Incidental Paper

The Impact of Section 310 of the Communications Act of 1934: Economic and National Security Issues

Sorin A. Bodea

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The Impact of Section 310 of the Communications Act of 1934: Economic and National Security Issues

Sorin Bodea
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Sorin A. Bodea is a doctoral candidate in Information Systems and Business Management at Harvard University.

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The Impact of Section 310
of the Communications Act of 1934:
Economic and National Security Issues

Executive Summary

This paper offers a brief, preliminary analysis of economic and political issues raised by restrictions imposed by Section 310 of the U.S. Communication Act of 1934, and later amendments, on foreign investment in common carrier firms using the radio spectrum. The paper focuses on the following issues:

- **National Security** How credible is the rationale for prevention of foreign control over common carrier firms in today's tightly integrated global economy, particularly in the context of presidential power to seize common carriers, regardless of ownership, in the event of war or national emergency? Given the broad emergency powers held by the President, is Section 310 still needed to accomplish its stated original purpose of national security? As information technology and systems become ubiquitous, are such restrictions on foreign ownership of common carriers based on national security concerns still reasonable when sensitive information could just as easily be transferred by facilities not based on common carriage?

- **Economic** Should the U.S. include common carrier ownership in negotiations for the North American Free Trade Agreement (NAFTA)? Should the U.S. relax the restrictions for common carriers on a selective basis, or for some quantitative or qualitative considerations, or both? How would altering or lifting the provisions of Section 310 affect the General Agreement on Tariffs and Trade (GATT) and Most Favored Nation negotiations on telecommunications services?

In the author's view, each of the areas identified in this preliminary analysis requires a full examination, because the increasing perception that the U.S. government unfairly protects the domestic telecommunications market could significantly hurt domestic telecommunications companies and those U.S. companies operating in overseas markets. Abroad, foreign governments might impose restrictions on telecommunications investments in their own countries, thus negatively affecting U.S. firms investing there. At home, domestic communications companies might wish to ensure that legislative reactions to the increased pressure from foreign governments for the U.S. to lift or alter the restrictions in Section 310 would not impact negatively on their business. Further, the U.S. government may want to reevaluate the relevance of the provisions of Section 310 to national security and adjust the U.S. policy accordingly.

Contents

The Problem

In the United States, Section 310 of the Communications Act of 1934 limits the level of investment foreign firms can make in a U.S. common carrier or broadcasting licensee. At the same time, U.S. companies are seeking new entrepreneurial ventures in the international telecommunications and broadcasting markets. Increasingly, foreign businesses and governments are questioning the limitations of Section 310 in the context of attempts by U.S. companies to gain access to those foreign markets.

In that context, increasing or lifting the current statutory limits on foreign ownership imposed by Section 310 of the 1934 Act have both been suggested, but with stated concerns about the political, economic, national security, and social consequences of such action.

Section 310 provides that the Federal Communications Commission (FCC) may not grant aliens and their representatives, foreign governments, and corporations organized under the laws of a foreign country a common carrier or broadcast license.[1] This paper discusses the restrictions imposed by Section 310 on *common carrier firms using the radio spectrum.* Section 310 limits a foreign investor to a stake in the licensee of 20 percent; the foreign investor may hold a stake of 25 percent in a licensee's parent and may seek a public interest finding from the FCC if investment above the 25 percent benchmark is in the public interest. A licensee may not have aliens as officers or members of the board of directors, and the company controlling the licensee may not, without a public interest finding by the FCC, have aliens as officers or as more than 25 percent of the members of its board of directors.[2]

For policy reasons, it is important to understand how interested parties, private or public, view the impact of foreign ownership of common carriers on U.S. national security and on U.S. and foreign business.

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[1]Section 310 also prohibits a foreign government and its representative from holding other types of radio licenses.

[2]The text of Section 310 (a) (b) can be found in the Appendix.

