

The FCC's rate regulations were 540 pages, rate calculation worksheets and instructions are over 50 pages, and the First Reconsideration of the rate regulations is 94 pages. The need to acquire the expertise and incur costs of preparing these analyses places an enormous burden on many small system operators who are not covered by any uniform system of accounting.

NECA-style average cost of service schedules are a practical streamlining alternative to both the benchmarks and cost of service showings. Although cost studies would have to be conducted to establish an appropriate sample of small systems, efforts to revise forms and procedures are justified by amount of the burden that could be alleviated on both the FCC and small operators. A representative sample of cost for systems and operators in various markets would suggest appropriate cost of service averages. Cost surveys may also reveal sufficient data about revenue to gross revenue ratios that would permit additional consideration of net income tests as an alternative to blanket rate regulation exemptions which some parties suggest.

Relief to Allow Rate Increases. The SBAC supports substantive and procedural relief for reasonable rate increases by small systems. Regarding procedural relief, the SBAC concurs that statistical analysis of small systems and operators is necessary to determine appropriate modifications to benchmarks formulas. The Commission allowed benchmarks that took into account the number of subscribers served by a system, petitioners claim that small systems in densely populated areas have higher costs. The SBAC

agrees. Many small systems serve rural areas with low population density - sometimes as low as 10 homes per mile. Revenue sources are limited because pay penetration is lower, there are fewer pay channels, and advertising is limited. Yet, small systems have same fixed compliance cost, and costs of plant and equipment, cost capital, headends, programming, and pole attachments are typically higher than for large scale operators. It has been indicated that the rate freeze imposed by the commission in 1993 has already damaged many small companies, primarily those in the middle of rebuilds or ones who have made major service improvements,¹⁴⁷ while increased competition from DBS and rural telephone companies entering cable will likely introduce additional destabilizing factors in the future.¹⁴⁸ For these reasons, the SBAC supports use of cost surveys based on small system samples.

The SBAC supports parity of tax treatment for subchapter S and C corporations. The current regulations provide a rate base allowance for tax liability of regular C corporations. This allowance enables C corporations to retain earnings which can be made available for other purposes such as upgrading or expanding business. Although Congress designed Subchapter S corporations to avoid income taxation at both the corporate and shareholder level, no allowance for S corporations were provided.

¹⁴⁷ SCBA Statement, at pp. 6.

¹⁴⁸ See, Michael Selz, "Small Cable TV Operators Face uncertain Future," Wall Street Journal, December 13, 1993, p. B-2.

Discretionary Relief for Small MSOs. The SBAC supports criteria for discretionary relief that will cover small systems and MSOs in accordance with provisions of the Cable Act and the Regulatory Flexibility Act. Small MSOs have to prepare benchmark rate calculations for many franchise areas where they provide service. As one small cable trade association executive stated, "[t]here are major differences in operating costs between large companies and small companies, no matter what size standard is involved."¹⁴⁹ One major difference for example is that regulatory burdens have a disproportionate impact on small operators who have no nationwide subscriber base to absorb these expenses as do dominant MSOs.

¹⁴⁹ SBAC Statement, *supra*, p. 4.

APPENDIX C: EMERGING TECHNOLOGY DOCKETS

A. Competitive Bidding: OPP Docket 93-253

Background

An important threshold issue is whether implementation of competitive bidding is mandatory as implied in the Notice. Although the Notice states that the auction system should be simple and easy to administer "given the short time in which we are required to implement competitive bidding regulations,"¹⁵⁰ the SBAC finds a more accurate statement of the effect of the Spectrum Act is given elsewhere in the Notice where the Commission states that provisions of the Act "give the Commission explicit authority to use competitive bidding,"¹⁵¹ subject conditions in Section 309(j)(2)(B).¹⁵² "[W]here a statute is valid only in case certain conditions exist, the enactment of the statute cannot alone establish the facts which are essential to its validity."¹⁵³ Since Section 309(j)(2) conditions the Commission's authority to implement competitive bidding on a determination that the use of the auction system it proposes to implement will promote the objectives of Section 309(j)(3), it is not accurate to say that implementation of competitive bidding is required. In short, whether implementation of competitive bidding is required as a

¹⁵⁰ Notice, at p. 6, para. 18.

