

UNRECORDED

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of)
)
Implementation of Section 309(j))
of the Communications Act -)
Competitive Bidding)
)
To: The Commission)

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FEDERAL COMMUNICATIONS COMMISSION
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PETITION FOR PARTIAL RECONSIDERATION

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SUMMARY

Blooston, Mordkofsky, Jackson & Dickens seeks clarification on behalf of our telephone company clients of various aspects of the Commission's general auction rules. As an initial matter, it is vital that the ambiguities in the auction rules be clarified immediately. The personal communications service (PCS) auctions are about to commence. Rural telephone companies will have to raise funds and/or become members of consortia to bid effectively on PCS spectrum licenses. That will take substantial planning, time and expense, and it is very important both to the rural telephone companies and potential investors that the applicable regulations are clear. A financing source when making commitments will not be inclined to commit to a rural telephone company if the definition of a rural telephone company or the consortium rules are unclear. This is especially true since the investor or lender can commit its funds to other prospective bidders, including minority or women owned designated entities, where the rules are clear. Therefore, we urge the Commission to clarify the ambiguities described below as soon as possible.

The first ambiguity which the Commission must eliminate is the term "independently owned and operated" in the definition of "rural telephone company." This term was added to the rule without discussion, and apparently is intended to prevent the largest local exchange carriers from taking advantage of rural telco benefits. However, this purpose is served by the 50,000 access line size limitation, since this limit includes the access lines of any affiliates. The Commission should use this affiliation language in the text of the Rule, since "independently owned and operated" can be interpreted in a number of ways, thereby preventing telephone companies from knowing whether they are eligible to bid.

Likewise, the Commission should clarify the meaning of the term "affiliate," for purposes of aggregating access lines. Independent telephone companies and cooperatives can be owned by persons and companies that have investments in other telephone companies, but can in no way exercise control over these other companies (especially those that are publicly traded). The Commission should clarify that such investments do not preclude rural telco status, so long as there is no common control between the rural telco and the other carrier. This common control definition is the one used by the auction rules for defining affiliates of small businesses, and has been used by the Commission in the telephone context when defining connecting carriers. It is also the standard used by the Securities Exchange Commission and the financial community in general. Thus, so long as the rural telco is not controlled by, and does not exercise control over the other carrier, this carrier should not be considered an affiliate.

Finally, it is urgent that the Commission reconsider its consortium rules, to allow rural telephone companies to attract

investors. Rural telcos should be able to form a consortium with other rural telcos, since combining these carriers does not change their rural nature. Moreover, these entities should be allowed to partner with investors, so long as they retain a 50.1% or greater ownership and control interest. Otherwise, rural telcos will not be ensured a meaningful opportunity to participate in the auction process.

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PETITION FOR PARTIAL RECONSIDERATION

Blooston, Mordkofsky, Jackson & Dickens (BMJ&D), on behalf of its rural telephone company (or "telco") clients, hereby petitions the Commission to reconsider various aspects of its Second Report and Order ("Order") in the above-captioned proceeding, Mimeo No. FCC 94-61, 59 Fed. Reg. 22,980 (May 4, 1994). BMJ&D currently represents hundreds of small, independent telephone companies and cooperatives. On behalf of a group of these carriers, BMJ&D is simultaneously filing a petition for reconsideration of the Order, requesting changes and/or clarifications to the auction rules with regard to (1) the definition of rural telephone company, (2) the benefits to be accorded to these entities, and (3) their ability to form consortia.¹ These changes are needed in order to have a realistic opportunity to participate in the upcoming spectrum auctions. BMJ&D concurs in the arguments set forth in these petitions. The instant filing concerns certain more focused aspects of the auction rules which require immediate clarification. These aspects will affect several of our telephone company clients, and it has become apparent from their inquiries that the rules as

¹ See Petition for Partial Reconsideration of South Dakota Network, Inc.

adopted create a great deal of confusion and uncertainty in the rural telephone industry. Many telcos are finding it impossible to effectively plan for the upcoming personal communication services (PCS) spectrum auctions. Accordingly, immediate Commission action is needed to remedy this confusion.

I. THE COMMISSION SHOULD CLARIFY THAT THE INDEPENDENT TELEPHONE COMPANY LANGUAGE IN SECTION 1.2110(b) (3) OF ITS RULES REFERS TO THE 50,000 ACCESS LINE CUT-OFF.