In the U.S., those who advocate lifting restrictions on foreign ownership point out that such investments can lead to capital accumulation, an increase in the value of common carrier properties, and, they hope, a reduction in the foreign trade imbalance. To them, it seems obvious that the existing legislation limits the infusion of foreign capital to the U.S. telephone industry and that other countries might consider U.S. practice unfair and wish to retaliate, thereby hurting U.S. economic and business interests. France, the United Kingdom, and other members of the European Community (EC) who consider Section 310 unfair might pass laws that would reciprocate the U.S. restrictions and create national barriers that might limit U.S. corporate investments, hamper some U.S. businesses in forming partnerships, and, generally, restrict such companies from entering attractive foreign markets. Moreover, Central and Eastern European countries aiming to become members of the EC might emulate laws and regulations of the EC that would hurt U.S. firms substantially. Other countries are considering passing laws similar to Section 310.

Those who advocate retaining the limitations of Section 310 fear the potential loss of control to foreigners, erosion of global market power, and diminished national security. They seem to believe that by promoting and enforcing protectionist measures at home the U.S. would maintain world leadership in business and technology.

This paper addresses the issues and questions mentioned above as well as others below both through a review of the literature — although little is available — and in informal and "off-the-record" interviews with representatives of regional Bell Operating Companies, foreign providers of local telecommunications, long distance service providers, communications consumers groups, unions, trade groups and associations, private and public investors, the National Telecommunication and Information Administration, the FCC, and regulatory bodies of countries that may want regulatory reciprocity with the U.S.

Historical Background

In response to the U.S. Navy's concern that a foreign-owned radio station might be used by the enemy in time of crisis or war to interfere with U.S. communications, with the Radio

Act of 1912 the U.S. passed its first laws limiting foreign ownership of broadcast facilities.[3] The Act required the licensee to be a citizen of the U.S. or Puerto Rico and granted the President power to seize control of any such facility in the event of war. But the 1912 Act was perceived as deficient in not specifying the President's power in the event of a crisis (other than war) with foreign countries and did not limit investment in corporations that control common carrier and broadcast licensees. This led to the Radio Act of 1927, mainly because during the first days of the First World War two U.S. licensed subsidiaries of German firms communicated with German vessels in spite of a U.S. presidential order prohibiting such communication. The 1927 Act "contained provisions to exclude and prevent alien ownership" (Ennis and Roberts 1991) which Congress later incorporated into the restrictions on foreign ownership of the Communications Act of 1934. In 1974, Congress amended Section 310 of the 1934 Act so that these restrictions applied only to broadcast, common carrier, and aeronautical services using the radio spectrum, areas that, Congress decided, uniquely impacted national security and therefore needed such restrictions.

Issues and Questions: The Relevance of Section 310 Today

The following issues were identified in an attempt to understand the relevance of the common carrier provisions enacted in Section 310 of the 1934 Act to common carriers today and to consider whether altering or lifting them would serve U.S. economic and security interests: Should the U.S. include basic common carrier ownership in negotiations for the North American Free Trade Agreement (NAFTA), or should Congress agree to lift the restrictions of Section 310 to entitle those countries to unrestricted opportunity to own U.S. common carrier firms, what might the parameters of the implementation of this decision be, and what would this decision mean. In making its decision, Congress might need to consider whether to allow the use of a phased or an one-step approach.

Further, in relation to those issues, the following questions arise: In the present political climate in the U.S., with its consciousness of foreign competition, what are the chances of making changes in the common carrier provisions of Section 310 either through NAFTA or

[3]This historical information is based in part, although not completely or exclusively, on Ennis and Roberts (1991) and Watkins (v. 33).

more generally, and how might the players react? What are the arguments for and against change? Should the U.S. alter the provisions of Section 310 or not, in the view of stakeholders, and why? With the collapse of the Communist regimes, is now the appropriate moment to reconsider foreign ownership in communications? What are the likely economic, social, and political consequences of lifting these restrictions?

