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**REPORT OF  
THE FCC SMALL BUSINESS ADVISORY COMMITTEE  
TO THE FEDERAL COMMUNICATIONS COMMISSION  
REGARDING GEN DOCKET 90-314  
SEPTEMBER 15, 1993**

**SUBMITTED THROUGH FCC OSBA SEPTEMBER 15, 1993**

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## **EXECUTIVE SUMMARY**

In order to assess the policy implications of General Docket 90-314, the FCC Small Business Advisory Committee (SBAC) held hearings in Washington, D.C. on May 27, 1993 and September 14, 1993. The Committee elicited testimony from industry leaders and other interested parties. Our findings and recommendations are summarized below.

### **Findings**

- o Entry opportunities for small service providers have been constrained in existing telecommunications markets by undercapitalization, concentration of ownership, and other conditions contributing to the exclusion of businesses owned by minorities and women.
- o Capital formation is one of the major economic barriers to full participation by small and minority owned businesses.
- o The FCC can make these barriers surmountable through its crafting of interlinking policies which affect the amount of cash required based on (1) the amount of spectrum bid, and (2) the size of the licenses. Additional measures including bidding enhancements and tax expenditure finance assistance are appropriate regulatory tools to ensure that the public receives the best practical service from emerging PCS technologies, and to increase economic opportunities in the PCS field.

### **Recommendations**

#### **Regulatory Proposals**

- o Service area designations and bandwidth assignments should attempt to remove significant impediments to entrepreneurial entry in the PCS field that could accompany a system of licensing based on competitive bidding.
  - Allocate a spectrum block for qualified small, female and minority businesses;
  - Allocate small spectrum blocks, e.g., 20 Mhz-25 Mhz per license;
  - Provide for multiple licenses in each geographic area.
  - Allow for an exemption to any proposed spectrum caps in a market where a joint venture exists with a small, female or minority business.
- o The Commission should encourage innovative and efficient service proposals by designing bidding methodologies, and supporting policies, to encourage entry opportunities and capital formation:
  - Use eligibility requirements for bidding designed to encourage equal employment opportunities, opportunities for minority and female vendors, and formation of strategic small business alliances with large LECs and cellular operators.
  - Allow applicants to certify financial qualifications based on "highly confident" letter and letters of intent from qualified investment banking firms, venture capital funds and Specialized Small Business Investment Companies.
  - Encourage strategic small business alliances generally by awarding "innovator's bidding credits" equal to 10% of an applicants bid.
  - Allow installment payments and royalty arrangements for qualified small, female and minority businesses.
  - Authorize distress sales to small business entities where winning bidders are ineligible, unqualified, unable to pay, or unable to complete construct requirements.
  - Seek legislation establishing a communications capital fund from revenues generated

by spectrum actions.

- o **The Commission should also authorize use of tax certificate and other financing techniques, in consultation with the SBA and the IRS, to encourage capital formation:**
  - **Fixed microwave licensees seeking tax certificates for relocation.**
  - **SBA licensed Specialized Small Business Investment Companies that furnish financial and technical assistance to small PCS licensees owned by members of minority groups, women and disadvantaged rural entities.**
  - **Owners and investors in minority owned and controlled PCS licensees.**

**Classification Standards**

- o **The criteria for small, female, and minority business standards should be consistent with the Small Business Administration's (SBA) current standards for small and minority business concerns applying for financial and or management assistance from Small Business Investment Companies (SBIC) under the SBIC program.**
- o **The Commission should request comment from the public, after consulting with the SBA, to determine complementary eligibility standards for PCS capital formation policies.**
- o **Minority and female controlled entities should be subject to anti-trafficking requirements, should maintain 51% equity and voting control from the initial grant through construction and operation of the PCS license.**

## MARKET OVERVIEW

Our review of existing radiotelephone industries confirmed that the universe of potential service providers is significantly constrained by increasing concentration of ownership and undercapitalization. In our view, the introduction of competitive bidding procedures is more likely to compound, rather than relax, these impediments to market entry.

### Need for Economic Opportunity

Economic opportunities for rural telephone companies, omnibus businesses owned by members of minority groups and women are major policy objectives of the Budget Reconciliation Act of 1993.<sup>1</sup> The legislative history of the Act indicates that the House Committee on Energy and Commerce was generally concerned that "unless the Commission is sensitive to the need to maintain opportunities for small businesses, competitive bidding could result in a significant increase in concentration in the telecommunications industries." (emphasis added) Following the Committee's initial concerns with small business generally, concerns arose that specific provisions were needed to "ensure that businesses owned by members of minority groups and women are not in any way excluded." The House Report goes on to state that the "Committee anticipates that in some instances the Commission will act in a manner that is comparable to a mortgage banker, who designs new mortgage instruments in order to increase the universe of people who can afford to buy homes."<sup>2</sup> (emphasis added) Senate-sponsored amendments later reflected similar concerns with respect to rural telephone companies. Thus, the economic opportunity provisions invite reference to the distinct public interests in disseminating licenses among a wide variety of applicants in the future to avoid excessive concentration of ownership,<sup>3</sup> and preempting exclusion of minorities and women from communications

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1 Pub.-Law 103-66, Title VI, 107 stat. 312.

2 Id., at p. 9.

3 The District Court for the District of Columbia recognized that avoidance of concentration of ownership initially justified efforts to encourage small business growth in electronic publishing through line of business restrictions under the AT&T consent decree. United States v. AT&T, 552 F. Supp. 131, 183 (D.C.D.C. 1983). The Commission has also invoked the public interest in internodal competition and new and expanded telecommunications service to justify inclusionary ownership policies for satellite transponders and earth stations. World Communications, Inc. v. FCC, 735 F. 2d 1465, 1475 (D.C. Cir. 1984) (transponder sales) (1934 Act arms FCC with "elastic powers to accommodate dynamic new developments in the field of communications"); TRT Telecommunications v. FCC, 876 F. 2d 134 (D.C. Cir. 1989) (earth stations).

ownership.