It is somewhat evident from the Commission's discussion of designated entities that it defined "rural telephone companies" as those companies not serving communities with more than 10,000 inhabitants, and not having more than 50,000 access lines, including all affiliates. Order at para. 282. Rule Section 1.2110(b) (3) clarified that the 50,000 access line requirement and the 10,000 or fewer inhabitants requirement were both to be satisfied. However, for the first time, the rule itself interjected the term "independently owned and operated". There is no discussion in the text of the Order as to what this language means. The full text of the rule is set forth below:

Rural telephone companies. A rural telephone company is an independently owned and operated local exchange carrier with 50,000 access lines or fewer, and serving communities with 10,000 or fewer inhabitants. (emphasis supplied)

The interjection of the words "independently owned and operated" in the definition of "rural telephone company" creates harmful uncertainty for prospective applicants, and requires immediate clarification. BMJ&D submits that the Commission should clarify that a telephone company having 50,000 access lines, or

fewer, including all affiliates, satisfies the independently owned and operated requirement of the rule. The Commission should further clarify that the term "affiliates" will not require that a shareholder's interest in another telephone company be attributed to a rural telephone designated entity, for purposes of qualifying as such, where there is not common control between the designated entity and the other carrier. These points will be discussed in order.

A. DEFINITION OF INDEPENDENT TELEPHONE COMPANIES AS THOSE HAVING 50,000 ACCESS LINES, OR FEWER, INCLUDING ALL AFFILIATES.

As previously discussed, the term "independently owned and operated" was not mentioned in the Notice of Proposed Rulemaking or the text of the Order in this proceeding. The Order simply specified that for designated entity purposes, rural telephone companies must serve 50,000 or fewer access lines, including all affiliates, and that they must serve communities with 10,000 or fewer in population. The rule promulgated to implement the Order, however, omitted the reference to affiliates, and interjected language, for the first time, concerning independent ownership and operation.

The Commission should clarify that the "independently owned and operated" language in the rule means telephone companies having 50,000 access lines, or fewer, including all affiliates. Several reasons support this result.

First, the Commission and the Courts have historically used the term "independent" telephone company to refer to local exchange

companies that are not Bell Operating Companies. Report and Order (MTS & WATS Market Structure: Phase III), 100 FCC 2d 860, 861, 871 (1985) [hereinafter ITC Equal Access]; Report and Order (Provision of Access for 800 Service), 4 FCC Rcd. 2824, 2825 (1989); United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1981), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983). Thus, for example, GTE, Cincinnati Bell Telephone Company and Southern New England Telephone Company have been considered to be independent telephone companies by the FCC. See ITC Equal Access, 100 FCC 2d at 871 (table listing ITCs).

The rural telephone company definition set forth in the Order (establishing a 50,000 access line cut-off, including all affiliates), goes well beyond excluding the Bell operating companies; it also excludes a large number of telephone companies, traditionally considered to be "independent," from designated entity status. The definition set forth in the text of the Order thus ensures that, for designated entity purposes, the Commission will be dealing with telephone companies which have been considered "small" in the telephone industry context. See, Report and Order, Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, 8 FCC Rcd. 4545, 4546 (1993); 47 C.F.R. §61.38-39 (1993) (classifying "small telephone companies" as those serving 50,000 or fewer access lines and allowing incentive regulation for these carriers).

No Bell, GTE, Sprint or other telephone company with more than 50,000 access lines will be able to qualify under this definition.

BMJ&D respectfully submits that efforts to further define "independently owned and operated" will involve the Commission in an unproductive morass of line drawing, creating confusion and uncertainty that will make it difficult for rural telcos to participate in the auction process.² As the Commission is aware, the rural telephone company industry consists of investor-owned local exchange companies, cooperatively owned companies, and companies owned by governmental entities such as municipalities. There are substantial differences among these companies in terms of corporate structure, their non-regulated activities, the manner and extent of their regulation and depth of experience in the telephone industry. One characteristic they share, however, is that none of them are controlled by Bell Operating Companies and, with the Commission's 50,000 access line cut-off, including affiliates, none of them would even qualify as "subset 2" companies under the Commission's Rules. (47 C.F.R. §69.602(a)(1)(1993) classifies non-Bell telephone companies with annual operating revenues in excess of \$40 million as "subset 2" companies).³

² This is especially true since telcos who are the high bidder, but are later found to be ineligible, face the loss of their substantial upfront payment and deposit, plus a penalty.

³BMJ&D is aware that the rural telephone industry has urged adoption of a rural telephone company definition that includes carriers having 50,000 access or fewer or serving communities with 10,000 or fewer inhabitants. BMJ&D agrees that this would be a more appropriate definition of rural telephone companies. Even with this change, or other changes expanding the definition of rural telephone companies, the Commission should delete the "independently owned and operated" language.