What is the trend of investments by U.S. common carriers in other countries, and of investments by other countries in the U.S.? What are the implications of the provisions of Section 310 for direct foreign investors, and for portfolio foreign investors? What are the implications for U.S. companies investing abroad?

How can the political climate of the 1990s be defined? Is the rationale of prevention of foreign control over common carrier firms still credible in today's tightly integrated global economy and in the context of presidential power to seize common carriers, regardless of ownership, in the event of war or national emergency?

The only stated rationale for the provisions of Section 310, according to Ennis and Roberts, is national security, that is, to prevent foreign control of common carriers; are those concerns still valid in today's political climate and in the context of potential threats the U.S. will face in the 1990s? Given the broad emergency powers held by the President, is Section 310 still needed to accomplish its stated original purpose of national security? Could any of the U.S.'s national security concerns be met by operational (control) restrictions as opposed to ownership ones? Accordingly, which would be the best approach: to give or confirm the FCC's authority to waive Section 310, or to ask it to consider both the effects of foreign ownership and control, whenever relevant?

Then, what is the relationship between U.S. economic and national security interests, as reflected in the present debate? Is it in the interest of the U.S. to differentiate between common carriers owned by friendly governments, such as Canada, and those of other countries, as seen by the interested parties? Would it be in the interest of various players to differentiate between a foreign government and a foreign-government-owned enterprise? Should the U.S. relax the restrictions for common carriers on a selective basis or for some quantitative or qualitative considerations, or both? How would altering or lifting the provisions of Section 310 affect General Agreement on Tariffs and Trade (GATT) and Most Favored Nation negotiations on telecommunications services?

As information technology and systems become ubiquitous, is it reasonable to maintain restrictions on foreign ownership of common carriers based on national security concerns, when sensitive information could just as easily be transferred using facilities not based on common carriage?

Preliminary Analysis

A foreign entity seeking to invest in a U.S. common carrier that uses the radio spectrum may do so, Section 310 notwithstanding. This entity could invest in U.S. firms that provide private radio-based services, such as the Specialized Mobile Radio Service, not included in the limitations of Section 310 (b), thus permitting alien holdings of up to 100 percent in the licensee. Such companies could provide services somewhat similar to those provided by common carriers,[4] and could compete, for instance, in the mobile services market with cellular service providers. In addition, Section 310 does not bar foreign ownership of U.S. equipment or telecommunications service providers that do not use the radio spectrum.

A common carrier licensee controlled by a corporation that proposes to restructure its ownership to include foreign investors also may seek the FCC's public interest waiver of the 25 percent alien ownership benchmark contained in Section 310 (b)(4). This approach, although encouraged by the FCC's frequent calls for some foreign carriers to file for a waiver of Section 310, is very time consuming, costly, and its outcome uncertain.[5] Another option currently available to foreign investors interested in the U.S. market is to group business processes that require a license into a separate U.S.-owned company that meets the provisions of Section 310, while allowing the foreign investor full ownership of the remaining business

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[4]Consider *the Request of Fleet Call, Inc., for Waiver and Other Relief to Permit Creation of Enhanced Specialized Mobile Radio Systems in Six Markets*, 6 FCC Rcd 1533 (1991) (Fleet Call Order).

[5]When Cable and Wireless North America, Inc., attempted to acquire TRT and filed for a waiver of Section 310, the FCC did not issue a response for ten months, and when it did, its answer was a letter "asking questions about radio license issues."

entities, a 20 percent interest in the licensee, and a 25 percent in the licensee's parent. The difficulty with this approach is that the investor must be able to structure the investment such that it is not deemed to have *de facto* control over the licensee. Therefore, legal costs are associated with restructuring the company and with perhaps more extensive regulatory approvals, and, in the end, this option can be less satisfactory than control over all business facets of the licensee, which could result in the investor's inability to compete with other common carriers on an equal footing. In spite of the openness of the U.S. telecommunications markets generally to foreign investment, potential foreign investors may see Section 310 as a barrier.