¹⁵¹ Notice, at p. 3, para. 2.

¹⁵² Notice at p. 4, para. 11.

¹⁵³ Whitney v. California, 274 U.S. 357, 374 (1927), cited in Lamprecht v. FCC, slip op. at p. 19.

matter of the public interest is the precise question before the Commission in Docket 93-253.

At bottom, auction advocates claim that deregulation of the spectrum assignment process,¹⁵⁴ and introduction of pricing mechanisms, encourages efficient license distribution and use of spectrum.¹⁵⁵ According to advocates, auctions reduce the time and money spent to assign frequencies by discouraging frivolous or speculative applications,¹⁵⁶ and increase the efficiency and effectiveness of the assignment process by granting licenses only to those who value the spectrum more than other applicants.¹⁵⁷ A marketplace approach to spectrum licensing could, in the long run,

¹⁵⁴ U.S. Spectrum Management Policy: Agenda for the Future, National Telecommunications and Information Administration, 1992, P. __.

¹⁵⁵ Mueller, Milton, Reform of Spectrum Management: Lessons from New Zealand, Reason Foundation, November 1991, p. 15. Felker and Kwerel also argue that auctions could also provide the Commission with useful information on the value of spectrum in alternative uses. The amount that bidders pay for spectrum reflects their estimates of the value customers place on the service they propose to provide. The authors argue that the Commission "should consider reallocating spectrum to the higher valued use if it were to find that the bids on licenses for one use greatly exceeded the bids on licenses for similar spectrum allocated to another use." Id. at pp. 14, 15.

¹⁵⁶ See Felker and Kwerel, p. 1.

¹⁵⁷ The use of auctions to expedite assignments to the parties who value spectrum the most is presented as a way to lower social costs attending license assignment by other methods. Felker and Kwerel, pp. 11, 12. This argument appears to assume that entities with significant economies of scale and scope will in most cases obtain licenses and that the foregone output of these entities represents an opportunity cost to society. See, Dingell, supra. ("potential economies of scale and scope ... delayed pending private negotiations").

provide regulators with new sources of information about values the market place on use of spectrum for new wireless services. Spectrum auctions may also impact technical efficiencies related to the manner in which spectrum and related inputs of production are combined to bring information goods and services to consumers. Arguably, spectrum auctions would also tend to force firms to structure operations in a manner that reduces cost of service delivery in order to achieve optimal levels of information output while absorbing the additional cost incurred for the acquisition of spectrum rights.

In the short run, however, it appears that licensing reforms are likely to yield only marginal and short term gains in efficiency. Spectrum auctions primarily impact the rate of license distribution to applicants, and maximizes short term distributive efficiency, but only if one assumes spectrum should be assigned to parties who place the highest monetary value on its use. There are also clearly less draconian alternatives available for encouraging technical and spectrum efficiency. From the SBAC's perspective, therefore, the optimal licensing approach from a public interest standpoint is to be one that distributes licenses based on relevant allocational goals and operational characteristics without the distributive inefficiencies associated with current administrative approaches. Overall, however, the Commission should also balance its attention on measures that can foster a vibrant secondary market for spectrum licenses to correct the anomalies of the licensing process.

Revision of Auction Design Criteria.

Section 309(j)(3) of the Spectrum Act states that the Commission must design multiple alternative bidding methodologies to protect the public interest in spectrum use. That section identifies four specific objectives concerning the public interest in spectrum use:

(A) the development and rapid deployment of new technologies, products, and services for the benefit of the public, including those residing in rural areas, without administrative or judicial delay;

(B) promoting economic opportunity and competition and ensuring that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women;

(C) recovery for the public of a portion of the value, if the public spectrum is made available for commercial use and avoidance of unjust enrichment through the methods employed to award users of that resource; and

(D) efficient and intensive use of the electromagnetic spectrum.

