

# THE FCC'S TRANSACTION REVIEWS, FIRST AMENDMENT RISKS, AND THE RULE OF LAW

*The commission uses transaction and licensing reviews to infringe on speech.*

◆ BY BRENT SKORUP AND CHRISTOPHER KOOPMAN

Today, regulated companies—including broadcast TV and radio, satellite TV and radio, cable TV, and internet service providers (ISPs)—are the primary producers and distributors of mass media and publications. Given the power that the Federal Communication Commission has over these regulated companies, most must remain in the commission's good graces to operate. With the proposed merger of AT&T and Time Warner, the power wielded by the FCC will once again become an issue of national importance. We argue that this power should be viewed skeptically in light of the danger it poses to both the First Amendment and the Rule of Law. We also provide some reform proposals to rein in the commission.

In late October, AT&T announced plans to acquire Time Warner (not to be confused with Time Warner Cable), which owns several media outlets, a film library, and TV channels. While the FCC is not responsible for reviewing the merger itself, the agency could play a central role in approving the deal: Time Warner has video-distribution facilities that are licensed by the FCC, and any transfer of those licenses is subject to the commission's approval. Should the FCC review and approve the transaction, all eyes will be on what conditions it coerces from the merged entity in return for the approval.

In prior decades, license approval of broadcasters gave the

commission and special interests a powerful tool to influence TV and radio programming. It also provided the FCC with power to dictate network operations, such as Fairness Doctrine compliance. In a world of broadband and 500-channel TV offerings, however, these tactics have changed. Increasingly, the FCC has turned to transaction reviews to extract "public interest benefits" from merging media and telecommunications firms, and uses its leverage during licensing and transaction proceedings to engage in ad hoc merger review that substitutes for formal rulemaking. It also enables the commission to pursue agendas unavailable to it through its rulemaking process.

This development has alarmed both communications scholars and free speech advocates. Through license renewals and—the focus of this essay—transaction approvals, the agency allows special interest groups to dictate media content, business models, and operations. The ensuing agreements between firms and the agency provide a glimpse into how political actors and activists are able to harness the FCC's regulatory process to chill unwanted speech and to promote speech favored by various pressure groups.

Once an acquisition or license transfer is before the commission, the applicants and the FCC engage in a secretive bargaining over what "voluntary" commitments the applicants must make to gain the FCC's blessing. As communications scholar Randolph May explains:

The Commission merely withholds approval of the merger until the parties come forward to propose conditions which the Commission has telegraphed in closed door negotiations that it would find acceptable to meet whatever public interest concerns that opponents, the FCC, and others have raised.

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These negotiated agreements are made pursuant to a consent decree or to gain transaction approval and are, practically speaking, not appealable.

Scholars criticize lawmakers' "jawboning"—a term for informal regulation and threats using dubious legal authority—of internet and media companies outside of transparent regulation. University of Arizona law professor Derek Bambauer notes that “informal enforcement ... cloaks what is in reality state action in the guise of private choice,” and such “regulation by transaction” has far-reaching legal and constitutional effects.

Neither the FCC nor the courts have put meaningful limits on what the FCC can extract during license transfers, leading to arbitrary and unpredictable results. Increasingly, the FCC extracts nominally voluntary concessions from firms—including programming decisions, hiring practices, and “net neutrality” compliance—via coercive conditions to transaction approvals.

In many cases, the FCC is legally barred from enforcing or is unwilling to enforce these policies through the normal regulatory process.

These circumstances eviscerate norms of good governance and rule of law and may also be unconstitutional because of the amount of discretion the FCC has over speakers. The FCC's transaction practices pose the speech infringement risks the Supreme Court warned of in the 1988 case *City of Lakewood v. Plain Dealer Publishing Co.*, regarding a city's licensing of newspaper racks: “The mere existence of the licensor's unfettered discretion, coupled with the power of prior restraint, intimidates parties into censoring their own speech, even if the discretion and power are never actually abused.”

The FCC continues down its current path at legal peril. The expansion of FCC authority during license transfers, its ad hoc determinations of the public interest, and the impracticability of

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timely judicial review have pernicious effects on modern media and the rule of law. Given the immense discretion over media, the FCC's transaction reviews may be subject to facial First Amendment challenges. If the FCC does not voluntarily abandon its de facto merger review, the agency should at least promulgate guidelines for what its public interest standard requires.