In regard to the U.S. common carrier industry, as for the auto industry, both Congress and the industry may be concerned with market dominance, thus with maintaining market share. If so, the real measure of control would shift from ownership to market power, in which case a major concern would be erosion of market power. If no significant erosion of market power for U.S. companies were proven, then foreign companies might be allowed to invest in the U.S. without restrictions. In this case, Congress might find it necessary to enact legislation based on market dominance rather than ownership.

U.S. businesses that support ownership restrictions of the 1934 Act point to issues related to national interests generally and national security specifically. One problem with this way of thinking is that such advocates do not appreciate that in a global information market the kind of security concerns that gave birth to Section 310 can no longer be addressed by the means offered by its ownership provisions.

Another problem is that when U.S. common carriers seek to invest abroad, increasingly foreign businesses and governments question the restrictions imposed on them by Section 310. They even, from time to time, threaten to adopt similar ones. The common carriers spoken with in connection with research for this paper consider that regulatory limitations to foreign ownership should be applied on the basis of reciprocity, and many said they would support lifting these restrictions only if they could receive not only reciprocal treatment but also some business favor in exchange for their support.[6]

On the other hand, Americans who support lifting the restrictions point to the need both for the U.S. to increase the opportunity for foreign parties to invest in this country and for U.S. companies to enjoy freedom, statutory or otherwise, to invest abroad — investments that would be hindered if other countries were to decide to make their unwritten rules on foreign investment in their own countries into statutory regulation. Most U.S. common carriers are strong at home, and an intensification of domestic competition through foreign investment may therefore benefit the American customer without immediate consequences for the structure of the telecommunications industry.

In spite of the issues and questions raised here, many of the parties spoken with in telephone interviews mentioned that they did not pay much attention to the potential impact of Section 310 on their operations at home and abroad, although some said they should.

A serious analysis of the implications for the U.S. of Section 310 is clearly needed. Although the U.S. claims that it has fewer restrictions and more unused negotiation leverage than other countries, the EC, for example, considers that U.S. restrictions on foreign ownership of common carriers "virtually preclude [foreign companies] from offering common carrier services in the U.S. using radio communications . . . because most common carriers need to integrate radio transmission stations and satellite earth stations into their networks. [The EC concludes that as foreign companies] may not own wireless facilities and networks, and may not take large stakes in U.S. companies providing them, foreign operators are effectively prevented from competing in providing many common carrier services."[7]

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[6]Virtually every country limits foreign investment in its common carrier(s), and by some accounts U.S. has fewer restrictions and more unused negotiation leverage than others. Thus, the U.S. might benefit from reciprocity in common carrier ownership. For this reason, the FCC could include *reciprocity* in its definition of *public interest* when it considers a request for waiver of Section 310.

[7]*Telecommunications Reports International* (29 May 1992), p. 9.

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Appendix

Communications Act of 1934

LIMITATION ON HOLDING AND TRANSFER OF LICENSES

SEC. 310. [47 U.S.C. 310] (a) The station license required under this Act shall not be granted to or held by any foreign government or the representative thereof.

(b) No broadcast or common carrier or aeronautical on route or aeronautical fixed radio station license shall be granted to or held by

(1) any alien or the representative of any alien;

(2) any corporation organized under the laws of any foreign government;

(3) any corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of record or voted by aliens or their representatives or by a foreign government or representative thereof or by any corporation organized under the laws of a foreign county;

(4) any corporation directly or indirectly controlled by any other corporation of which any officer or more than one-fourth of the directors are aliens, or of which more than one-fourth of the capital stock is owned of record or voted by aliens, their representatives, or by a foreign government or representative thereof, or by any corporation organized under the laws of a foreign country, <u>if the Commission finds that the public interest will be served by the refusal or revocation of such license</u>.