### **Barriers To Market Entry**

While uncertainty exists about the precise economic impact of the future PCS market structure, based on our findings, we are concerned that existing investment policies and practices, concentration of ownership, and undercapitalization, pose a serious risk that competitive bidding for spectrum will unduly burden, and in some cases foreclose, entry opportunities for small service providers.

### **Investment Trends**

Although the precise economic impact of the future PCS marketplace is difficult to predict, it is widely accepted that the "primary obstacle to new entrants is lack of capital ..."<sup>4</sup> According to a recent NTIA study, taxation of capital gains is a major contributor to the high cost of capital for U.S. telecommunications firms.<sup>5</sup> The United States is the only major industrialized country that neither provides any capital gains tax relief or relief from double taxation of corporate profits. For this reason, some conclude that the internal revenue code "penalizes equity investment to a greater extent than any of our foreign rivals." The decline in capital available to small start-up firms following the passage of the 1986 Tax Reform Act, which raised capital gains tax rates by 40%, dramatically illustrates the adverse effect of current tax policy on small business investment. Between 1986 and 1991, the amount of venture capital made available to start new companies fell from \$4.19 billion to \$1.41 billion - a two thirds decline in financing for small business. During the same period, the number of start-up firms financed with venture capital dropped from 1,512 in 1986 to 792 in 1991.<sup>6</sup>

Debt financing practices among institutional lenders have also been cited as a cause of debt capital unavailability to small entities, including small FCC regulatees. Acquisition and operation of regulated communications facilities is extremely capital intensive. Without a track record of ownership

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4 **Statement of Barry Pineles, Assistant Chief Counsel for Market Competition Before the FCC Small Business Advisory Committee, May 27, 1993, p. 6.**

5 **U.S. Department of Commerce, Telecommunications in a Global Economy: Competitiveness at the Crossroads, Washington, D.C., (1990), p. 29.**

6 **McArdle, "Can Gov't Afford Cap Gains Hike?" Investor's Business Daily, July 22, 1993, p. 1, 2.**

and substantial capital resources, new entrants typically encounter difficulties obtaining start-up funds. Lenders are frequently reluctant to finance loans, even when applicants have a track record, since FCC licenses cannot be used for collateral. Lenders also prefer to work with multiple-property owners.

#### **Concentration of Ownership**

Recent market trends in the existing radiotelephone industry suggest a trend toward concentration of ownership. SBA sales and employment data shows that a significant decline in the total number of firms in the radiotelephone industry coincided with declines in sales and employment shares among radiotelephone operators with less than 249 employees between 1989 and 1991. Of a total of 990 firms in SIC Code 481 in 1989, 971 firms with 249 employees or less possessed a 35.1 percent cumulative market share in 1991, compared to 927 firms in the same employment size range with a cumulative market share of 52.5 percent in 1989. In contrast, there were a total of 19 firms with over 249 employees commanding a 64.9 percent cumulative market share in 1991, compared to 21 firms of the same size range with a cumulative market share of 47.5 percent in 1989. SBA data on employment growth patterns shows that employment decreases due to firm "deaths" exceeded employment increases due to firm "births." We interpret data concerning firm "deaths" to mean that contraction among firms with less than 249 employees is due in part to attrition, and is not entirely explained by consolidation of ownership in the radiotelephone industry.

#### **Racial and Gender Disadvantage**

Women and members of minority groups have encountered special barriers to telecommunications ownership.<sup>7</sup> At a time when women are becoming a major force in the world of small business generally, significant disparities between female ownership in telecommunications and the general economy persist. Between 1982 and 1987, the number of women owned proprietorships, partnerships, and Subchapter S corporations rose from 2,612,621 to 4,112,787, an increase of about 58% compared to a 26.2 percent increase among small businesses generally. In addition, total receipts of women owned businesses nearly tripled over this period -- rising from \$98.3 billion in

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7 Letter of Hon. Larry Irving, Asst. Sec. for Communications and Information, to Hon. James H. Quello, Acting Chairman, FCC, September 14, 1993. ("We encourage the Commission to develop rules to implement competitive bidding for PCS that will provide greater opportunities for participation by groups currently underrepresented in telecommunications industries").

1982 to \$278.1 billion in 1987, compared to a 55% increase among small businesses as a whole during the same period. The Census Bureau's Survey of Women owned businesses showed that 30% of U.S. businesses were owned by women. The industry subgroup containing transportation, communications, and public utilities, however, accounted for only 1.9% of the women owned firms.<sup>8</sup>

The advocacy group American Women in Radio and Television suggests that lack of financing may account for the disparities between the percentage of communications businesses owned by women and the percentage of all businesses owned by women. "No existing FCC policy provides an incentive for women to enter the [communications] business. Nor are there any small business investment companies operating to assist women..."<sup>9</sup> In view of the disparity between the statistical profile of businesses owned by women in telecommunications and the profile of women in other areas of the economy, we believe the lack of telecommunications-specific financial and technical assistance should be considered significant impediment to market entry.

Businesses owned by minorities also face special problems. A recent study by the U.S. Minority Business Development Agency found minority firms represent only 0.5 percent of all firms in SIC Code 4812 and 4813 combined.<sup>10</sup> In that study, moreover, researchers found only 11 minority firms engaged in the delivery of cellular, specialized mobile radio, radio paging, or messaging services, while only 11 minority firms in SIC Code 5065 distribute cellular equipment.

The factors that have precluded minorities from effective participation in ownership of radio facilities involve access to finance, but are difficult to isolate or quantify. Dr. JoAnn Anderson, Director of NTIA's Minority Telecommunications Development Program, testified at our May hearing that there are often similarities between small businesses and minority businesses indicating that capital access is a problem for small businesses across the board, but "minorities will have additional

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8 Letter of Melodie Virtue, Vice President Government relations, American Women in Television and Radio, August 6, 1993.

