureau, this time as an objection to the application. His argument was that Centennial was not qualified to be or remain a licensee because Centennial was improperly trying to assert control over the programming of Burns's station.

Lo and behold, the Media Bureau concluded that Burns might be on to something. In what seems to be the first time the FCC has considered a case with these particular issues, the Bureau's Audio Division decided that Centennial's efforts to enforce the non-compete *did* constitute a violation, but not so serious a violation as to disqualify Centennial from being a licensee. Rather, the violation warranted an \$8,000 fine. With that, Centennial was free to acquire the additional stations, provided that Centennial also dissolves the injunction against Burns and refrains from any further attempts to enforce the Burns/Centennial non-compete.

The Audio Division apparently felt that Centennial's successful efforts to enforce the non-compete in court constituted an attempt by Centennial to control the programming of Burns's station. Since programming is one element of a station's operation that is not supposed to be handed off to anyone other than the station's licensee without prior FCC approval, Centennial's injunction constituted (in the eyes of the Division) a kind of unauthorized assumption of control.

This decision raised a number of eyebrows. Seller non-compete agreements are commonly negotiated by buyers as part of radio and television station sale/purchase transactions. And while the specific terms of non-competes can vary widely, the Burns/Centennial non-compete was actually pretty modest: it did not completely prevent Burns from owning another station in the market; rather, it merely prevented Burns from utilizing one particular format if he happened to acquire such a station. Ordinarily, this type of bargained-for, voluntary acceptance by a party (in this case, Burns) of a narrow limitation on the range of programming it might provide would not have been seen as implicating any unauthorized transfer of control – particularly since the non-compete had been submitted to the Commission with the Burns/Centennial assignment application and had not apparently triggered any adverse reaction from the Commission's staff. In view of this decision, it may be necessary to alter hitherto conventional approaches to non-compete agreement terms in purchase/sale deals.

There are several lessons to be learned from this decision.

1. ***Narrow is not necessarily better.*** As a general contract law principle, the narrower a non-compete agreement is tailored, the more likely it is to be enforced by a court. For example, a non-compete agreement that prohibits someone from competing anywhere in the United States is normally less likely to be enforceable in the courts than an agreement which prohibits competition in just one metropolitan area. In the Centennial case, the non-compete agreement was narrow: it merely banned Burns from owning a station broadcasting with one particular format (*i.e.*, the format of the station he sold to Centennial). But that was apparently unacceptable from the FCC's perspective, since the format restriction impermissibly encroached on a fundamental control factor (at least in the Audio Division's eyes). The irony is that when Centennial and Burns were negotiating their original deal, Centennial wanted Burns to agree to a broad prohibition against owning any other stations in the market, but Burns negotiated for the more narrow format-specific non-compete provision. In the future, if a station buyer wants the seller to sign a non-compete agreement as part of a sale transaction, the ban upon the seller owning another nearby station should apparently be absolute and not format-related.

2. ***Timing is everything.*** The FCC's decision in the Centennial case hinged upon the staff's perception that Centennial was exercising programming control over Burns's new station by obtaining an injunction against Burns. At the time Centennial obtained the injunction, Burns (through a company he controlled) was already the FCC-approved licensee of the new station. But suppose Centennial had obtained the injunction *before* Burns acquired the station, and then petitioned against Burns's FCC assignment application on the grounds that the proposed acquisition would violate not only Burns's non-compete agreement with Centennial but also the terms of a court-ordered injunction. It is at least possible that Centennial would have prevailed. Note that the FCC did not address this hypothetical scenario in its decision in the Centennial case, so we can't make this conclusion with absolute certainty.

3. ***Money damages, not injunction.*** If the Audio Division's decision is not reversed, we now know that seeking an injunction to enforce a format-based non-compete is apparently a violation of the Communications Act and the FCC's rules. But there are other ways to enforce such provisions. For example, an obvious alternative approach is to sue for monetary damages, rather than for an injunction. In other words, a non-compete violator can continue to program his station any way he wants, he just has to pay money to the other party to the non-compete agreement to compensate for the damage caused by his violation. Actual damages can be difficult to prove, but not impossible. As an alternative to proving damages, the aggrieved party might seek a refund of the money it paid to the violating party. Another alternative would be to require the non-compete payments to be made periodically over time to provide incentive not to violate the non-compete terms until the last payment is made (the incentive being that the payments stop

if the non-compete is violated). Note again that the FCC did not address this question in the Centennial case, so we don't know with 100% certainty that the FCC won't consider a suit for monetary damages or a refund of a non-compete payment to be an impermissible exertion of control.

4. ***Full disclosure in applications.*** In the Centennial decision, the Audio Division acknowledges that Centennial and Burns did in fact file a copy of their non-compete agreement with their original assignment application. But both parties also certified in the application that their agreement (including the non-compete) complied with the FCC's rules, when, in fact, it did not – at least according to the Audio Division, long after the fact. While the worksheet to the FCC assignment application does not itself suggest that the terms of the Burns/Centennial non-compete were on their face a violation, with the luxury of 20/20 hindsight Centennial and Burns might have elected at least to highlight the terms of the non-compete so that the staff would be sure to see them. On this point the Division's decision contains a startling admission: when applicants certify that their sale/purchase transaction agreements comply with the FCC's rules, the staff does not “routinely scrutinize” copies of such documents that are required to be filed along with the application. (This is something we had suspected, but were nonetheless surprised to see the FCC admit.) Accordingly, approval of an assignment application does *not* establish compliance with the FCC's rules of all transaction documents filed with the application. The FCC cautioned all applicants that they will held “strictly accountable” for disclosing in FCC applications any contract terms that do not comply with the Commission's rules and policies.

As noted, this decision has been met with some surprise and criticism. It is possible that review or reconsideration may be sought, or that the staff may choose to re-think this case on its own. But it's not clear that either Burns or Centennial has much motivation to go another round on this, and the staff is not known for second-guessing itself. Accordingly, it is probably best to assume that, for the time being, the law of non-competes is as the Audio Division says it is. Given that, anyone looking to enter into a new non-compete, or enforce an existing non-compete, should take a very careful look at the staff's opinion before going forward.