

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Updating Part 1 Competitive Bidding Rules)	WT Docket No. 14-170
)	
Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions)	GN Docket No. 12-268
)	
Petitions of DIRECTV Group, Inc. and EchoStar LLC for Expedited Rulemaking to Amend Section 1.2105(a)(2)(xi) and 1.2106(a) of the Commission's Rules and/or for Interim Conditional Waiver)	RM-11395
)	
Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures)	WT Docket No. 05-211
)	

COMMENTS OF UNITED STATES CELLULAR CORPORATION

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TABLE OF CONTENTS

I.	INTRODUCTION AND EXECUTIVE SUMMARY.....	2
II.	THE DE PROGRAM IS NECESSARY, BENEFICIAL, AND HAS SERVED THE PUBLIC INTEREST.....	3
A.	U.S. Cellular’s Participation in the DE Program Has Been Vital to Its Success.....	3
B.	The Current DE Program is Grounded in the Communications Act and the Commission’s and Industry’s Experience With It.....	5
C.	The History of the DE Program Supports Leaving Its Basic Structure in Place.....	7
III.	THE COMMISSION SHOULD MODIFY ITS BIDDING AGREEMENT RULES.....	9
IV.	THE COMMISSION SHOULD REPEAL THE AMR RULE AND RESIST PROPOSALS TO SUBJECT DEs TO OTHER HARMFUL “FACILITIES-BASED” REQUIREMENTS.....	11
V.	ANY TYPE OF “CAP” ON THE LEVEL OF BIDDING CREDITS A DE MAY CLAIM WOULD PREVENT THESE ENTITIES FROM BECOMING TRULY VIABLE COMPETITORS.....	19
VI.	CONCLUSION.....	20

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United States Cellular Corporation (“U.S. Cellular”) submits these Comments in response to the Public Notice released April 17, 2015 in the above-captioned proceedings.¹ As detailed herein, U.S. Cellular is a strong supporter of the Commission’s current Designated Entity (“DE”) rules, which permit an entity such as U.S. Cellular to become a limited partner of a DE that otherwise would have no opportunity to enter the wireless industry due to the high cost of acquiring spectrum rights and the fact that the market is currently dominated by a few very large, deep-pocketed carriers. Also as detailed herein, U.S. Cellular generally supports the proposals set forth in last year’s Notice of Proposed Rulemaking (“NPRM”). U.S. Cellular agrees with the Commission that, in light of “changes in the marketplace, including the challenges faced by new

¹ See *Request For Further Comment on Issues Related To Competitive Bidding Proceeding: Updating Part 1 Competitive Bidding Rules*, Public Notice, FCC 15-150 (rel. Apr. 17, 2015) (“Public Notice”).

entrants,” the proposals are needed to provide DEs with a reasonable opportunity to participate in the provision of spectrum-based services, as well as to ensure that the Commission’s competitive bidding rules continue to promote its fundamental statutory objectives.²

I. INTRODUCTION AND EXECUTIVE SUMMARY

Maintaining a competitive marketplace has long been a goal of the Commission, and the DE program is an important facet to an effective competition agenda. U.S. Cellular has participated in the DE program since its inception, and U.S. Cellular’s involvement as a DE investor has been vital to its success as one of the few surviving mid-sized wireless carriers. With its DE partners, for example, U.S. Cellular has been able to expedite the deployment of high-speed broadband to over 90 percent of its customers over the past three years. That deployment has covered significant parts of rural America ignored by the national carriers. The DE program has also helped U.S. Cellular to compete successfully with its much larger nationwide carrier rivals in areas where they do serve. Whatever changes the Commission may make to its competitive bidding rules, it should not undermine or destroy a viable DE program.

The current DE program is supported by the Communications Act, which requires the “dissemination” of licenses to, *inter alia*, small businesses. It is also supported by decades of experience. More than twenty years ago, the Commission correctly determined that DEs require bidding credits in order to meaningfully participate in auctions, and rightly permitted non-controlling investments by larger carriers in DEs in order to allow DEs to achieve reasonable scale for their operations.

When the Commission has sought to restrict DEs by adopting burdensome requirements applicable only to them, DE auction participation has dropped drastically. At present, however,

² *Updating Part 1 Competitive Bidding Rules*, Notice of Proposed Rulemaking, 29 FCC Rcd 12426, 12427 (2014). All comments and reply comments cited herein are those filed in response to the NPRM on February 20, 2015 and March 6, 2015, respectively, in Docket No. 14-170.

the rules regarding DE ownership structures are largely reasonable, and resulted in high levels of DE participation in the recent AWS-3 auction. Accordingly, for the reasons discussed in these Comments, these rules generally should be left in place, subject to certain reforms. Specifically, the Commission should prohibit persons from having knowledge of, or participating in, the bids or bidding strategies of more than one auction participant. This will eliminate the “collusion” abuses alleged to have recently occurred in the Auction 97.