9 Comments of AWRT in MM Docket 91-140, pp. 2, 8 (citing The State of Small Business: A Report to the President, 1991).

10 Market Analysis of the Telecommunications Industry - Opportunities for Minority Businesses, U.S. Minority Business Development Agency: Washington, D.C. (1991)

problems."<sup>11</sup> One additional problem is that minorities frequently do not or cannot use traditional sources of financing, and that the most frequent source of capital is family savings and friends.<sup>12</sup> Another problem noted by the U.S. Senate is that spectrum for radio facilities was first allocated at a time when "undisguised discrimination in education, employment opportunities, and access to capital excluded minorities from all but token participation."<sup>13</sup> Thus, through no fault of their own, minorities were impeded from competing successfully for licenses when they were first awarded and as they became available in the market due to systemic barriers to technical training and employment opportunities.<sup>14</sup>

### **Consequences of Spectrum Malapportionment**

Burdens on small business entry poses a risk of spectrum malapportionment that could significantly limit the value of PCS spectrum to society as a whole. While companies of all sizes are potential contributors to innovation and efficiency, many technological advances in recent years have been introduced by small firms and new entrants. For instance, 55 percent of all technological innovations are attributable to firms with less than 500 employees.<sup>15</sup> Studies have also shown that small firms innovate at a per person rate twice that of large firms, spend more on research and development, and translate research and development spending into new products more efficiently than large firms.<sup>16</sup> In addition, "[s]mall businesses were responsible for 33.1 percent of employment and 45.7 percent of the growth in the communications sector from 1986-1988, and accounted for 90 percent of all new jobs created in fiscal year 1990."<sup>17</sup> Nontechnical innovation and efficiency also

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11 Statement of JoAnn Anderson, PhD. Before the FCC Small Business Advisory Committee, May 27, 1993.

12 Anderson, supra, note 8.

13 Brief of the U.S. Senate As Amicus Curiae in Metro Broadcasting, Inc. v. FCC, 110 S. Ct. 2997 (1990), p. 32, 33.

14 See, Telecommunications Minority Assistance Program, 1978 Pub. Papers 253 (President Carter).

15 "Characterizations of Innovations Introduced on the U.S. market in 1982," U.S. Small Business Administration.

16 Joint Petition for Further Rulemaking of Advanced Mobilecomm Technologies, Inc. and Digital Spread Spectrum Technologies, Inc., in Gen. Docket 90-314, Exhibit #3, pp. 12, 13.

17 Statement of PCS Action, Inc. Submitted to the FCC Small Business Advisory Committee, May 27, 1993, p. 1.

appears to vary with ownership and control factors. The Congressional Research Service found that, compared to stations with no minority ownership, most radio stations in which members of minority groups hold an interest provide services designed to meet the needs of a diverse array of consumer groups including women, children, senior citizens, and foreign language groups.<sup>18</sup> Thus, underrepresentation or exclusion of applicants likely to introduce innovative and efficient service has direct implications for small businesses and residential consumers who seek expanded communications capabilities offered by PCS technologies.

Some have argued that the productivity and competitiveness of the nation's citizens and small businesses are severely limited by inferior telecommunications capabilities.<sup>19</sup> Unlike large business users, small and medium sized users frequently lack in-house managers, advanced telecommunications equipment and service options, redundant telecommunications capabilities during disasters and outages, and the inability to collect proprietary information about calling patterns. Critics also allege that these inferior telecommunications capabilities are in part the result of certain tariff restrictions imposed by LECs, and other 'use' and 'user' restrictions, that arbitrarily prevent small businesses from establishing sharing arrangements to achieve volumes and economies of scale enjoyed by larger businesses. Residential communities also have specialized needs. Possible consumer uses for PCS include personal emergency situations, routine point-to-point communications,<sup>20</sup> transmission of medical data, and dissemination of news, information services, and educational materials. Rural populations may also benefit from use of PCS technologies for mobile emergency and activities, farming applications, and rural community hospitals and clinics.<sup>21</sup> Based on available data, we believe a universe of service providers that utilizes small businesses is most likely to meet these specialized needs of small businesses and residential consumers effectively and efficiently.

#### **DISCUSSION OF REGULATORY PROPOSALS**

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- 18 CRS, Minority Broadcast Station Ownership and Broadcast Programming: Is there a Nexus? (June 29, 1988).
- 19 Gorosh, Steve, Small Business, Telecommunications, and Economic Development, California Western Law Review, Spring 1993.
- 20 Barrett and Marchant, Emerging Technologies and Personal Communications Services: Regulatory Issues, CommLaw Conspectus Vol. 1, p. 7.
- 21 CTIA White Paper #7: For Small Business, PCS is a Big Deal, September 8, 1993, p. 3.

## **Overview**

One major challenge remaining before the Commission in Docket 90-314 is the task of implementing the economic opportunity provisions of the Budget Reconciliation Act. In this section of our report, we discuss specific proposals for implementing economic opportunity safeguards. In general, our recommendations seek to promote capital formation and entry opportunities through allocation of local spectrum blocks for small business applicants, size conscious bidding methodologies, and a PCS tax certificate program.

Prior to the passage of the Act in August, the Commission adopted a First Report and Order concerning eligibility criteria, service areas, and spectrum allocation for narrowband PCS, which represents an important first step in bringing PCS technologies to the marketplace. The First Report and Order<sup>22</sup> will create 5,500 new licensing opportunities for national, regional, and local narrowband PCS providers, including licensing opportunities for small business at the local level, and ancillary marketing and equipment manufacturing opportunities. The Act opens the door to more pro-active steps along these lines by providing the Commission with explicit authority to promote economic opportunity.