### BACKGROUND ON FCC AUTHORITY OVER COMMUNICATIONS TRANSACTIONS

By statute, the FCC must find that the transfer of a wireless license or a common carrier line serves "the public interest, convenience, and necessity." Notably, the Communications Act provides no general merger authority, but the agency has treated its authority over license transfers as reason to evaluate and approve media and telecom mergers.

This vague standard had little meaning even to the congressmen who promulgated it in the 1920s, but contemporaries believed that courts would give meaning to the standard. Courts had, after all, constrained seemingly discretionary antitrust laws via common law-like development. Despite the passage of decades, however, neither the FCC nor the courts have put meaningful limits on what the FCC can do under the public interest standard.

Since the 1970s, Congress and the FCC have moved away from formal industrial policy in telecommunications and programming mandates. Old habits die hard, however. Lacking the legal authority or political will to engage in, for instance, formal broadband rate regulation and cable TV programming mandates, the FCC extracts nominally voluntary commitments from merging firms about rates, programming, and other issues like net neutrality. Combined with the FCC's pervasive public interest standard, regulation by transaction commitments "may be the [FCC's] primary and most potent form of regulatory control," as Randolph Beard et al. noted in a 2015 paper. Merging firms that disagree with the need or legality of a merger condition are in no position to challenge the condition.

There are sensible debates about where voluntary action by a private firm ends and government coercion begins. We do not believe that distinction is relevant here and are aware of no scholarship defending the agency's coercive "regulation by transaction." We therefore argue that conditions extracted during the FCC approval process are coerced and not voluntary because of the severity of the penalty for not offering concessions: a rejected transaction. Further, as we explain below, when speech interests are at stake, the Supreme Court regards even modest regulatory oversight—such as licensure and a requirement to show public interest benefits—as unconstitutional because the risk of government intimidation is too large.

In the next section, we outline a basic model of bureaucratic action. Beginning with the premise that officials within the FCC are individuals that respond to incentives, it is important to model what incentives are driving decisions within the agency. By

revealing the legal precariousness of the FCC's current practice, in the subsequent section we aim to change the incentives of agency officials to attempt more modest, defensible transaction reviews.

### A MODEL OF FCC ACTION, AGENCY COERCION, AND THE RULE OF LAW

Scholars have long recognized that government actors are not selfless, disinterested actors seeking to maximize the public interest. Instead, regulators may use the appearance of altruism as cover to achieve their own goals and objectives. If the "public interest" is not the chief concern of individuals within the FCC, what then do bureaucrats within the agency seek to maximize? Max Weber, the German political economist, notes that in general bureaucrats seek to maximize "power." While this basic idea has laid the foundation for much of the public choice research on bureaucratic action, it nonetheless fails to adequately describe FCC decisions. A more specific description is necessary.

Elaborating on the idea that individuals within agencies seek to increase power, William Niskanen provided the first systematic analysis of bureaucratic action in his 1971 book *Bureaucracy and Representative Government*. The core insights of his initial framework are that individuals within agencies such as the FCC are primarily engaged in maximizing their budgets and expanding the overall scope of their agency's jurisdiction. This is what scholars have come to recognize as "empire building," and this insight has shaped the understanding of agency behavior. It is also central to understanding the FCC's use of its merger review authority.

The model has been refined over time and our use of its insights extends beyond the FCC's budget. While agencies may seek to enlarge budgets, there are other ways in which an agency such as the FCC may build its empire. In addition to simply seeking a larger discretionary budget, an agency may seek to build its empire by maximizing, among other variables, the agency's public reputation, patronage, output, ease of rulemaking, and ease of management. For the FCC, this can be best understood as seeking to increase a combination of the agency's discretionary budget, the scope of the agency's jurisdiction, and its independence from congressional oversight and the courts.

