



PUBLIC NOTICE

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DOMESTIC SECTION 214 APPLICATION GRANTED SUBJECT TO CONDITION

WC Docket No. 18-268

By this Public Notice, the Wireline Competition Bureau (Bureau) grants, subject to condition, the application requesting approval to transfer control of Smart City Telecommunications LLC (SCT), Smart City Solutions, LLC (SCS), Smart City Networks, Limited Partnership (SCN), Smart City of Washington D.C., LLC (SDC), and Convention Communications Provisioners, Inc. (CCP) (collectively, Licensees) to Sapphire Intermediate Holdings, LLC (Sapphire Intermediate Holdings).¹ On September 18, 2018, we released a Public Notice requesting comment on the Application.² We received no comments in opposition to a grant of the Application.

Background. SCT is the incumbent local exchange carrier (LEC) serving Celebration, Lake Buena Vista, Little Lake Bryan, and Bay Lake, Florida. SCT receives universal service support under the Alternative Connect America Cost Model (A-CAM).³ SCS provides competitive telecommunications services in Florida. SCN is authorized to provide competitive intrastate telecommunications services in Florida, North Carolina, and Nevada. SDC provides competitive telecommunications services in Washington, D.C. CCP provides competitive telecommunications services in the state of Washington.

¹ See 47 U.S.C. § 214; 47 CFR §§ 63.03-63.04. Domestic Section 214 Application for Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended, for Consent to Transfer Control of Smart City Telecommunications LLC *et al.*, WC Docket No. 18-268 (filed Sept. 5, 2018) (Application). Applicants filed supplemental letters addressing the Application. Letter from Paige K. Fronabarger, Counsel to Sapphire Intermediate Holdings, LLC, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 18-268 (filed Oct. 19, 2018) (Oct. 19 *Ex Parte*); Letter from Paige K. Fronabarger, Counsel to Sapphire Intermediate Holdings, LLC, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 18-268 (filed Sept. 14, 2018); Letter from Paige K. Fronabarger, Counsel to Sapphire Intermediate Holdings, LLC, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 18-268 (filed Sept. 12, 2018). Any action on this domestic section 214 application is without prejudice to Commission action on other related, pending applications.

² *Domestic Section 214 Application Filed for the Transfer of Control of the Subsidiaries of Smart City Holdings, LLC to Sapphire Intermediate Holdings, LLC*, Public Notice, WC Docket No. 18-268 (WCB 2018) (*Public Notice*).

³ October 19 *Ex Parte* at 2; *Wireline Competition Bureau Authorizes 182 Rate-of-Return Companies to Receive \$454 Million Annually in Alternative Connect America Cost Model Support to Expand Rural Broadband*, WC Docket No. 10-90, Public Notice, 32 FCC Rcd 842 (WCB Jan. 24, 2017) (*A-CAM Public Notice*). The Commission adopted a voluntary path by which rate-of-return carriers could elect to receive a fixed amount of universal service support under A-CAM, a forward-looking broadband cost model, for 10 years in exchange for deploying broadband-capable networks to eligible locations. *Connect America Fund et al.*, Report and Order, Order and Order on Reconsideration and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087, 3090, para. 4, 3096-3117, paras. 20-79 (2016).

Sapphire Intermediate Holdings, which Applicants created for the purposes of this transaction, will indirectly wholly own the Licensees.⁴ Court Square Capital Partners (Court Square), a New York private equity firm, will ultimately control Sapphire Intermediate Holdings.⁵ Court Square controls other telecommunications providers, including MBS Holdings, Inc. and its subsidiary, Alteva of Warwick, LLC (Alteva of Warwick).⁶ Alteva of Warwick receives cost-based universal service support for its rate-of-return incumbent LEC service in one study area in New Jersey (Alteva NJ).⁷ Alteva of Warwick receives support under the A-CAM for its rate-of-return incumbent LEC service in one study area in New York (Alteva NY).⁸