Under the Act, the Commission has several means to promote the public interest in the use of spectrum and encourage economic opportunity, competition, and new and expanded telecommunications services. The overriding purpose of the Act is to improve licensing and spectrum allocation by authorizing competitive bidding procedures with safeguards to protect the public interest in the use of spectrum. The text of the Act plainly contemplates that safeguards in the form of small business ownership regulations that further economic opportunity. First, the Act directs the Commission to design competitive bidding procedures that will avoid excessive concentration of licenses and disseminate licenses among a wide variety of applicants. 47 U.S.C. 309(j)(3). The Act further directs the Commission to prescribe area designations and bandwidth assignments that promote economic opportunity for a wide variety of applicants. 47 U.S.C. 309(j)(4)(C). Finally, the Act directs the Commission to consider the use of tax certificates, bidding preferences, and other procedures to ensure that small businesses are given opportunities to participate in providing spectrum based services. 47 U.S.C. 309(j)(4)(D).

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22 GEN. Docket No. 90-314 58 FR 42681 (August 11, 1993).

## **Service Areas and Bandwidth Assignments**

### **Background**

Our May hearing revealed several differing viewpoints on the way service area and bandwidth assignments might be used to promote small business participation. The Small Business PCS Association (SBPA) emphasizes that small businesses will be effectively excluded from all but the smallest service area being considered due to the capital intensive nature of PCS technology, and that even the Basic Trading Area "will be a large bite for small businesses to swallow in large metropolitan areas." SBPA's recommends two regional service areas and two BTA's spectrum blocks for small business eligibles. One of the small business BTA spectrum blocks would be awarded as a "Small Business Developer's License" to a qualifying small business experimental license holder who has put forth significant effort and investment in developing the service being licensed.<sup>23</sup>

APC, an advocate of 40 MHz allocations, maintains that small spectrum blocks will delay deployment, cripple local licensees with high infrastructure costs, and deny economies of scale enjoyed by entrenched competitors.<sup>24</sup> According to APC, a better way to target programs for small and minority entrepreneurs is to provide an opportunity for PCS licensees to "franchise" portions of licensing areas to other entities. APC, like SBPA, also points out that a spectrum set-aside may also be a reasonable means to promote entry by small service providers. APC notes that several agencies of the federal government, such as the U.S. Forest Service, the Bureau of Land Management, and the Bureau of Indian Affairs, employ set-asides to foster small business participation in government auctions.<sup>25</sup>

In a similar vein, MCI originally proposed in the PCS rulemaking that the FCC issue three national PCN licenses, by comparative hearings, to qualified consortia subject to ownership requirements to ensure local diversity; or alternatively, two national licenses with 40 MHz of spectrum

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23 Letter of Robert H. Kyle, Chairman, Small Business PCS Association, August 7, 1993.

24 Statement of Gary L. Thomas, American Personal Communications, Inc., May 27, 1993.

25 American Personal Communications, Small Business and Minority Participation in the PCS Industry (August 1993).

and two local licenses with 20 MHz of spectrum. According to MCI, small, minority and female entrepreneurs would benefit from the significant opportunities this approach offers to participate in national consortia as local PCS operators.<sup>26</sup> We discuss these approaches below.

#### **Discussion**

Our basic premise is that the primary business opportunities the Commission should promote with service areas and bandwidth assignments are those that provide direct licensing opportunities for small service providers, and that mechanisms to encourage new entrants must be balanced with the larger objective of encouraging the best practicable service to the public. Based on these considerations, we have decided to support a regulatory structure with four to five service providers with 20-25 MHz of spectrum in small service areas of equal size, with one spectrum block for small business PCS applicants in the lower band.

**Service Areas.** In our view, a regulatory structure with many providers, and a large number of small service areas, is likely to promote competition, accelerate deployment, encourage diverse services, and promote economic opportunities. Small service areas permit parallel efforts to deploy PCS infrastructure. Small service areas could also have important benefits during the initial implementation of PCS when the market is still being defined. Accordingly, we support the use of local service areas based on Rand McNally Basic Trading Areas.

In order to ensure that small licensing areas will not be barrier to delivery of wide area services, the Commission should encourage existing standards-setting bodies to adopt a voluntary "Common Air Interface Standard" for handsets and base stations. The Commission could chose the standard by soliciting recommendations from the Telecommunications Industry Association (TIA), the Institute of Electrical and Electronic Engineers (IEEE), and the Advisory Group of Accredited Standards Committee (T1). We propose that each organization submit no more than two standards by April 1, 1994. The Commission could then publish and distribute the recommendations to facilitate consensus on standards issues among small businesses interested in participating in auctions.

**Bandwidth Assignments.** We recognize that debate over large vs. small spectrum blocks

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26 Remarks of Steven Zecola, MCI, Inc., May 27, 1993.

involves any valid concerns. For instance, the costs of relocating existing users may be less with large spectrum blocks since licensees could more easily avoid certain frequencies encumbered by microwave users. Larger allocations could also lead to alternative services, such as larger bandwidth data or imaging services, and affordable equipment for consumers. However, since comparable efficiencies could be accomplished through issuance of tax certificates to microwave incumbents, and by allowing aggregation through group license bids, we are not persuaded that PCS technically requires 40 MHz of spectrum. Instead, we believe that the competition that would result from four or five licenses in each market will better serve the public interest, and foster maximum economic opportunities. For these reasons, we conclude that 20-25 MHz is a reasonable allocation of spectrum for PCS. To ensure that small businesses are not excluded from licensing opportunities due to the use of competitive bidding, we also support at least one 20 -25 MHz allocation for small business PCS applicants in the lower band. In any event, the amount of spectrum for the small business allocation should be consistent with the predominant spectrum block allocations.

### **Conclusion**

As indicated before, our vision of PCS leads us to endorse direct mechanisms for promoting economic opportunities rather than rely on indirect "trickle-down" approaches. Nevertheless, we are aware that small service areas and spectrum blocks will provide only a limited number of opportunities for small service providers. Because fixed and operating capital requirements will deter many small companies from participating in PCS as licensees, strategic alliances with larger entities may well be a practical economic necessity for many small companies. For these reasons, we construe the principle of economic opportunity broadly to encompass diverse forms of commercial participation, such as procurement of goods and services and strategic alliances. We examine ancillary opportunities below in the context of regulatory proposals addressing bidding preferences and other procedures.