The Commission also should adopt its proposal in the NPRM to abolish the “attributable material relationship” (“AMR”) rule applicable to DE lease interests, and to replace it with a two-pronged approach using its longstanding controlling interest and affiliation rules. Finally, U.S. Cellular opposes any type of “cap” on the amount of bidding credits a DE may claim in a given auction. The caps proposed by some commenters are unreasonable and arbitrary, and these caps could preclude meaningful participation by DEs in future auctions if they are too low to promote scalable robust competition.

II. THE DE PROGRAM IS NECESSARY, BENEFICIAL, AND HAS SERVED THE PUBLIC INTEREST

A. U.S. Cellular’s Participation in the DE Program Has Been Vital to Its Success.

U.S. Cellular is the fifth largest full service wireless carrier in the United States, serving over 4.8 million customers in 23 states. To put this in perspective, however, U.S. Cellular has about one twelfth the number of wireless customers as T-Mobile, the nation’s fourth largest carrier, and about one twenty-fourth the number of wireless customers as Verizon, the nation’s largest carrier.³ U.S. Cellular is one of the last remaining mid-sized wireless carriers, with many

³ See Goldstein, Phil, *Sprint Clings to No. 3 Carrier Spot in Q1, as Tablet Customer Additions are Offset by Phone Losses*, Fierce Wireless (May 5, 2015) (available at www.fiercewireless.com/story/sprint-clings-no-3-carrier-spot-q1-tablet-customer-additions-mask-phone-los/2015-05-05); see also www.verizon.com/about/news-verizon-strong-balanced-results-1q-2015-April-21, 2015.

similarly-situated carriers having exited the wireless marketplace in recent years, usually by selling out to one of the nationwide carriers.⁴

For a mid-sized carrier such as U.S. Cellular, staying in the wireless business has not been easy in a time of technological upheaval and widespread industry consolidation. U.S. Cellular has sought to preserve its competitive position in various ways. First, it has continually upgraded its network in order to compete with its national (and other) carrier rivals, while also emphasizing customer service. In 2014, U.S. Cellular was named a J.D. Power and Associates “Customer Champion” for the third time in four years. Second, U.S. Cellular has concentrated its efforts in those states and markets in which it has the best chance to succeed. Third, U.S. Cellular has worked and partnered with DEs in order to improve the technological capacity and footprint of both its networks and the networks of its DE partners. It is fair to say that the DE program has been crucial to U.S. Cellular’s success as an independent carrier.

U.S. Cellular has participated in the DE program since its inception. At present, its main DE operating partner is King Street Wireless L.P. (“King Street”), in which a U.S. Cellular subsidiary is a non-controlling limited partner. King Street holds 152 licenses for the 700 MHz A and B Blocks, which operate in conjunction with U.S. Cellular’s network.

U.S. Cellular’s relationship with King Street has provided undeniable public interest benefits. Through the relationship, U.S. Cellular and King Street have been able to expedite deployment of high speed broadband, using King Street’s spectrum, over the past three years to areas covering more than 93 percent of the population of U.S. Cellular’s service areas. Many of these customers are in rural areas, and but for the access to this spectrum, they would have limited or no access to high speed wireless broadband.

⁴ See, e.g., Dobson Cellular Systems, Inc., Midwest Wireless, Western Wireless Corporation, Alltel Wireless, Aloha Partners, Leap Wireless, Atlantic TeleNetwork, and MetroPCS, all of which are no longer in existence as independent carriers.

U.S. Cellular also participated in Auction 901, the 2012 “grant” auction which provided funding for broadband in unserved rural areas. Notably, in nineteen of the areas in which U.S. Cellular received funding, it has been able to provide 4G service because of its relationship with King Street. Moreover, in Auction 97, U.S. Cellular held a limited partnership interest in Advantage Wireless, L.P., which won 124 AWS-3 licenses. U.S. Cellular hopes to work closely with Advantage to their mutual benefit and to the benefit of their customers.

These DE partnerships have enabled both U.S. Cellular and its partners, as well as other carriers like them, to participate in the provision of wireless services and to compete effectively with the nationwide carriers. Accordingly, the Commission must not place restrictions and conditions on DEs which singly or (more likely) together close the door to participation in the DE program by King Street, Advantage, and similarly-situated DEs, as well as by U.S. Cellular and similarly-situated limited partners.

B. The Current DE Program is Grounded in the Communications Act and the Commission’s and Industry’s Experience With It.

The current DE program is supported both by the Communications Act’s express language and its legislative history.⁵ The Communications Act provides that, when the Commission exercises its auction authority, it must promote “economic opportunity and competition ... by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses [and] rural telephone companies...”⁶ The Commission must also “ensure that small businesses [and] rural telephone companies ... are given the opportunity to participate in the provision of spectrum-based

⁵ See Furchtgott-Roth, Harold, *Economic and Regulatory Perspectives on Structuring Designated Entity Programs for Commission Auctions*, pp. 4-6 (May 2015) (“Furchtgott-Roth Paper”) (attached hereto).