Absent clarification of independent ownership and operation language, the Commission may penalize many rural telephone companies who are a part of a holding company or other corporate structure, in order to facilitate the provision of non-regulated services (such as paging), or for financing and other valid business reasons. It may also penalize rural telephone companies that are owned by persons or entities that own and operate other businesses. For tax, financing, and other valid business purposes, these owners may structure their various businesses in a way that could be interpreted as falling outside of the term "independently owned and operated," since that term is undefined and open to numerous interpretations. Likewise, this vague term could be interpreted as excluding telephone companies whose shareholders have invested in other telephone companies, even though these shareholders are in no position to exercise control over those other carriers. It is inconceivable that the Commission intends to prohibit such rural telephone companies from participating in PCS.

It is respectfully submitted that the Commission's Order thus will prevent any "gaming" of rural telephone company designated entity status. The Commission should clarify that the "independently owned and operated" language in Rule Section 1.2110(b)(3) carries no meaning apart from the text of the Order. Indeed, the Commission should delete the term "independently owned and operated," and instead insert the language "including affiliates" after the term "50,000 access lines" (or other language

the Commission may adopt expanding the definition of rural telephone company).

B. THE COMMISSION SHOULD CLARIFY THE MEANING OF "AFFILIATES"

It would not be uncommon in the small telephone company industry to encounter owners who are also invested in other enterprises, perhaps some of which are publicly traded. Examples of such owners would include (1) banks who are owners/customers of telephone cooperatives, and who also have trust departments or other investment activities; (2) other institutional investors whose investment activities go beyond the small telephone company or cooperative; or (3) individual investors who may own other businesses. Some of these owners or owner/customers, as in the case of cooperatives, will certainly own stock in other telephone companies who do not qualify as "designated entities" under the Commission's definition. At issue is how such common ownership interests of this type should be treated, in terms of determining who is "affiliated" with a small telephone company, with less than 50,000 access lines, for purposes of qualifying as a designated entity. This issue will become much more substantial as rural telephone companies seek funds to bid on and build PCS and other emerging technologies in their certificated areas.

The Commission should find that affiliation exists only if the small telephone company is either directly or indirectly controlling or controlled by, or under direct common control with another telephone company. Substantially the same definition already is used in the Communications Act of 1934, as amended ("the

Act") to define "connecting carrier", which encompasses the vast majority of small telephone companies. See, 47 U.S.C. §§152(b)(2) and 153(u).⁴ The Commission and the telecommunications industry thus are familiar with and experienced in applying this definition and indeed, the Commission has used substantially the same definition to determine 'affiliates' for Small Businesses. Order, at para. 272. This definition is also consistent with the affiliation standard applied by the Securities Exchange Commission and the financial community in general, the latter of which is likely to be a primary source of financing for rural telephone companies.⁵

This definition would not penalize rural companies whose owners have less than a controlling interest in other telephone

⁴ The FCC has repeatedly applied Section 2(b)(2) of the Act to small telephone companies that qualify as connecting carriers by providing interstate or foreign service through physical connection with other carriers. 47 U.S.C. § 152(b)(2) (1988); See e.g., Memorandum Opinion and Order (Puerto Rico Telephone Company), 92 FCC 2d 1461, 1462 (1983); see also Initial Decision (The Telephone Co., Inc.), 66 FCC 2d 855, 861 (ALJ 1975) (connecting carrier status of Silver Beehive Telephone Company which connects with Mountain States Telephone and Telegraph Company), review denied, 69 FCC 2d 1968 (1978); Initial Decision, (Complaint of Mrs. Martha Tranquilli), 38 FCC 2d 201, 202 (Hear. Exam.) (connecting carrier status of Mississippi Telephone and Communications, Inc. which connects with South Central Bell Telephone Company), modified on other grounds, Decision, 38 FCC 2d 192, 194 (Rev. Bd. 1972) (acknowledging connecting carrier status).

⁵ Section 12b-2 of the 1934 Securities Exchange Act Rules provide that "an 'affiliate' of, or a person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." 17 CFR § 240.12b-2 (Emphasis added.)

companies, many of which are publicly held.⁶ In short, it would prevent large telephone companies from exerting any direct or indirect control over a rural telephone company having PCS interests, and thus would prevent "gaming" by those companies. The Commission could further require that stockholders in the rural telephone company could not be officers, directors or a controlling person of the outside carrier, in order to ensure that no indicia of common control exists between the companies.

In sum, the Commission should hold that affiliation exists between telephone companies when there is direct or indirect common control between such carriers similar to the test used for jurisdictional purposes in Section 152(b)(2) of the Act, and in the Order's definition of 'affiliate' for small businesses. The Commission, the industry and the financial community have experience in applying this test and it should be used to determine the fact of affiliation.