### **Bidding Methodology**

#### **Bidder Eligibility Conditions**

**Background.** We strongly endorse the principle of encouraging the widest possible participation by private enterprise in PCS development. Some have suggested that the Commission should condition eligibility to bid on minimum procurement efforts as a means to further minority and small business enterprise. For instance, the National Association of Black Owned Broadcasters points

out that "the Commission must create a system of minority incentives similar to those used by other agencies and departments of the Federal government."<sup>27</sup> APC likewise notes that several agencies of the federal government, such as the SBA and the Department of Defense, employ incentive policies to provide small business participation in auctions of government property rights.<sup>28</sup> We note, however, that the Commission has not requested comment on either of these approaches. In our view, if the regulatory structure for PCS fails to include these types of participatory safeguards, it will fail to achieve the widest possible participation by private enterprise.

General Bidder Eligibility Requirements. We agree that the interest in the widest possible participation could be furthered by requiring a "trustee" commitment from PCS bidders. As a basic condition of eligibility, we believe all bidders should be required to establish and maintain programs designed to ensure that minorities and women are not excluded from licensee efforts to procure equipment and value added services, and to recruit, hire and promote employees. Regulations dealing with employment and procurement practices of PCS regulatees, such as those currently applicable to cable television system operators, can be justified as necessary to enable the FCC to satisfy its obligation under the Omnibus Budget Reconciliation Act to ensure that the regulatory structure for emerging technologies fosters economic opportunity, competition, and new and expanded telecommunications services.<sup>29</sup> As Congress, and the Commission acknowledged in the cable context, employment and procurement opportunities are significant areas of economic opportunity which enhance the prospects for telecommunications ownership by minorities and women. In the long run, employment and procurement opportunities should also reduce capital formation difficulties businesses owned by minorities and women face due to lack of technical and managerial experience in the telecommunications field.

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27 Letter of James L. Winston, Esq., Executive Director and General Counsel, National Association of Black Owned Broadcasters, May 27, 1993, p. 2.

28 We believe targeted policies encouraging employment and procurement opportunities for minorities and women are consistent with range of economic opportunities made possible by programs of other federal agencies. The SBA's section 8(a) procurement program identifies government contracts that should be awarded only to small disadvantaged firms. 13 CFR §124.307 et seq. The Department of Defense uses targeted policies to reach its statutory goal of awarding five percent of its contracting and subcontracting dollars to small disadvantaged firms. See generally, DFAR 219.5.

29 Compare, NAACP v. FPC, 425 U.S. 662 (1976). See also, Non-discrimination in Common Carrier Employment Practices, 24 FCC 2d 725 (1970).

telecommunications field.

**Cellular and LEC Bidding Requirements.** In the interest of economic opportunity, we also support entry provisions for rural cellular licensees and LECs. However, we do have strong reservations about the merits of allowing unconditional eligibility for large cellular licensees and LECs in view of the potential for anti-competitive warehousing of spectrum. The need for restrictions on cellular eligibility presents an opportunity to encourage small business participation. While we are somewhat skeptical about the franchisee relationship as a primary means to promote viable opportunities for new entrants, we view bona fide local consortia, and joint venture arrangements, as a reasonable quid pro quo for eligibility for large cellular and LEC entities -- if they provide new entrants with an equity ownership stake in the licensee entity. We believe this proposal is justified by the fact that the overhead and competitive position of these firms are substantially enhanced by pre-existing infrastructure. Unless eligibility to pursue local licensing opportunities is conditioned on a requirement to form strategic alliances with new entrants, the viability of licensing opportunities for small applicants may be reduced.

#### **Financial Certification Guidelines**

In order to realize the full potential of competitive bidding to streamline the licensing process, we believe it is appropriate to permit applicants to self-certify financial qualifications, as outlined below. First, the Commission should affirm that a small applicant may support all, or a substantial part, of the required financial showings with a proposal for an initial public offering, as in Advanced Mobile Phone Service, Inc., 91 FCC 2d 512, 517 (1982). There, the Commission held that an investment banker's letter, combined with the applicant's internal funds and bank commitments, constituted a reasonable assurance.<sup>30</sup> In addition, the Commission noted that the rules contemplate that "applicant might need equity financing," and while this was a case of first impression, the IPO proposal deserved "careful analysis" because "we never before licensed such costly facilities..." Id. We believe the need of PCS applicants, especially minority owned applicants, for equity financing to

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30 The Commission cited three factors to justify its holding: (1) a large and experienced investment banker was familiar with the marketplace's reaction to the applicant's offerings based on three previous successful financings; (2) the banker had analyzed the applicant's ability to develop additional, sophisticated mobile communications services; and (3) a group of qualified lending institutions had established credit for the applicant aggregating approximately two thirds of the funding required for construction of the proposed cellular facilities.

cover the unprecedented cost of acquiring construction permits and building PCS facilities likewise justifies combined use of "highly confident" letters, letter of intent and commitment letters to satisfy applicable financial qualifications.

Second, the Commission should adopt financial qualifications guidelines that treat SBA chartered Small Business Investment Companies (SBICs) and Specialized Small Business Investment Companies (SSBICs), as bona fide financial institution for reasonable assurance purposes.<sup>31</sup> The source of an SSBICs capability to act as a de facto financial institutions for small entities stems from their ability to leverage \$3 - 4 from the SBA for every \$1 of equity capital from private sources pursuant to the Small Business Investment Act of 1958.<sup>32</sup> As such, SBICs are an integral part of the national policy encouraging development of small business, frequently come under the FCC's ancillary jurisdiction by virtue of the assistance they render to FCC regulatees. In this regard, we note that "Administrative agencies have been required to consider other federal policies ... when fulfilling their mandate to assure that their regulatees operate in the public interest... [A]gencies should constantly be alert to determine whether their policies conflict with other federal policies and whether such conflict can be minimized... [E]stablishment of policies that would accommodate ... diverse interests ... is [also] in keeping with the overall agency responsibility."<sup>33</sup> Treating SBICs as financial institutions is consistent with both the Commission's overall responsibility, and its stated policy for purposes of cellular financial commitments, that "we do not wish to exclude smaller entities with the financial ability and genuine desire to finance cellular systems."<sup>34</sup> As indicated in the section below on tax certificates, we believe tax certificates would also enhance the financial ability of SBICs to assist FCC regulatees.