⁶ 47 U.S.C. §309(j)(3)(B).

services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures.”⁷

As the Commission recognized in 2014 when it adopted rules for the AWS-3 bands, “[o]ne of the principal means by which the Commission fulfills the mandate is through the award of bidding credits to small businesses.”⁸ The Commission has acknowledged the need for bidding credits in this context for more than twenty years, consistently recognizing that DEs might lack necessary capital. As the Commission stated in 1994:

The record clearly demonstrates that the primary impediment to participation by designated entities is lack of access to capital. This impediment arises for small businesses from the higher costs they face in raising capital... In this regard, it should be noted that although auctions have many beneficial aspects, they threaten to erect another barrier to participation by small businesses ... by raising the cost of entry into spectrum-based services.⁹

In the same order, however, the Commission explicitly recognized that the solution to this problem was to allow larger carriers to invest in DEs and then grant bidding credits to the DEs:

[T]o encourage large companies to invest in designated entities and to assist designated entities without large investors to overcome the additional hurdle presented by auctions, we will make bidding credits available to designated entities.¹⁰

In another 1994 order, the Commission also concluded that it “may be necessary to provide bidding credits to designated entities to achieve the objectives of Section 309(j)(4)(D).”¹¹

At that time, carriers provided what would now be considered “first generation” voice service. Capital requirements are now obviously far greater than twenty years ago for all carriers

⁷ 47 U.S.C. §309(j)(4)(D).

⁸ *Amendment of the Commission’s Rules with Regard to Commercial Operations in the 1695-1710 MHz, 1755-1780 MHz, and 2155-2180 MHz Bands*, Report and Order, 29 FCC Rcd 4610, 4677 (2014).

⁹ *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, Fifth Report and Order, 9 FCC Rcd 5532, 5537 (1994).

¹⁰ *Id.* at 5539.

¹¹ *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, Second Report and Order, 9 FCC Rcd 2348, 2391 (1994).

in a fourth generation wireless world, in which high speed broadband is the most important service offering for any carrier. Thus, access to capital for DEs is even more important now than in 1994. There is no practical alternative to present DE structures if DEs are to remain meaningful participants in the auction process.¹² Rightly, both the Act and the Commission's regulations permit, and indeed encourage, the necessary investments to sustain DEs.

C. The History of the DE Program Supports Leaving Its Basic Structure in Place.

The DE rules have admittedly been controversial, and the Commission has sometimes sought to place restrictions on DE opportunities, with unhappy results. For example, in 2006, the Commission amended the DE rules in three important ways. First, it adopted the AMR rule for the purposes of Section 1.2110(b)(3)(iv)(B) of its rules, finding that there was an “attributable material relationship” between a DE and any individual who leased more than 25 percent of the spectrum capacity of any of the DE's licenses. Second, the Commission adopted Section 1.2110(b)(3)(iv)(A), which prohibits a DE from leasing or reselling, on a cumulative basis, more than 50 percent of the spectrum capacity of any of its licenses. Third, the Commission amended Section 1.2111(d) to require that unjust enrichment penalties would have to be paid if a DE that had received a bidding credit sold its license within ten years of licensing, while the previous rule had required only a five-year holding period.¹³

The purpose of those rule changes was ostensibly to promote DE construction of facilities-based systems and to discourage “speculative” investment in DEs. The effect of the rule changes, however, was to discourage both the formation of DEs and their participation in auctions.

¹² See Furchtgott-Roth Paper at 14-16.

¹³ See *Council Tree Communications, Inc. v. FCC*, 619 F.3d 235 (3d Cir. 2010).

The latter two rule changes were found to be unlawful in 2010 by the U.S. Court of Appeals for the Third Circuit in the *Council Tree* case. However, between 2006 and 2010, as the appeals process wound its way through the courts, the Commission held two auctions: Auction 66 for AWS-1 licenses, and Auction 73 for 700 MHz licenses. The Court did not, however, overturn the results of those auctions, which had been held pursuant to rules which had the effect of dramatically curtailing both DE participation in auctions and investor participation in DEs.

The *Council Tree* Court described the dramatic effects of the rule changes:

While Petitioners' first petition for review was pending in 2006, the FCC conducted Auction 66 subject to the rules challenged here. ... DEs accounted for 166 of 252 applications and 100 out of 168 qualified bidders permitted to participate. ... DEs were 57 of the 104 winning bidders, winning 20% of the individual licenses auctioned. Measured in terms of dollar value, however, DEs won only 4% of the spectrum licenses... By comparison, in auctions held prior to the new rules, DEs had won, on average, 70% of the licenses by dollar value.

In late 2007 and early 2008, during and just after the pendency before the FCC of Petitioners' petition for reconsideration, the FCC held another, even larger spectrum auction, known as 'Auction 73.' Auction 73 generated about \$19 billion in winning bids, and was also conducted under the rules challenged here. In Auction 73, DEs comprised 119 of 214 qualified bidders and 56 of 101 winners, and won 35% of the individual licenses. They won only 2.6% of the total dollar value of the licenses, however.¹⁴

In response to the Court's decision, the Commission eliminated the onerous 50 percent "permissible relationship" and ten-year holding period rules, while retaining the 25 percent AMR rule. Thus, for the most part, it restored the pre-2006 *status quo* with respect to DEs, with the exception of the 25 percent attributable AMR rule.¹⁵

The response of DE bidders in Auction 97 is instructive. In contrast to Auctions 66 and 73, in Auction 97, DEs won 26 percent of the "aggregate value of the spectrum available during

¹⁴ *Id.* at 248 (emphasis added).