Discussion. The Applicants request approval to consummate a transaction involving companies that receive high-cost universal service support under the different mechanisms of fixed model-based support and cost-based support. The Commission has found that these types of mixed support transactions could result in potential harm to its goal of ensuring that limited universal service funding is distributed efficiently and effectively.⁹ When a company receiving a fixed level of support acquires or is acquired by a company receiving support based on its costs, the combined companies could, and in some instances might have an economic incentive to, shift certain shared or common costs from the model-based support company to the cost-based support company.¹⁰ If cost shifting were to occur, the combined company, post-transaction, could obtain more high cost universal service support than the two companies did as separate entities, not because of any new investment, expense, or buildout, but rather solely because of the application of accounting procedures. Such an outcome is inconsistent with the Commission's general expectation that transactions generate efficiencies that reduce the combined company's costs.¹¹ Moreover, providing additional universal service support to a company as a result of cost shifting solely because it acquired or merged with another company is not an efficient use of limited universal service resources.¹²

In the *Hargray/Com South Order*, approving a mixed support transaction to prevent cost shifting and to protect the finite resources of the high-cost universal service fund, the Commission imposed a limited condition that capped high-cost universal service support based on the operating expenses of the entity receiving cost-based support.¹³ The Commission also directed the Bureau to impose the same limited condition on future transactions between parties receiving different types of high-cost universal

⁴ Application at 5.

⁵ *Id.* at 5-6; *Public Notice* at 2.

⁶ Court Square controls other entities that provide competitive telecommunications services in multiple states. *Public Notice* at n.3. According to the Applicants they do not provide overlapping telecommunications services in any of their incumbent LEC service areas. Application at 4, 9, 24; *Public Notice* at 2.

⁷ October 19 *Ex Parte* at 2; Universal Service Administrative Co., Tools, <https://www.usac.org/hc/tools/default.aspx>.

⁸ October 19 *Ex Parte* at 2; *A-CAM Public Notice*, 32 FCC Red at 845.

⁹ *Joint Application of W. Mansfield Jennings Limited Partnership and Hargray Communications Group, Inc., for Consent to the Transfer of Control of ComSouth Corporation Pursuant to Section 214 of the Communications Act of 1934*, WC Docket 18-52, Memorandum Opinion and Order, FCC 18-62, para. 19 (rel. May 11, 2018). (*Hargray/ComSouth Order*).

¹⁰ *Id.* at para. 20.

¹¹ *Id.*

¹² *Id.* at para. 21.

¹³ *Id.* at paras 26-31.

service support.¹⁴

In this proceeding, because Court Square, which holds a cost-based support company, Alteva NJ, is acquiring SCT, a fixed model-based support company, the potential for harm caused by cost-shifting is a transaction-specific harm. Accordingly, to mitigate the potential for cost shifting, we grant the Application subject to the condition adopted in the *Hargray/ComSouth Order*.¹⁵ The combined operating expense of Alteva NJ and any other rate-of-return affiliates¹⁶ shall be capped at the averaged combined operating expense of the three calendar years preceding the transaction closing date for which the operating expense data are available.¹⁷

The cap will apply to cost recovery under both High-Cost Loop Support (HCLS) and CAF-Broadband Loop Support (CAF-BLS) and will be applied proportionately to each affiliate's accounts used to determine the affiliate's eligible operating expense for HCLS and CAF-BLS.¹⁸ For example, if the cap requires that a post-consummation company's eligible operating expense be reduced by 10 percent, then each account used to determine each rate-of-return affiliate's eligible operating expense shall be reduced by 10 percent.¹⁹ For purposes of this cap, operating expense shall include maintenance, network support/network operations/general, benefits, rent expenses, and corporate operations, while depreciation, return on investment, and taxes shall be excluded.²⁰

For all covered entities, the new cap shall also include an annual adjustment for inflation based on the Gross Domestic Product-Channel Price Index (GDP-CPI) for the years in which the new cap remains in effect.²¹ This cap shall remain in effect for seven years from the consummation of the transaction.²² The condition will also sunset if all of a post-consummation company's rate-of-return subsidiaries

¹⁴ *Id.* at para 27, n. 72.