Against this background, we question whether the auction design criteria which holds that "the parties that value the license the most should generally best serve the public and make rapid and efficient use of the spectrum," is consistent with the objectives set forth in Section 309(j)(3) because it arbitrarily equates the interest in use of spectrum for developing and deploying information services and equipment for the benefit of the public with private sector interests in spectrum use. There are numerous reasons why pricing mechanisms that discriminate against bidders based on their ability to pay the most for the license could lead

to private valuations of spectrum use that are materially different from valuations of spectrum use based on the public interest.

A design criterion which equates the private interest of license applicants with the public interest in spectrum use may afford inadequate protection for the public and is arguably inconsistent with the textual objectives set forth in Section 309(j)(3). Interpreted literally, the value of spectrum implied by language of the auction design criteria would exclude public interest factors from the valuation equation. This omission appears to be incompatible with the explicit recognition by Commission staff in the Office of Plans and Policy that consumer surplus is a factor which must be considered in deriving economic values for spectrum use.¹⁵⁸ Commission staff has assumed elsewhere that the measure of the social value of spectrum in providing a spectrum dependent service is "the change in consumer plus producer surplus" from a modification in the use of spectrum. The authors correctly note, however, that there is no universally accepted discount rate for calculating social spectrum values. Thus, the Commission cannot reasonably expect the market to employ valuation methodologies that treat the public interests in a uniform manner. Although social opportunity costs are typically difficult to quantify, failure to take qualitative factors into consideration may have serious

¹⁵⁸ See, "Value of Spectrum Used in TV Broadcasting," in Evan Kwerel and John Williams, Changing Channels: Voluntary Reallocation of UHF Television Spectrum, Federal Communications Commission (November 1992), p. 29, 34.

consequences for the public.¹⁵⁹ To reduce these risks, we propose that the Commission revise the design criteria to provide that "the parties that propose to use spectrum in a way which most directly corresponds to the combined public and private value of spectrum resources should generally best serve the public and rapidly achieve larger and more innovative use of the spectrum to deliver information services.

Modification of Bidding Methodologies

Auctions have several inherent disadvantages which competitive bidding methodologies should address to ensure that the auction design criteria achieves the intended public benefits. First, the price of spectrum apportionment deregulation is unprecedented intrusion into the micro-economy of licensee firms. The Commission can protect the public against these risks by designing the competitive bidding process to take into account material differences among applicants in terms of commitments to facilitate production and distribution of information goods and services, beneficial externalities concerning competition and innovation, and to engage in equitable practices.

Innovator Credits. The SBAC proposes that the Commission award innovator credits to qualified non-dominant entities in all PCS

¹⁵⁹ For additional insight into important qualitative aspects of the public valuation of spectrum use, see "Ethnic Media Serve as Lifeline Amid the Chaos," Los Angeles Times, Monday, May 4, 1992 ("In these days of crisis, ethnic and foreign language radio stations, newspapers and television are serving as both lifeline to and voice of communities that have been devastated disproportionately by the mayhem").

spectrum blocks based on the same geographical and allocational efficiency rationales the Commission initially proposed as the basis for comparative criteria for assigning cellular licenses.¹⁶⁰ The geographic area that an applicant proposed to serve was considered a major basis of comparison because availability of service is a primary goal. Significant factors under this criterion included population density, and substantial need for the services proposed, including the results of public need surveys. The second major comparative factor was the applicant's ability to expand its system capacity to serve increasing numbers of subscribers as warranted by market demand. Preference was to be given to designs entailing efficient frequency use, and personnel and practices were to be significant to the extent that they affect an applicant's ability to implement service.

The record of the proceeding already established a basis for applying these criteria. The infrastructure preference proposed by Cal Cell Wireless is basically consistent with the geographical focus of the cellular comparative criterion. Likewise, the specialized PCS Service concept outlined in petitions by American Mobilecomm Technologies, et al, is consistent with the spectrum efficiency rationale of the comparative criterion for cellular.