The adoption of this affiliation standard will avoid penalizing small telephone companies -- who must attract capital to provide service in rural, high cost areas -- and who have attracted stockholders that have invested for that purpose. At the same time, the Commission can be assured that the "common control" standard enacted by Congress and applied by the Commission, will

⁶ Any affiliation standard should make sure that securities held by banks, brokers, money managers, mutual funds, etc., for the economic benefit of others, should not count against carriers who otherwise qualify as rural telephone companies. It is unfair to both the telco and its owners to impute to a carrier investments held in a fiduciary capacity for the ultimate benefit of others. The "common control" test would accomplish this objective.

work to limit entitlement to designated entity status consistent with the intent of the Order.

II. THE COMMISSION SHOULD RECONSIDER ITS RULING ON CONSORTIA

The Commission's Order adopted a harsh rule on the formation of consortia to pursue auctionable spectrum. Specifically, the Commission ruled that it will disqualify designated entity consortia, if by the fact of combining, "they deviate from our standard definitions of designated entities..." Id. at para. 286. The rules are also unclear about the ability of rural telcos to form consortia with non-telephone entities, as a means of obtaining investment capital. The Commission should reconsider and clarify this policy, since it will deny designated entities a realistic chance to obtain auctionable spectrum, and since it is inconsistent with the Commission's own recognition that designated entities require access to capital. These points will be discussed in order.

The Commission is well aware that advanced telecommunications services, such as PCS, will be capital intensive undertakings. In this respect, it is unrealistic to expect that designated entities -- which by their very nature require special measures to be enfranchised in auctionable services -- will be able to realistically bid for spectrum against well-heeled companies, without either combining with each other or with outside capital sources. This is particularly the case if designated entities are forced to compete with no frequency set-asides, such that the universe of bidding competitors would be even larger. Thus, the

Commission's apparent intention to attribute the individual characteristics of a consortium's members, in order to disqualify the entire consortium from designated entity status, closes the economic door on that group's ability to bid for spectrum. This is a particularly absurd result for rural telephone consortia, since the rural nature of the areas served by these carriers does not change when they form a consortium.

As previously discussed, this result is at odds with the Commission's own policy announcements in the Order. For instance, in discussing the definition of "minority and female owned businesses" the Commission recognized the necessity of raising capital:

We seek to encourage designated entities to raise capital by selling less than controlling interests in their companies. We do not intend to restrict the use of such financing mechanisms, provided that the minority and female principals continue to maintain 50.1% of the equity on a fully-diluted basis and that their equity interests entitle them to a substantial stake in the profits and liquidation value of the venture relative to the non-controlling principals.

Order, at para. 278.

This policy of encouraging designated entities to sell less than controlling interests in their companies is not consistent with a policy which would prohibit designated entities from achieving the same result (without having to actually sell company interests), by the formation of a consortium. Indeed, women and minority bidders will often be entities formed for the purpose of bidding for a PCS license, and are free to change their ownership as desirable to maximize their bidding opportunity. Rural telcos,

on the other hand, are established entities formed for another purpose, and are heavily regulated. Such telcos cannot so freely sell off interests in the carrier, and must be able to form consortia in order to raise capital for bidding.

The Commission is thus respectfully requested to reconsider its ruling on consortiums that would apparently attribute the characteristics of individual designated entities in order to disqualify them as a consortium. The Commission should rule that consortiums may be formed and maintain their designated entity status, as long as the majority of the equity and control resides in members who are designated entities. This policy should specifically recognize that the individual characteristics of independent, designated entity members of the consortium, will not be attributed in a fashion as to disqualify the entire consortium. It should also recognize that the consortium may have members who are not designated entities, as long as designated entities have control and majority ownership of the consortium.

This result will enhance the likelihood that designated entities will be able to effectively pursue spectrum -- a likelihood that is practically nil under the Commission's current policy. It will also allow rural telephone companies to raise capital, without having to sell any part of their business, which, perhaps unlike women and minority owned businesses, is not a feasible alternative for these heavily regulated companies.

CONCLUSION

For the reasons set forth above, it is respectfully requested that the Commission move quickly to clarify its rural telco definition, affiliation and consortium rules. PCS auctions are nearly upon us. Without the changes specified herein, the rural telephone companies which Congress sought to protect will be excluded from participation due to confusion and uncertainty. This uncertainty will hinder their ability to plan for the auctions, and may even cause some qualified telcos to believe they are excluded. The ability of these carriers to obtain financing or find investors/joint venturers will likewise be stymied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, John A. Prendergast, hereby certify that I am an employee in the Law Offices of Blooston, Mordkofsky, Jackson & Dickens and that on this 3rd day of June, 1994, I caused to be mailed a copy of the foregoing "**PETITION FOR PARTIAL RECONSIDERATION**" to the following:

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