#### **Innovator Bidding Credits**

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- 31 Compare, Application for Review of Salt City Communications, Inc, in MM Docket 89-311 (August 6, 1993) (File No. BPH-870918MN).
- 32 Storer Broadcasting Company, 70 FCC 2d 709 (1979). SBICs are allowed to leverage \$3 from the SBA per \$1 of private capital, while SSBICs can leverage \$4 per \$1 of private capital.
- 33 LaRose v. FCC, 494 F. 2d 1145 (D.C. Circuit 1974).
- 34 Rules for Rural Cellular Service, 4 FCC Rcd 2542 (1988). See also, Washington's Christian Television Outreach, Inc., BC 002820, released August 19, 1981) (Hearing Designation Order).

**Background.** Of course, the central concern over the use of competitive bidding lies in potential adverse effects on opportunities for new entrants.<sup>35</sup> To avert spectrum inefficiency and exclusion of innovative and efficient service providers, the Act gives the Commission broad discretion to establish flexible payment methods. Specifically, the Act requires the Commission to "consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments, with or without royalty payments, or other schedules or methods that promote the [economic opportunity] objectives..." There are several ways the Commission can use this discretion to respond to requests for policies to promote superior service efforts to the public and "economic opportunity".

While the details of the various proposals differ, a common theme among them is the demand for appropriate recognition of innovative proposals for equitable distribution of service to the public, and spectrum-efficient infrastructure sharing arrangements that encourage new entry. For example, American Mobilecomm Technologies, Inc. and Digital Spread Spectrum Technologies, Inc. advocate a "host license" arrangement for firms offering specialized PCS services. APC states that by adopting a program that would establish and guarantee "technology affiliations" with a PCS licensee to secure a portion of the licensee's overall licensed areas, small business could share a portion of the licensee's facilities, particularly in switching and access management functions, and other services, such as billing, marketing, maintenance, technical matters, and accounting. CalCell Wireless advocates an "infrastructure preference" for PCS applicants that commit to serve and operate in designated enterprise zones and promote participation by racial minorities. MCI advocates a consortium approach with opportunities for small, minority and female entrepreneurs. NABOB contends that major companies deriving substantial benefits from FCC licenses should be required to joint venture or otherwise participate with minority companies. SBPA recommends a Small Business Developer's License for experimental licensees who have put forth significant effort and investment in developing the service being licensed. Tampa Electric Company calls for partnering incentives between 2 GHz incumbents and PCS licensees based on the wholesale licensee concept.

**Discussion.** These proposals indicate that the Commission could protect the public interest

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35 Letter of Hon. Larry Irving, Assistant Secretary for Communications and Information, to David Honig, trustee, Minority Media Ownership Fund, June 17, 1993.

in the use of spectrum by authorizing alternative methods of bidding, bid calculation, and bid payments for bidders with superior service proposals. In particular, alternative bidding calculations would allow technical and non-technical innovators to discount a percentage of the bid the applicant would otherwise pay based on a qualitative assessment of the applicant's business development proposal. To qualify for the credit, bidder would have to qualify as (a) a member of a designated group, or (b) as a consortia owned and controlled by firms owned by members of the designated groups. The business development proposal could establish eligibility for credits based on multiples of expenditures for research and development on spectrum efficiency incurred by the applicant; the projected value of the bidder's commercial activities to the community of license; or the value of public services the bidder proposes to offer. Public service could include, for example, provision of on-the-job training or work-study relationships with local educational institutions. We believe a ten percent credit for individual small business entities is an adequate incentive for this purpose. For business development proposals involving consortia, the consortia should be allowed to elect a combination of credits and installment payments reflecting the quantifiable value of the proposal involved, not to exceed twenty five percent of the total bid.

#### **Installment Payments and Royalties**

Where small entities bid, but make no superior service proposal, the Commission can foster economic opportunities by allowing unconditional installment payments with or without royalties. Consistent with the purpose of the Budget Reconciliation Act, this approach would permit winning small bidders to elect to make payments over time, and thereby reduce the up-front capital requirements the prospective licensee must have to bid. However, we are somewhat uncertain about the net value of royalty payments to small businesses. MCI points out that the recovery of \$4 billion in the form of auction bids from PCS licenses over the next five years would equate to an effective charge of \$12 per PCS customer per month. This is roughly 25 percent of expected revenues, assuming 1.6 million PCS customers in 1994, and 9 million in 1998. The burden of this surcharge for spectrum access, it is asserted, would "eliminate the ability of new PCS entrants to compete against the entrenched [cellular incumbents]."<sup>36</sup> For these reasons, we do not view royalties as the optimal solution to the entry cost problems of small business bidders.

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36 Steve Zecola, MCI, *supra*, note 26.

### **Distress Sales**

The broadcast distress sale policy has some promise as a model for an economic opportunity safeguard. In the broadcast context, licensees designated for hearing have the option to assign the license to a minority firm for 75% of market value or less. Distress sales serve the dual public interests in diversity of ownership and administrative efficiency by obviating the need for costly and time-consuming hearings to resolve alleged violations of Commission rules, while remedying informational and financial barriers to market entry for historically underrepresented groups. In the PCS context, a distress sale policy could achieve analogous administrative equities and efficiencies.