The innovator credit can be crafted to avoid the problems with the integration credit for comparative broadcast hearings. Caselaw indicates that in adopting preferences, the FCC must substantiate

¹⁶⁰ Separate Allocation Order, supra, at pp. 502, 503.

the relevance of factors used to differentiate applicants in the licensing process, and should be able to verify the performance of individual applicant receiving the preferences.¹⁶¹ The comparative licensing proposal for cellular establishes the relevance of geographical and allocational factors. Furthermore, use of behavioral tests such as accelerated deployment in enterprise zones and specialized PCS service offerings make it possible to verify whether licensees receiving the credit do what they are supposed to do.

Qualitative Benchmarks. Competitive considerations suggest that competitive bidding procedures should retain the ability to discover material qualitative differences between applicants concerning ownership diversification, and external competition and innovation benefits. Selection by price discrimination favors incumbents with substantial financial resources, and disregards the precept that "[d]iversification of control is a public good in a free society, and is additionally desirable where a government licensing system limits access by the public to the use of radio ... facilities."¹⁶² More importantly, however, price discrimination alone is insufficient to isolate material differences among applicants in terms of potentially beneficial externalities for the public involving competition and innovation. According to NTIA's Spectrum Management Report, at least fifteen commentators, including major trade associations such as CTIA, NAB, NABER, NCTA, OPASTCO,

¹⁶¹ See, Bechtel v. FCC [cite omitted].

¹⁶² Minority Ownership in Broadcasting, *supra*, at p. 4.

and USTA, expressed concerns not unlike our own that competitive bidding would favor deep pockets over "smaller, possibly more innovative parties without the same access to capital," or would drive small firms away altogether. (emphasis added)¹⁶³ Five commentors in the 1992 NTIA spectrum management proceedings expressed the view that "comparative hearings are the best way to determine the public interest or choose the applicant best suited to serve the public interest."¹⁶⁴ We note also that Congressional Budget Office has concluded, "[n]o strong evidence exists to suggest that auctioning alone would do more to promote economic efficiency in the day-to-day operations than assignment by comparative hearing ... if there is an active secondary market for spectrum licenses."¹⁶⁵

Bidding methodologies should include a qualitative merit system consistent with the textual commitment to avoiding undue concentration of ownership and disseminating licenses to a variety of licensees in Section 309(j)(3)(B). One reason for the popularity of comparative licensing is that these methods enable regulators to detect divergences between private and public values in the production of information services and products, and reduce those divergences through regulation of use and access to spectrum

¹⁶³ NTIA report, p. 109.

¹⁶⁴ These commentors included Advanced MobileComm, Inc., (AMI) BellSouth Corporation (Bell South), Forest Industries Telecommunications (FIT), Land Mobile Communications Council (LMCC), and the Organization for the Protection & Advancement of Small telephone Companies (OPASTCO). NTIA Report, at p. 103.

¹⁶⁵ CBO Report, p. 19.

resources. The Commission could award points for accelerated buildout schedules and infrastructure development in underdeveloped areas, development and delivery of specialized services, and voluntary affiliation with non-dominant value-added service providers and manufacturers. The applicant who places the highest quantitative and qualitative value on the license wins.

Licensing Controls.

To ensure consistency with the public benefits identified in section 309(j)(3)(A), the auction design should take the public interest in use of spectrum directly into account for purposes of determining which bidder places the highest value of spectrum being auctioned. Spectrum auctions in New Zealand and England recognized potential divergence between public and private values. TV spectrum auctions in England, for example, retained public interest criterion as a post-auction quality control mechanism that allow regulators to award franchises to low bidders if it benefits the public. "About a third of the bidders [in England's auction for Channel 3] were disqualified on the basis of the public interest, and roughly half of the franchises were awarded to bidders that did not make the highest bid."¹⁶⁶ This public interest mechanism is comparable to a procedure used by the Department of the Interior to estimate the value of leases in coal auctions to determine whether

¹⁶⁶ CBO Report, p. 13.

or not to accept the highest bid.¹⁶⁷ Similarly, New Zealand spectrum auctions also contained other quality control provisions, such as opportunities for pre-auction allocation negotiations and blanket exemptions for designated user groups.