¹⁵ *Id.* at paras 26-31.

¹⁶ See 47 U.S.C. § 153(1).

¹⁷ *Hargray/ComSouth Order* at para. 27. The cap will apply to the combined operating expenses of Alteva NJ and any other existing rate-of-return affiliate and any rate-of-return affiliates that Court Square may acquire during the time in which the condition is in effect (together covered entities). To monitor compliance with the condition adopted herein, to the extent it does not already do so, we direct Alteva NJ and any other covered entity to submit its relevant cost data to the National Exchange Carrier Association (NECA). We direct NECA to provide the dollar amount of the operating expense costs that will be capped pursuant to this Public Notice to the Universal Service Administrative Company (USAC) within 30 days following submission of any covered entity's cost data. We further direct NECA to provide USAC with the reductions in HCLS and CAF-BLS for any covered entity pursuant to this Public Notice for each year following the effective date of this Public Notice. USAC shall validate all calculations received from NECA before making disbursements subject to any such support reductions. We also direct all covered entities to provide USAC with an annual certification of compliance on or before December 31 of each year for the duration of the condition. With the certification, each covered entity must also submit its latest audited financial statements to USAC, including all notes and consolidating statements, on an annual basis, by December 31 of each year. *Hargray/ComSouth Order* at para. 31. If a covered entity does not maintain audited financial statements in the ordinary course of business, it may submit financial statements that meet the requirements of Form 481. *Hargray/ComSouth Order* at n.82.

¹⁸ *Hargray/ComSouth Order* at para. 28.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at para. 30.

²² The Commission has found seven years to be an appropriate period over which to monitor enforcement of the condition and to ensure that the combined entity, which will continue to receive support, does not shift costs from year-to-year. *Id.* at 11, para. 29. The cap will not apply if the parties do not consummate the proposed transaction.

become model-based support companies at any point during the seven-year period.²³

We find, upon consideration of the record, that grant of the Application listed above, subject to compliance with the condition, will serve the public interest, convenience, and necessity.²⁴ Therefore, pursuant to section 214 of the Act, 47 U.S.C. § 214, and sections 0.91, 0.291, 63.03, and 63.04 of the Commission's rules, 47 CFR §§ 0.91, 0.291, 63.03, and 63.04, the Bureau hereby grants the Application discussed in this Public Notice subject to compliance with the condition described above.²⁵

Pursuant to section 1.103 of the Commission's rules, 47 CFR § 1.103, the grant is effective upon release of this Public Notice. Petitions for reconsideration under section 1.106 or applications for review under section 1.115 of the Commission's rules, 47 CFR §§ 1.106, 1.115, may be filed within 30 days of the date of this Public Notice. For further information, please contact Dennis Johnson, Wireline Competition Bureau, Competition Policy Division, (202) 418-0809.

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²³ *Id.* at para. 29.

²⁴ See 47 U.S.C. § 214(a); 47 CFR § 63.03; see also *Applications of Level 3 Communications, Inc. and CenturyLink for Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 32 FCC Rcd 9581, 9606, para. 54 (2017) (finding that the transaction would advance the public interest by expanding the reach and service capacity of the combined entity); *Applications Filed by Qwest Communications and CenturyTel, Inc. d/b/a CenturyLink for Consent to Transfer Control*, Memorandum Opinion and Order, 26 FCC Rcd 4194, 4202, para. 15 (2011) (referring to Applicants' overlapping competitive LEC operations and stating "[r]ather than harming competition, we believe that the combination of the Applicants' facilities in these markets could result in a stronger competitive LEC and enhance the merged company's ability to compete against the incumbent LEC.").

²⁵ The applicants in this proceeding provide incumbent LEC services in their respective study areas. Within 30 days of closing the proposed transaction, they must notify USAC so that it can make any appropriate changes to the High Cost Universal Broadband (HUBB) on-line location reporting portal for universal service recipients.