¹⁵ The Public Notice asks whether that rule should be eliminated, which we discuss in Section IV below.

the auction.”¹⁶ The results of Auction 97 furnish additional evidence, if any was required, that if there is to be appreciable DE participation in auctions, there must be both reasonable rules applicable to DEs and adequate incentives provided to DE investors.

There is no “magic formula” whereby the DE rules can be changed to promote the participation of minorities and small businesses in the provision of wireless service on a large scale, while at the same time preventing their investors from receiving any benefit from the arrangement, including a right to exit after a reasonable time.¹⁷ If the DE rules are altered to limit the opportunity for larger companies to participate in DEs, there will be fewer DEs, and those that remain will not have the resources needed to serve more than a few markets.¹⁸ When individual, properly constituted DEs win auctions, that is not an abuse of the rules. Rather, it carries out their intent.

III. THE COMMISSION SHOULD MODIFY ITS BIDDING AGREEMENT RULES

Auction 97 has given rise to controversy with respect to the Commission’s rules regarding the arrangements auction participants may enter into with other participants. U.S. Cellular suggests that this controversy can be ended, at least with respect to future auctions, by modifying its “bidding agreement” requirements. Section 1.2105(a)(2)(viii) of the Rules requires auction applicants to include in their short-form applications:

An exhibit, certified as truthful under penalty of perjury, identifying all parties with whom the applicant has entered into partnerships, joint ventures, consortia or other agreements, arrangements or understandings of any kind relating to the licenses being auctioned, including any such agreements relating to the post-auction market structure.¹⁹

¹⁶ See, e.g., Comments of DE Opportunity Coalition at 11-12.

¹⁷ See Furchtgott-Roth Paper at 12-17.

¹⁸ An example of such actions would include imposing additional buildout requirements in addition to the stringent requirements already imposed on all services licensed since 2008, and which will be imposed on 600 MHz licensees. Another would be to lengthen the time beyond five years before DE licenses can be sold without “unjust enrichment” consequences.

¹⁹ 47 U.S.C. §1.2105(a)(2)(viii).

Such applicants are also required to:

Certif[y] under penalty of perjury that [they have] not entered and will not enter into any explicit or implicit agreements, arrangements or understandings of any kind with any parties other than those identified pursuant to paragraph (a)(2)(viii) regarding the amount of their bids, bidding strategies or the particular licenses on which they will or will not bid.²⁰

As interpreted by the Commission, Section 1.02105(a)(2)(viii) requires auction applicants to identify in their short-form applications those parties with whom they have pending license transfer and assignment applications, as well as other auction participants in which they have an attributable interest, even if such arrangements do not affect an applicant's bids or bidding strategies. The rules also require the disclosure of joint bidding agreements or "bidding consortia," which are agreements among applicants which do affect bids and bid strategies. Applicants may enter into more than one bidding agreement per auction. However, it is unclear under the rule as to how applicants participating in such bidding agreements may actually cooperate with each other. For example, they may not submit "collusive" or "rigged" bids, which violate the antitrust laws.²¹ What does that prohibition mean in the context of Commission-approved bidding arrangements among multiple applicants? It is very uncertain.

We suggest that the Commission eliminate it as an issue in future auctions by amending Section 1.2105(a)(2)(viii) to require that those persons with knowledge of or involvement in the bidding strategy of one applicant should not have such knowledge of, or involvement in, the bidding strategy of any other applicant in the same auction.²²

²⁰ 47 U.S.C. §1.2105(a)(2)(ix).

²¹ See, e.g., *Auction of Advanced Wireless Services (AWS-3) Licenses Scheduled for November 13, 2014*, Public Notice, DA 14-1409, ¶ 35 (2014) ("Regardless of compliance with the Commission's Rules, applicants remain subject to the antitrust laws, which are designed to prevent anticompetitive behavior in the marketplace.").

²² Current Commission auctions require certifications that "precautionary steps" have been taken to prevent impermissible communications between authorized bidders. See, e.g., *Auction of Advanced Wireless Services (AWS-3) Licenses Scheduled for November 13, 2014; Notice and Filing Requirements Reserve Prices, Minimum*

For example, there are still in existence various wireless partnership licensees dating back to the cellular era. A corporation may hold a limited partnership interest in such a licensee partnership, which is participating in a given auction, while also investing in a DE auction applicant. Under our proposal, an employee of the corporation might have knowledge of the bid strategies of the licensee partnership; provided he or she was “walled off” from any knowledge of the bids and bidding strategies of the DE applicant. Other “walled off” employees of the corporation might participate in the DE applicant’s bids and/or bidding strategies. The relevant employees of the corporation would be required to certify in the applicable applications that they only had knowledge of, or participated in, the bidding strategies of that particular applicant.

This proposal, therefore, would not preclude applicants from having pending transactions with, or minority interests in, other applicants, which would be reported as they are under the current rules. But the possibility of unlawful collusion would be eliminated if knowledge of auction strategy or actual participation in bidding on behalf of one applicant precluded those with such knowledge from participation in any other applicant’s bidding strategy by any means, direct or indirect. This prohibition would also eliminate the problems generated by “anonymous” but concerted bidding among connected entries, “bid stacking,” etc.