Using this framework as a lens to view FCC behavior, we reject the argument that the agency is simply seeking to pursue the public interest in imperfect ways. Instead, this framework provides a coherent theory that explains why much of FCC policymaking is done on an ad hoc basis and in the form of nominally voluntary concessions extracted from firms in exchange for transaction approvals. If the goal of the agency is to increase its jurisdiction, public reputation, patronage, and output, while also balancing a desire for ease of rulemaking and management, the FCC's reliance on its amorphous public interest standard to create rules through its transaction reviews rather than through its formal rulemaking is the most effective tool at the agency's disposal.

Moreover, if policy changes and agency management were otherwise accomplished through a formal process, it would require congressional participation as well as formal notice and comment under the Administrative Procedure Act. By relying on informal rulemaking, however, through voluntary concessions the agency is able to increase its jurisdictional domain without either an act of Congress or court review. Thus, the FCC will look to novel approaches to expand the agency's jurisdiction while minimizing congressional oversight and control. As a result, the FCC has a strong incentive to build its empire through ad hoc consent decrees and conditions extracted via transaction reviews.

This, in many ways, describes the FCC's approach to rulemaking since the Telecommunications Act of 1996. Over the past two decades, the FCC's merger review process has become far more active and the agency has increasingly relied on the

public notice and comment periods as well as the potential for judicial review. Working through merger conditions, however, avoids notice and comment and is unreviewable by the courts.

Moreover, the FCC uses its transaction review to create policies that are beyond the scope of its statutory authority. For example, AT&T Broadband agreed to comply with the FCC's dubious regulations that capped a cable company's market share at 30% when AT&T acquired MediaOne in 2000. Those regulations were subsequently struck down in 2001 in *Time Warner Entertainment Co. v. FCC*. Similarly, the agency conditioned the Bell Atlantic-NYNEX merger on the merged firm's agreement to accept a complex price ceiling—a total element long run incremental cost (TELRIC)—for allowing competitors access to the firm's networks. This remained in force even though the Eighth Circuit had just ruled that TELRIC was impermissible and beyond the agency's jurisdiction.

The result is a clear threat to the rule of law. Merging parties may not know what conditions will be tied to their transaction and, more importantly, may not be able to escape those conditions even when the underlying policies are beyond the agency's authority. In effect, the FCC is able to create rules with the force of law that apply only to specific firms and are virtually unreviewable by courts.

By disregarding the formal rulemaking process and using transaction reviews to enforce policy positions, the FCC has left market participants in a position of knowing only the law once it is applied to them. This creates an environment with no ex ante predictability, no opportunity for notice and comment, and little ability to challenge the agency's decisions in court.

#### THREAT TO FREE SPEECH

If the FCC persists in extracting public interest benefits from firms that create and distribute speech, it may see its transaction authority limited after a facial First Amendment challenge. When courts are alerted to circumstances where government intimidation of the press is foreseeable and appeal is difficult, they typically take a dim view. The Supreme Court noted in its 1994 ruling in *Turner Broadcasting v. FCC* that "laws that single out the press, or certain elements thereof, for special treatment pose a particular danger of abuse by the State." Since court scrutiny is higher when government action is directed at portions of the press, the FCC's chosen path of empire building—extracting unreviewable concessions from firms during coercive transaction reviews—likely violates the Constitution's protection of the press and free speech.

Speech distributors that the FCC oversees, like cable and satellite TV companies, are protected by the First Amendment press protections. As Justice Potter Stewart wrote:

*The FCC will look to expand its jurisdiction while minimizing congressional oversight. Thus it has a strong incentive to build its empire through ad hoc consent decrees and conditions extracted via transactional reviews.*

use of "voluntary commitments" and merger conditions to accomplish its policy goals. This has been undertaken through concessions from merging parties to achieve what would traditionally be done through formal, industry-wide rulemakings. In addition, as suggested earlier, many of these voluntary concessions would not have been achieved if sought through the formal process.

Given the lack of institutional constraints, the FCC can engage in de facto rulemaking via transaction review with little external oversight or control. Without a clear objective standard upon which merger approvals are granted, the agency can use its amorphous public interest standard to achieve its policy goals without any practical limitations. As noted above, merging parties are forced to establish—to the FCC's satisfaction—that the merger will affirmatively provide public interest benefits. Moreover, unlike other agencies, the FCC has no statutory time limits to review mergers.