In order to assure prompt delivery of PCS services to the American public, the Narrowband PCS Order provides that failure by any licensee to meet construction requirements will result in forfeiture of the license and the licensee will be ineligible to regain it. At the present-time, however, no provisions for the disposition of the narrowband or broadband PCS licenses exist. The distress sale concept could answer this problem by granting forbearance on royalties or installment payments if the defaulting licensee assigns the license to a new qualified small business entrant. Unlike the broadcast distress payment, however, the assignee of a PCS distress sale license would assume all or part of the licensee's obligation.

Another variation of the distress sale concept might apply where tentative winners are ineligible, unqualified, or unable to pay, such as in the context of multiple license bids. We believe the Commission should impose penalties on parties that knowingly abuse the bidding process. This policy could also include a distress sale option to create incentives for defaulting bidding to assign construction permits to small entities.

### **Communications Capital Fund**

Spectrum auctions would benefit designated groups to a greater extent if a portion of the revenues from spectrum auctions were reinvested in small businesses seeking to enter the communications field.<sup>37</sup> Accordingly, we recommend that the Commission seek legislation from Congress to establish an investment fund small businesses. Alternatively, the Commission could

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37 Prof. Andrea Johnson, Statement before the SBAC, May 27, 1993, p 6.

explore with the NTIA and the SBA whether an executive order can and should be adopted to accomplish this end.

### Tax Certificates

#### **Background**

The SBAC has reviewed numerous expressions of interest in routine issuance of §1071 tax certificates for various PCS transactions. The SBA Office of Advocacy, through a spokesman who participated in our May hearings, informally endorsed consideration of the use of tax certificates for investments in SBA licensed investment companies. Several parties also advocated various proposals for issuance of tax certificates to entrepreneurs in PCS industries.<sup>38</sup> Numerous parties in the Emerging Technologies proceeding submitted comments in support of the Commission's subsequent determination that Docket 90-314 is eligible for §1071 treatment, and that issuance of tax certificates is necessary to facilitate relocation of microwave licensees in the 2 GHz frequency band.

#### **Discussion**

At the outset, we are compelled to acknowledge certain criticisms involving allegations of misrepresentation and rapid transfer of facilities acquired with tax certificates. For example, the 1958 amendments to the tax certificate statute resulted from some cases in which broadcast properties were intentionally acquired in excess of the applicable multiple ownership rules, and then improperly sold in an attempt to obtain certificates that would not otherwise be available. While we are not aware of any recent deliberate abuses along these lines, we believe IRS authority to rescind tax certificate benefits upon a finding by the Commission that a sale or exchange under the policy involved fraud or misrepresentation operates as a strong structural deterrent to abuse.<sup>39</sup> We are also aware that the one year holding period requirement applicable to minority owned facilities acquired under §1071 has been criticized. The one year rule, however, was adopted in a Commission action repealing anti-trafficking rules and was not originally a part of the tax certificate policy.<sup>40</sup> The solution to this problem, therefore, would appear to be the reinstatement of a lengthier holding period for all

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38 The parties include representatives from a coalition of civil rights groups, the Coalition to Improve the Tax Certificate Policies, and American Personal Communications, Inc.

39 Cloutier v. United States, 709 F.2d 480 (7th Cir. 1983).

40 Prior to that time, minority owners, like other licensees, were routinely required to hold the license for a minimum period of three years Amendment of Section 73.3597 of the Commission's Rules, 99 F.C.C. 2d 971,973, 974 (1985).

broadcast licensees.

While we are concerned by these criticisms, we believe the benefits of the policy far outweigh the disadvantages. First of all, §1071 authorizes capital gains deferrals, rather than capital gains exemptions, tax credits, or across-the-board tax rate reductions. In this regard, the benefit of the tax certificate is more comparable to an interest-free government loan equal to the taxable portion of the gain. Moreover, as with involuntary conversions of property covered by §1033 of the Internal Revenue Code, the policy also leverages private investment by requiring entrepreneurs to use the entire gain from the sale to reinvest or reduce basis in retained property. This means that for every dollar in taxes the taxpayer avoids, the tax certificate leverages about three dollars of private reinvestment capital, for public interest investment, that were not subject to taxation in the first instance. We note that the government also captures tax revenues from the jobs associated with the buyer's grandfathered property, from jobs associated with the seller's replacement property, and from the sale of the depreciated or replacement property if the sale produces a taxable gain.

#### **Conclusion and Summary of Recommendations**

Due to the important capital leveraging benefits, and apparent fiscal neutrality of the policy, we support extending tax certificate treatment to microwave licensees and SBA chartered investment companies that promote small business participation in PCS deployment. We also urge the Commission to revise the existing minority tax certificate program. At the same time, it has come to our attention that the U.S. House Subcommittee on Select Revenue Measures will hold hearings on proposals to deter abuse of the tax certificate policies. We support these efforts to deter abuse of the public trust and intend to work closely with the Commission and the Congress to ensure, to the extent possible, that no abuses result if the proposals we endorse below are adopted.

**Microwave Tax Certificates.** The basic justification for issuing tax certificates to microwave licensees is that deployment of broadband PCS technology cannot commence until the 2 GHz frequency band allocated for PCS is vacated. The rules give most incumbents three years to relocate voluntarily with the assistance of tax certificates, however, some incumbents are exempt from these rules. We believe these rules should have two economic opportunity components. First, we propose that the Commission consult with the IRS on ways to encourage incumbents seeking tax certificate

treatment for relocation to satisfy replacement property requirements by investing in small business concerns. Second, we propose that the Commission issue tax certificates to exempt microwave licensees that establish PCS consortia or joint ventures, and extend equity ownership opportunities to small business concerns, upon divestiture of their interest in the consortia or venture. Giving exempt incumbents the option to participate in the development and implementation of PCS facilities, by forming small business consortia, could accelerate speed of deployment while meeting financial and technical assistance needs of small business concerns.