IV. THE COMMISSION SHOULD REPEAL THE AMR RULE AND RESIST PROPOSALS TO SUBJECT DEs TO OTHER HARMFUL “FACILITIES-BASED” REQUIREMENTS

U.S. Cellular joins a majority of those filing comments in response to the NPRM²³ in supporting the Commission’s proposal to repeal the AMR rule, and to replace that rule with a two-pronged approach using its existing controlling interest and affiliation rules to determine

Opening Bids, Upfront Payments, and Other Procedures for Auction 97, Public Notice, 29 FCC Rcd 8386, 8394 (2014). Our proposal is intended to strengthen the current certification requirements.

²³ See, e.g., Comments of DE Opportunity Coalition at 16; Comments of Competitive Carriers Association (“CCA”) at 9; Comments of the Wireless Internet Service Providers Association (“WISPA”) at 10; Comments of NTCA–The Rural Broadband Association (“NTCA”) at 5; Comments of the Auction Reform Coalition (“ARC”) at 17.

both whether an entity qualifies as a DE and whether it retains control over the spectrum associated with the licenses for which it seeks bidding credits.²⁴ A key benefit of this proposal is that it would rely on the Commission’s longstanding controlling interest and affiliation standards, which ARC explained would add “continuity and predictability to the application process” for both applicants and the Commission.²⁵ Similarly, WISPA explained how the use of these well-known standards would permit small businesses “to structure relationships in ways that are understood and predictable,” while also allowing the Commission “to pass on transactions just as it does in other cases.”²⁶ On the other hand, because they would “mak[e] complex rules even more complex,” some of the proposed revisions to these longstanding standards “would likely discourage participation in FCC auctions by both designated and other entities.”²⁷

Even more significantly, the Commission’s proposals would free DEs from the AMR rule’s various harmful restrictions. As the Commission recognized, this rule has had “the unintended consequence of hindering the Commission’s ability to satisfy its statutory goal of promoting opportunities for wireless entry by small businesses.”²⁸ For instance, both the Commission and commenters have explained how the AMR rule’s restrictions on spectrum leasing and other arrangements prevent DEs from securing the financing they require to purchase licenses at auction and to subsequently build out their networks.²⁹ As CCA underscored, for

²⁴ See NPRM, 29 FCC Rcd at 12431-40.

²⁵ Comments of ARC at 17.

²⁶ Comments of WISPA at 11.

²⁷ Furchtgott-Roth Paper at 26.

²⁸ NPRM, 29 FCC Rcd at 12436; see Comments of WISPA at 12 (describing the AMR rule as an “impediment to new entrants”).

²⁹ See NPRM, 29 FCC Rcd at 12436 (explaining that the AMR rule “may inhibit the highest and best use of spectrum by preventing small businesses that lack access to traditional sources of capital from being able to acquire alternative revenue streams through leasing and other spectrum use arrangements”); see also Comments of NTCA at 6 (explaining that the AMR rule “unduly restricts DE’s ability to enter into certain wholesaling and leasing

these reasons, the AMR rule “ultimately inhibits participation by such entities in spectrum auctions and prevents them from becoming viable facilities-based competitors.”³⁰ Like the Third Circuit in *Council Tree*, commenters also noted how the major spectrum auctions since adoption of the AMR rule provide real world evidence of the detrimental effect that rule has with respect to DEs’ auction success.³¹

Although raising the current rule’s 25 percent cap may mitigate some of these harms, setting any absolute limit on the amount of spectrum a DE may lease or resell likely would have negative consequences. U.S. Cellular also notes that both legal and equitable considerations weigh strongly against reestablishing any absolute limit. For instance, as detailed by former Commissioner Harold Furchtgott-Roth in the attachment hereto, “the Communications Act does not refer to any ‘facilities-based’ limitations on licensees or services, much less specifically in 309(j) for designated entities,”³² and any facilities-based limitations noted in the legislative “do not likely reflect Congressional intent.”³³ U.S. Cellular therefore agrees with the Commission that, in adopting the AMR rule, it “placed undue weight on language from the House Report, given all of the various factors that the actual text of section 309(j) gives the Commission the

arrangements that are vital to small businesses’ ability to gain access to capital”); Comments of DE Opportunity Coalition at 25 (explaining that the AMR rule “makes it more difficult for DEs to secure capital, grow their businesses, or expand spectrum holdings at auction”).

³⁰ Reply Comments of CCA at 8; *see* Comments of DE Opportunity Coalition at 16 (describing the AMR rule as a “counterproductive regulatory restriction that impedes new entrant and incumbent DE participation”).

³¹ *See, e.g.*, Comments of ARC at 18 (“After it was adopted in 2006, there was a precipitous decline in the success of DEs in spectrum auctions.”); Comments of DE Opportunity Coalition at 18 (“[T]he AMR Rule proved to be a major impediment to DE participation in Auctions 66 and 73...”); Reply Comments of Council Tree Investors, Inc. at 3 (“With the 2006 DE Rules in place, major spectrum Auctions 66 (2006) and 73 (2008) witnessed historically low levels of DE participation and parallel domination by the large incumbents.”) (internal citation omitted).