This places the FCC in a position of power and creates a strong incentive to achieve extraneous policy goals through merger review. This has consistently played out in several high-profile examples. For instance, when News Corp acquired DirecTV in 2004, the FCC used its transaction review to impose program access conditions. Program access rules are authorized by Congress through formal, industry-wide rulemaking, but require

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The Free Press guarantee is in essence a *structural* provision of the Constitution. Most of the other provisions in the Bill of Rights protect specific liberties or specific rights of individuals: freedom of speech, freedom of worship, the right to counsel, the privilege against compulsory self-incrimination, to name a few. In contrast, the Free Press Clause extends protection to an institution.

As one federal court said in the 2000 case of *Comcast Cablevision of Broward County v. Broward County*, striking down access regulations directed at an ISP, “Not only the message, but also the messenger receives constitutional protection.” Court sensitivity to state intrusions into the press arises because there is a historical appetite among many lawmakers and regulators to censor undesired speech, to compel desired speech, and to compel speakers to waive their speech rights. For hundreds of years, governments have targeted speech intermediaries for censorship rather than dispersed speakers and authors, who are more numerous, more difficult to identify, and more protected by social norms. Regulation of nascent distributors of speech throughout history is unfortunately the norm, not the exception. Ever since the spread of the printing press in the 1500s, when “broadcast” media first became economical, governments have initially sought to license and exert control over the producers and distributors—the printing press, the first newspapers, and motion pictures—of mass communications.

Those illiberal instincts survive today. In the 20th century, U.S. scholars and judges—like the printing press licensors of old—manufactured justifications for why new speech distributors should face license renewals, should be compelled to carry speech, or should be prosecuted for transmitting speech the government or its constituencies dislike. Though First Amendment jurisprudence since the 1970s has weakened direct FCC regulation of speech, legacy FCC intrusions into a free media exist today. In the United States, radio and TV broadcasters can be subjected to programming mandates and cable and satellite TV companies are compelled to carry video and speech from local broadcasters.

Therefore, our model of empire building suggests that the FCC’s transaction reviews will increasingly violate free speech norms. The appetite to put speech distributors under duress is always present and transaction reviews give the agency leverage and little risk of judicial review. Alarming, governments are increasingly looking to regulate content online even as internet-delivered media gains constitutional protection in the United States. Federal courts and legal scholars are concluding that internet-based media distributors—ISPs, search engines, online video distributors, and social media companies—create and dis-

seminate information and therefore are speakers protected by the First Amendment. Congressional policy is that the internet should be unregulated and the Supreme Court applies strict scrutiny to internet regulation that has a nexus to speech, so regulation is more difficult, but online speech regulations continue to arise in the United States and around the world.

The FCC’s recent Open Internet regulations, for instance, compel ISPs to carry video and other content they do not wish to carry. In recent years, several states and Congress have attempted to deputize ISPs and other online intermediaries to remove indecent material and prevent copyright infringement. Lawmakers recently requested the FCC chairman pressure Facebook to prevent terrorist and gang communications. In 2015, the United Nations Broadband Commission went so far as to encourage regulators to “use their licensing prerogative to ensure that only those Telecoms and search engines” that monitor and screen “cyber abuse and violence” against women are allowed to operate.

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*Whenever some new form of "broadcast" media becomes economical, governments have initially sought to license and exert control over its producers and distributors, whether newspapers, motion pictures, or electronic media.*

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Coverage of the First Amendment has broadened in recent decades but advocates still call for compelled speech of new speech distributors. In the 1970s, courts began reversing the earlier trends, which permitted expansive regulation of media. The Supreme Court’s 1974 *Tornillo* decision held that freedom of speech is violated not only by censorship but also by governmental attempts to compel speech. Since the First Amendment is a hindrance to regulation of modern distributors like cable TV, the internet, search engines, and algorithms, legal scholars are now searching for novel justifications for why search engines and ISPs lack First Amendment protection and can be compelled to carry speech.