**SSBIC Tax Certificates.** We also agree with the SBA Office of Advocacy that the Commission should consider extending tax certificates to encourage investment by, and in, SBA chartered SSBICs that provide debt and equity financing, and technical assistance, to licensees and applicants owned by members of minority groups and women. Integration of the Commission's tax certificate program with the SBA's SSBIC program is appropriate for several reasons. Tax certificates would make SSBICs specializing in telecommunications more competitive with venture capital firms in other fields as a result of tax advantaged capital gains deferrals. This would also enhance their ability to syndicate debt and equity securities for small business participation in PCS development and implementation. As we pointed out before, passive investors, including SSBICs, have long been subject to the FCC's regulatory jurisdiction by virtue of assistance provided to FCC licensees.<sup>41</sup> Finally, cooperation between the FCC, SBA and IRS would also help contain the potential for abuse.

**Minority Tax Certificates.** Finally, the use of tax certificates to promote minority ownership of non-broadcast facilities has been advocated for over a decade.<sup>42</sup> At the recommendation of the 1982 FCC Advisory Committee on Alternative Financing Strategies for Minority Telecommunications Ventures, members of Congress introduced proposals for extension of §1071 to non-broadcast

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41 While the resources available to SSBICs are modest compared to chartered banks and savings and loan institutions, the Commission has stated for purposes of cellular financial commitments that "we do not wish to exclude smaller entities with the financial ability and genuine desire to finance cellular systems." Rules for Rural Cellular Service, 4 FCC Rcd 2542 (1988) See also, Washington's Christian Television Outreach, Inc., BC 002820, released August 19, 1981) (Hearing Designation Order).

42 For a discussion on the use of minority tax certificates in the broadcast area, see Krasnow, Kennard, and Temkin, Maximizing the Benefits of Tax Certificates in Broadcast and Cable Ventures, Hastings Communications and Entertainment Law Journal, Volume 13, Number 4 (Summer 1991).

transactions in 1983. In 1990, the League of United Latin American Citizens, the National Association for the Advancement of Colored People, the National Black Media Coalition, and the National Hispanic Media Coalition, petitioned for issuance of tax certificates for satellite transponder enterprises. In 1992, the Coalition to Improve the Tax Certificate Policies petitioned the Commission to expand the tax certificate policy to promote investment by joint ventures and specialized minority venture capital funds in common carrier and non-mass media technologies. The recent passage of the Budget Reconciliation Act eclipses the various legal ambiguities and technicalities that have encumbered consideration of these proposals. For reasons we have already substantially explained throughout this report, we believe the time has come to take action. Therefore, we urge the Commission to respond favorably by announcing that in the future it will follow the expansive definition of "broadcasting" applied in Telocator Network of America, 58 RR 2d 1443 (1985), recon dismissed, 1 FCC Rcd. 509 (1986) in reviewing requests for PCS tax certificates pursuant to the Statement of Policy Regarding Minority Ownership In Broadcasting, 52 R.R. 2d 1301 (1982).

## **CLASSIFICATION STANDARDS**

### **Background**

The SBA administers a variable standard for determining whether an entity is small for purposes of obtaining financial assistance from an SBIC. The standard permits an applicant to qualify based on a net worth not in excess of \$6.0 million with average net income after Federal income taxes for the two preceding years not in excess of \$2.0 million. Alternatively, the applicant can qualify by showing that together with affiliates, and excluding affiliates, it meets the size standard for the industry in which it is primarily engaged as set forth in §121.601. See, 13 CFR 121.802(a)(2). Regarding the latter test, PCS fits the definition of a radiotelephone service which the Census Bureau includes in standard industrial classification code 4812. SBA standards define "small" in that SIC code as firms that employ 1,500 employees or less. 13 CFR 121.610. In addition, SBA guidelines contain provisions for waiver whereby applicable thresholds are increased by 25% whenever an applicant agrees to use the SBA's assistance within a "labor surplus area" or "redevelopment area." §121.802(d).

### **Discussion**

The basic problem with the existing standards is that these standards were not tailored to

implement the economic opportunity provisions of the Budget Reconciliation Act. The existing net worth/income size standard is probably too low for an industry that will be as capital intensive as the PCS industry. The service area and bandwidth recommendations would not be effective if the classification excludes independently owned and non-dominant firms with the wherewithal to construct PCS facilities that may cost from \$50 - 100 million. On the other hand, size standards based on a threshold of 1,500 employees is too high. This threshold runs the risk that the vast majority of the entities covered by SIC Code 4812 would be eligible for bidding preferences and tax certificate assistance even though these entities face no special history of exclusion or economic disadvantage.

If the Commission concurs that a new standard should be established, it will also have to determine whether the Small Business Act governs its discretion to prescribe numerical size standards for determining whether an entity is small. Prior to the Small Business Credit and Business Opportunity Enhancement Act of 1992, federal agencies could establish size standards for activities not covered by the Small Business Act by merely consulting with the SBA Administrator. The 1992 amendments limit agency discretion by requiring agencies to promulgate size standards based on gross receipts indices that are to be approved by the SBA Administrator and to comply with SBA policies regarding the formulation of the standards.<sup>43</sup> The Act, however, does not "impair the ability of an agency to implement small business size standards without obtaining SBA's concurrence in response to a specific statutory direction or a general legislative authorization to prescribe small business size standards." Thus, if the Commission determines that the Budget Reconciliation Act constitutes a specific statutory direction, consultation with the SBA Administrator should suffice for procedural purposes.

### **Conclusion**

Consistent with our focus on capital formation and utilization of SBICs, we believe size standards should be consistent with the SBA's approach to eligibility for financial assistance from

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43 Under the SBA's proposed regulations to implement the Act, an agency may prescribe a size standard different from that determined by the SBA under three conditions. First, the standard is being proposed after an opportunity for notice and comment. Second, the standards provide for size determinations of concerns providing services based on average gross receipts over a period not less than three years. Third, the size standard must be approved by the SBA Administrator.