³² Furchtgott-Roth Paper at 12 (internal citation omitted); *see* NPRM, 29 FCC Rcd at 12505 (Statement of Commission Mignon L. Clyburn) (“Clyburn Statement”) (noting the “term ‘facilities based service’ does not appear anywhere in Section 309(j),” and that there is no “other language in Section 309(j) which would compel the Commission to decide that entities who acquire licenses with small business bidding credits must use that spectrum to directly provide facilities based service”).

³³ Furchtgott-Roth Paper at 12; *see* Comments of DE Opportunity Coalition at 19-20.

discretion to balance.”³⁴ As Commissioner Clyburn explained, while “legislative history can be helpful, there is no specific language in those two sentences from the 1993 House Report that requires the phrase ‘offering service to the public’ to be defined as ‘designated entities providing facilities based service.’”³⁵ Rather, the “plain meaning of those two sentences in the House Report is that any entity, which uses a small business bidding credit to acquire spectrum in an auction, should primarily intend that the spectrum be used to serve the public,” including through a lease agreement, “and not simply try to resell the spectrum to another entity for a profit.”³⁶

In addition, as Commissioner Furchtgott-Roth explains, application of a facilities-based requirement leads to inequitable consequences for DEs given that other licensees “in the normal course of business have ‘arrangements’ for more than 25% of spectrum capacity without regulatory consequences.”³⁷ In this way, the facilities-based requirement constitutes a “rigid form of economic regulation”³⁸ that has “create[d] a second-class form of spectrum license, one that is less sensitive to market forces and likely less efficiently allocated.”³⁹ For instance, the DE Opportunity Coalition explained how the Commission mistakenly interpreted a brief passage from the House Report “as a statutory mandate to require that DEs operate solely as facilities-

³⁴ NPRM, 29 FCC Rcd at 12436.

³⁵ *Id.* at 12505 (Clyburn Statement).

³⁶ *Id.*

³⁷ Furchtgott-Roth Paper at 7; *see* Comments of DE Opportunity Coalition at 21 (“[I]f the AMR Rule is not repealed, DEs would unreasonably be treated differently than other auction participants...”).

³⁸ Furchtgott-Roth Paper at 13; *see id.* at 31 (explaining that a “facilities-based requirement would limit the economic choices available to a firm and compel it to invest in equipment that an unregulated firm might rationally choose not to invest in”).

³⁹ *Id.* at 29.

based providers, offering service on a retail basis, the most expensive form of service, especially for new entrants.”⁴⁰

For these same reasons, in addition to repealing the AMR rule, U.S. Cellular supports the Commission’s proposal “to make clear that DEs may fully benefit from the same *de facto* control standard for spectrum manager leasing in [its] secondary market rules as non-DE lessors.”⁴¹ Notably, in adopting its secondary market framework, the Commission determined that neither the “language of Section 310(d) nor the general statutory framework of the Communications Act requires that [it] apply a facilities-based *de facto* control analysis when interpreting Section 310(d) requirements.”⁴² Consequently, it concluded “that providing licensees with the flexibility to lease certain of their spectrum usage rights to third parties ... is consistent with the Section 310(d) requirements so long as the licensee exercises both *de jure* control and *de facto* control...” For more than a decade, the Commission has successfully ensured that non-DE licensees continue to exercise such control, and U.S. Cellular supports its proposal to adopt the same framework for DEs.⁴³

Given that Section 310(d) applies equally to every licensee, the Commission should have applied this same reasoning to DEs at that time. Notably, even then, the Commission concluded that, in the leasing context, the facilities-based *Intermountain Microwave* standard for assessing transfers of *de facto* control was “outdated” and “no longer consistent with the public interest”

⁴⁰ Comments of DE Opportunity Coalition at 19; *see* Reply Comments of Council Tree at 10, n. 24 (“Implicit in such an approach is a desire to force new entrant DEs to start up a business with an outsized, immediate, and prohibitively expensive retail component and presence...”).

⁴¹ NPRM, 29 FCC Rcd at 12440.

⁴² *Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, Report and Order and Further Notice of Proposed Rulemaking, 18 FCC Rcd 20604, 20638 (2003) (“*Secondary Markets Order*”).

⁴³ *See* NPRM, 29 FCC Rcd at 12442 (“[S]pectrum manager leasing applications will continue to be evaluated to determine whether control of, or affiliation with, the small business applicant and its overall business venture has arisen through any the terms of the leasing agreement that might lead to attribution and result in unjust enrichment...”).

because it did “not adequately accommodate” the changes that had occurred in the wireless industry, including “an increase in the demand for spectrum, the need for more ready access to it, and a greater emphasis on efficient and flexible use of spectrum.”⁴⁴ Considering that these trends have continued at an ever-quickenning pace, as well as the fact that “over the last decade small businesses have faced various increased difficulties in becoming wireless licensees,”⁴⁵ it is appropriate at this time for the Commission to harmonize the treatment of DEs and non-DEs in the context of its leasing standard.