Under existing law, the FCC can require more racial minority, children’s, health, and public affairs programming on broadcast TV and radio through rulemaking. The FCC can also promulgate modest regulations about industry composition if intended to increase viewpoint diversity in broadcast and cable TV. Yet, today the FCC is wary of formal mandates because they bring unwanted congressional attention, irritate media companies, and provoke public complaints of censorship. In ways consistent with the empire-building model, the agency uses opaque, coercive pressures that end in ostensibly voluntary commitments, thereby avoiding headline risk while allowing the agency to take credit for any public benefits.

Jawboning and informal pressures on media cannot be eliminated. It is likely beneficial to have government officials joining advocates in encouraging media norms about, say, offering diverse viewpoints, respectful treatment of controversial issues, and educational programming. The problem of coercion arises when these expectations are paired with the FCC's coercive power in transaction reviews. Hortatory language about diverse viewpoints and local news transforms into something more pernicious for a free media, and media companies are increasingly cooperating to satisfy their regulator's whims, including decisions related to content.

Firms that have been through the FCC transaction process and are likely to have transactions in the future are, for fear of FCC retaliation and poor press, not forthcoming about their motivations for various concessions. Nevertheless, the political activity and advocacy surrounding a transaction suggests which concessions will quiet a powerful transaction opponent and sate the FCC's loudest constituencies. Occasionally, parties' transaction strategies become public information.

The size of the Comcast-NBCUniversal merger in 2010 and the nature and amount of the concessions received news and scholarly coverage. The episode reveals what firms are willing to accept in order to accomplish a merger, and many of Comcast's and NBCUniversal's concessions were related to hiring, pricing, and programming decisions. For instance, knowing the commission's desire for more TV programming targeted for racial and ethnic minorities, Comcast promised to add cable channels that were owned by minorities or aimed at minority audiences. After pressure from smaller cable distributors who feared a vertically integrated competitor, a commissioner also requested that Comcast allow small cable providers easier, inexpensive access to NBCUniversal content.

Comcast-NBCUniversal volunteered many other conditions that the FCC will enforce. The concessions require Comcast to continue providing NBC programming to online distributor Hulu. Hulu is a joint venture of NBCUniversal, 21st Century Fox, and Walt Disney Co., but NBCUniversal can no longer exercise influence over Hulu operations. The merged firm was required to create a new Spanish-language broadcast channel and to expand its Spanish-language video-on-demand programming choices from 35 to 300 within three years. Comcast-NBCUniversal agreed to purchase certain programming content ("a new weekly business news program") from an independent producer and use a certain business model (syndication) for that program. The content-based conditions included expanding local and public interest programming and entering into agreements with local nonprofit news organizations for local reporting. There are similar requirements for children's programming and the FCC required the company to add 1,500 choices of video-on-demand programming targeted to children and families. Comcast-NBCUniversal is also required to spend "\$15 million each year on digital literacy, FDA nutritional guidelines, and childhood obesity" on networks targeted to young families, and must transmit public access,

educational, and governmental programming to 85% of its cable subscribers, exercise no editorial discretion over these programs, and create additional video-on-demand options. The list goes on, and Comcast-NBCUniversal's agreement showed sufficient public interest benefits to gain approval.

The FCC asserts it is preserving Comcast-NBCUniversal's editorial discretion with regard to these conditions, but this is a fiction. The company must file semi-annual reports with the FCC identifying the parties with which it is working, the nature of its agreements, and the quantity of programming produced down to individual "videos, articles, blog posts, and photos." The fact that the content required in these programming concessions are pro-social or (more dubiously) relatively easy for the merged company to accomplish distracts from the questionable legality of the process. These are precisely the circumstances the courts would deem unconstitutional for print media.

Suppose the same regulatory process that applies to broadcast, cable, and internet companies applied for newspaper-related transactions. Any time major newspapers merged, or sold or acquired delivery trucks, printing facilities, or some other necessary input for operation, the newspaper would have to first show the FCC that the transaction served the public. Suppose further that in short time the commissioners made it publicly known to newspapers that they would substantially help the likelihood of a transaction if they made certain public interest concessions. The agency does not formalize these guidelines, but in short time merging newspapers promise to give a column to an activist, publish more stories about climate change, no longer endorse candidates, publish new Russian-language dailies, and give free advertising to local churches.