The Commission should incorporate these types of public interest safeguards into its competitive bidding process to create an American style spectrum auction. Following the New Zealand model, this could be accomplished by allowing applicants to negotiate competitive bidding procedures to correct local market failures, spectrum sharing arrangements, or other structural parameters to encourage market participants to respond to specialized local needs. In accordance with the English style public interest component, the Commission could use a "best and final round" in which applicants submit voluntary performance bids.

B. Financial Subsidies: OPP Docket 93-253 and ET Docket 92-9

The SBAC continues to support financial subsidies for non-dominant entities through installment payments and Small Business Investment Company financial assistance. These proposals have implications for dockets on both competitive bidding and emerging technologies.

Installment Payments. The SBAC opposes some aspects of the installment payment plan described in the competitive bidding notice. First, the commission should not assess interest on installment payments. Second, the payment schedule should be

¹⁶⁷ Felker and Kwerel, p. 7.

amortized over the longest feasible period possible to avoid restricting output. Third, the Commission should assure that parties having difficulty in maintaining payment receive full process protection before the Commission seeks to reclaim any license.

C. PCS Spectrum Use-Diversity Management: Gen. Docket 90-314

The SBAC has reviewed comments opposing BTA spectrum block allocations and continues to support this proposal. The Commission explained that four factors established the legal foundation for its traditional separate allocations for radio common carriers: (1) there was a need for mobile services to the public; (2) the need could be addressed quickly with the expertise of eligible entities; (3) the separate allocation was a reasonable means of avoiding delays due to comparative hearings; (4) steps were taken to guard against anti-competitive practices. Report and Order in CC Docket 79-318, 86 FCC 2d 469 (1981).

The BTA spectrum block allocations can be justified on the same basis. Congress has found a need for a way to deploy new mobile services that will avoid concentration of ownership. The propensity of non-dominant firms to innovate indicates that the need for expanded mobile services can be efficiently addressed by these firms. A separate allocation avoids potential delay due to litigation about treatment of non-dominant entities. The net effect of the special allocation is pro-competitive in so far as it facilitates inclusion and has de minimis anti-competitive effects. In this regard, The SBAC views this alternative as a form of

"spectrum enterprise zone," rather than the more controversial type of set-a-side frequently employed in government procurement programs, and in any event, as less intrusive than multiple ownership rules or mandatory affiliation agreements with small suppliers and franchises.

The SBAC notes that there have been two types of concerns about special allocations for non-dominant entities. First, some argue that the social goals of including non-dominant entities are better achieved by price preferences than by set-asides. In addition, there is also concern that separate allocations could inadvertently result in a "spectrum ghetto" due to disparities in service areas and bandwidth assignments, and potential aggregation difficulties.

While the SBAC supports price preferences for non-dominant entities, the Commission should not rely on price preferences alone. First, the statutory goal of avoiding concentration of ownership is an economic one which will be more difficult to accomplish without separate allocations. Second, a revised, pro-public auction criteria would disfavor sole reliance on price preferences since these devices are inflationary and should therefore not be the sole method of encouraging non-dominant ownership. Finally, it appears premature to assume that separate allocations are less efficient because there may be fewer bidders in the set asides. The vast majority of firms in SIC Code 4812 are non-dominant entities. We see no empirical basis for assuming that separate allocations would produce fewer bidders, although those

who bid for 20 MHz blocks may be more capital constrained than others.¹⁶⁸

Finally, while the SBAC is concerned about doubts that have been expressed about the economic viability of the BTA spectrum blocks, market participants have evaluated this concern and developed various responses, such as volume buying arrangements and spectrum sharing proposals. As a result, the SBAC concludes that the Commission should resolve any residual doubts about economic viability in favor of flexible regulations that will permit market participants to correct inadvertent anomalies in the allocation scheme.

¹⁶⁸ See, SBAC Report, p. 3 (19 firms with cumulative market share of 64.9 percent vs. 971 with 35.1 percent market share).