In addition to finally applying this relaxed standard to all licenses evenhandedly, this action also would advance the overarching objectives of the Commission’s secondary market policies. As the Commission explained when it adopted those policies, “[s]econdary markets can be expected to function best when licensees are free to transfer spectrum usage rights to different uses and users with a minimum of administrative review.”⁴⁶ For well over a decade, however, the Commission unnecessarily restricted a particular class of licensees from participating in such transfers, which undoubtedly at times precluded the highest value use of our nation’s limited spectrum resources.⁴⁷ The Commission, therefore, must take action here to remove this restriction, and thus better advance its secondary market efforts. By doing so, the Commission will help to “ensur[e] many small businesses have significant new opportunities to provide spectrum-based services,” including in rural areas, where “a substantial amount of spectrum is underutilized” and where an expansion of the secondary market would assist the Commission’s

⁴⁴ *Secondary Markets Order*, 18 FCC Rcd at 20623-24.

⁴⁵ NPRM, 29 FCC Rcd at 12436.

⁴⁶ *Principles for Promoting the Efficient Use of Spectrum by Encouraging the Development of Secondary Markets*, Policy Statement, 15 FCC Rcd 24178 (2000).

⁴⁷ *See id.* 24182 (“The preclusion of higher valued uses might occur if service flexibility is restricted by rule...”).

“efforts to promote the further development and delivery of spectrum-based services to rural communities.”⁴⁸

U.S. Cellular further supports the Commission’s proposal “to determine an entity’s eligibility to retain small business benefits on a license-by-license basis, based on whether it has maintained *de jure* and *de facto* control of the license.”⁴⁹ Significantly, under this approach, a licensee would “not necessarily lose its eligibility for all current and future small business benefits solely because of a decision associated with any particular license.”⁵⁰ As ARC emphasized, because “[u]nique situations can arise in any number of markets across the country,” a single “transaction between a DE and a non-DE in a particular market should not adversely affect the licensee’s continuing eligibility as a designated entity elsewhere.”⁵¹

Notably, as detailed in the NPRM, the Commission need not adopt any type of inflexible facilities-based requirement in order “to ensure that a small business applicant has the independent ability to direct its decision making regarding its overall business venture and how its licenses are used to offer service to the public.”⁵² Rather, sufficient, generally-applicable safeguards would remain in place. Specifically, repeal of the facilities-based service requirement would “not alter the rules that require [the Commission] to consider whether facilities sharing and other agreements confer control of or create affiliation with the applicant.”⁵³ Nor would it “alter the general standard by which the Commission evaluates whether a licensee has ceded *de*

⁴⁸ *Secondary Markets Order*, 18 FCC Rcd at 20626.

⁴⁹ NPRM, 29 FCC Rcd at 12438.

⁵⁰ *Id.*

⁵¹ Comments of ARC at 19-20.

⁵² NPRM, 29 FCC Rcd at 12438.

⁵³ *Id.*

facto control and effected an unauthorized transfer of control of its spectrum authorization to a third party.”⁵⁴

Finally, U.S. Cellular urges the Commission to promptly adopt and implement the NPRM’s proposals regarding repeal of the AMR rule and the removal of any bright-line facilities-based requirements. As Commissioner Clyburn explained, “[s]ubstantial changes in the structure of the commercial wireless market call for a change to the AMR rule.”⁵⁵ For instance, in recent years, as consumers’ skyrocketing demand for mobile broadband services has made it critically important for carriers to have access to additional spectrum resources, “the costs of spectrum and network deployment, especially for small and new entrants, have increased...”⁵⁶ As a result, it is now more important than ever “for small businesses to develop business models that can attract capital for both acquiring communications licenses and for deploying networks that can provide service to the public.”⁵⁷ Although many DEs will undoubtedly continue to have challenges securing necessary capital, the Commission’s proposals to replace the AMR rule with a two-pronged control test and to apply its secondary market rules evenhandedly, if adopted, will remove some of the impediments that DEs currently face in this respect.

⁵⁴ *Id.*

⁵⁵ *Id.* at 12505 (Clyburn Statement).

⁵⁶ *Id.* at 12506 (Clyburn Statement); *see also* Reply Comments of DE Opportunity Coalition at 3 (“Changes in the marketplace and the capital-intensive nature of the wireless business require that the Commission refrain from limiting the business plans and options available to DEs to gain a foothold in the wireless sector.”); Comments of ARC at 10 (“With a new generation of DEs on the horizon, facing substantially increased costs to acquire spectrum rights and other necessary inputs, in addition to deeply entrenched competitors in a highly concentrated market, the Commission’s proposals in the NPRM are timely.”).

⁵⁷ NPRM, 29 FCC Rcd at 12506 (Clyburn Statement).