Most readers likely sense that these circumstances represent a First Amendment violation and predictably chill the free exercise of speech. They would be correct. This follows from the Supreme Court's holding in *City of Lakewood*, where a city ordinance that gave the mayor a much more modest regulatory power—the ability to reject and accept applications to install newsracks on public property according to public interest determinations—was found to violate the First Amendment. In that case, the Supreme Court established that a licensing law with a "nexus to expression" that gives discretionary power to a governmental official is subject to facial challenge and presumptively unconstitutional. The Court went on to note:

A law requiring the licensing of printers has historically been declared the archetypal censorship statute.... Without standards to bound the licensor, speakers denied a license will have no way of proving that the decision was unconstitutionally motivated, and, faced with that prospect, they will be pressured to conform their speech to the licensor's unreviewable preference.

The Court noted that "nothing in the law as written requires the mayor to do more than make the statement 'it is not in the public interest' when denying a permit application." Recall, this

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is the very standard to which the FCC is bound. The *City of Lakewood* Court called such a standard an “illusory constraint” on the mayor’s discretion. The Court stated that absent binding judicial or administrative construction of the public interest or some other explicit limits, the law was impermissible.

The review of mergers by media companies and distributors gives the FCC substantial power to discriminate between speakers. Improper censorial motive is not required for an action to be a vio-

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lation of the First Amendment. If Congress authorized expressly that the FCC could compel, say, Spanish-language programming and contracts with independent documentary producers, the law would likely be subject to facial challenge by any party subject to the rules. Many large cable companies, broadcasters, and ISPs have many financially significant dealings with the FCC and are unlikely to challenge the law even if there is a great possibility of success. The risk of retaliation in other proceedings is too great. Further, some large parties may regard the existence of opaque public interest reviews as a competitive benefit. Any challenge, therefore, would likely need to come from a smaller operator that is not as reliant on the commission’s good graces for competitive survival. Such a challenge, however, may be successful in light of the FCC’s more recent transactions that single out certain speech distributors and solicit “voluntary” programming obligations.

### PROPOSALS FOR REFORM

If the agency does not articulate predictable standards in transaction reviews, it is vulnerable to a facial First Amendment challenge that could limit the FCC’s existing authority.

The most straightforward proposal to guard against the problems inherent in the FCC’s current approach is to simply stop reviewing mergers. The Communications Act provides no general merger authority. The agency has treated its authority over license transfers as de facto merger review authority. Reversing this position could be achieved by something as simple as the chairman of the FCC stating that the commission would no longer review mergers under the public interest standard because it is outside its authority under current law.

Second, if the FCC is unwilling to constrain itself, Congress could explicitly preclude the FCC’s Communications Act authority to review transactions. It is important to note that constraining

the FCC’s authority to review transactions would not leave telecommunications industry mergers unreviewed. The Department of Justice currently reviews telecommunications mergers under the Clayton Act, with overlapping authority given to the FCC. Instead of FCC reviews, however, transaction review could be left with the DOJ or given to the Federal Trade Commission, whose scope and jurisdiction already cover mergers in most industries, rather than the FCC’s industry-specific focus.

Ending the FCC’s transaction reviews and leaving the reviews with the DOJ and FTC would achieve two goals. First, it would provide for a transaction review process that has clearly delineated standards. Currently, mergers reviewed by the FTC and DOJ are subject to welfare-based standards and analysis rather than the FCC’s amorphous public interest standard. Second, since the FTC and DOJ focus almost solely on anticompetitive effects across a number of industries, the incentive to use transaction review as a tool to further other communications and media policies is much lower.

### CONCLUSION

Regulatory agencies have a natural incentive to engage in empire-building behavior and the FCC, through its public interest standard, faces few formal legal constraints on growing its power. As the agency uses its transaction review authority to extract concessions from individual companies, it has created a powerful tool for informal rulemaking that binds parties to policy goals that are otherwise unachievable in the formal rulemaking process. Moreover, this tool allows the FCC to pursue policy goals that lie outside its jurisdiction.

Because of these abuses, we propose doing away with the FCC’s transaction review authority altogether or, at the very least, reforming the process to better protect transacting parties from the designs of political actors. Such reforms would be an exercise in good governance and would mitigate the possibility of a successful facial First Amendment challenge to FCC transaction review. R

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