V. ANY TYPE OF “CAP” ON THE LEVEL OF BIDDING CREDITS A DE MAY CLAIM WOULD PREVENT THESE ENTITIES FROM BECOMING TRULY VIABLE COMPETITORS

The Commission must reject proposals to impose any type of “cap” on the amount of bidding credits a DE may claim during an auction because, as ARC previously stressed, any “artificial limit on a DE’s ability to utilize bidding credits would [] restrict its ability to acquire spectrum licenses and participate in spectrum-based businesses.”⁵⁸ Consequently, the proposed caps would violate the statutory mandate that the Commission ensure that its competitive bidding rules adequately promote “economic opportunity and competition.”⁵⁹

In particular, AT&T’s proposal that the Commission prohibit a DE from claiming more than \$32.5 million in bidding credits in a given auction is wholly unreasonable.⁶⁰ AT&T bases its proposed cap on the SBA’s annual revenue limit for “all other telecommunications” entities to qualify as a small business,⁶¹ but fails to acknowledge that the capital costs a business must incur often dwarf its annual revenues. This is especially true for new entrants, as well as in industries such as the wireless industry, where carriers need to invest substantial sums in order to acquire spectrum rights and to deploy networks prior to earning any revenue. AT&T’s proposed cap also bears no relation to the situation this cap allegedly is needed to address. For instance, while AT&T complains that a truly small business “should not be able to extract subsidies worth *billions of dollars* from the Commission’s DE program,”⁶² its proposed cap is only about 1% of

⁵⁸ Reply Comments of ARC at 7.

⁵⁹ 47 U.S.C. §309(j)(3)(B).

⁶⁰ See Comments of AT&T at 17.

⁶¹ See *id.*

⁶² *Id.* at 16-17 (emphasis added).

the amount of bidding credits AT&T alleges were improperly claimed by bidders for Auction 97.⁶³

An unreasonably low cap like that proposed by AT&T also would effectively prevent DEs from competing for spectrum in heavily-populated markets. And it would deny DEs access to some scale economies by limiting the number of licenses they can acquire, and thus, the number of markets they can serve. The proposed cap, therefore, “would benefit only AT&T and other bidders having greater access to capital markets than do DEs,”⁶⁴ and thereby conflict with the requirements of Section 309(j) by leading to an even greater concentration of spectrum in these markets amongst the already-dominant nationwide carriers.⁶⁵ Notably, these harms related to AT&T’s proposal, or to any fixed dollar cap, would continue to increase over time as a result of both inflation and the ever-increasing cost of acquiring spectrum rights.⁶⁶ Finally, U.S. Cellular notes that any dollar cap, even if adjusted for inflation or increasing spectrum costs, would permit the largest carriers to engage in anti-competitive bidding strategies. As ARC explained, “well-financed incumbents such as AT&T could easily calculate the price they would have to bid for a license in order to place it above the threshold for a capped DE benefit.”⁶⁷

VI. CONCLUSION

For the foregoing reasons, the Commission should maintain the DE program for wireless services. It has served the public interest by facilitating wireless competition and bringing

⁶³ See *id.* at 16 (“Giant businesses, such as DISH, should not be able to creatively craft end-runs around the DE rules and lay claim to over \$3 billion in spectrum subsidies.”).

⁶⁴ Reply Comments of ARC at 7.

⁶⁵ See Reply Comments of Council Tree at 4 (“Section 309(j)’s twin goals of wide license dissemination and avoidance of excessive license concentration would be gutted if the FCC designed a DE program merely to facilitate small auction bids by DEs (*e.g.*, for small markets or small spectrum blocks).”).

⁶⁶ See Reply Comments of ARC at 6 (“As the price of spectrum continues to soar, a fixed dollar cap on DE benefits would have the perverse effect over time of automatically reducing the dissemination of licenses to DEs.”).

⁶⁷ *Id.* at 6-7.

Federal Communications Commission

**Economic and Regulatory Perspectives on Structuring Designated Entity Programs for
Commission Auctions**

WT Docket No. 14-170; GN Docket No. 12-268; RM-11395; WT Docket No. 05-211

Harold Furchtgott-Roth

May 2015

I. INTRODUCTION AND BACKGROUND

A. *Background and assignment*

I have reviewed much of the recent record in the FCC dockets related to designated entities and competitive bidding rules.¹ I have followed auction rules since I was a commissioner of the FCC.

I have been asked by U.S. Cellular to comment from an economic and regulatory perspective on the current Public Notice seeking further comment on issues related to the competitive bidding process that were initially raised in a Notice of Proposed Rulemaking in October 2014.² The Public Notice seeks comments on how to structure designated entity (“DE”) programs within the FCC’s auctions. The FCC’s Public Notice is premised on preserving the DE programs.³ My comments below assume the retention of the DE programs and focus on how to make the FCC’s current structure of DE programs more consistent with statute and more economically efficient.⁴

¹ See in particular FCC Docket 14-170.

² FCC 15-49, (“Public Notice”), released April 17, 2015. See also FCC 14-146, Notice of Proposed Rulemaking, (“NPRM”), released October 10, 2014. The views expressed in this report are my own and do not necessarily reflect the views of anyone else.

³ “Specifically, the Commission seeks further, more detailed input on alternative proposals as well as questions posed and issues raised by commenters on how the Commission can meet our statutory obligation to ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women (collectively, “designated entities” or “DEs”) have an opportunity to participate in the provision of spectrum-based services...” Public Notice, paragraph 1.

⁴ As an FCC commissioner, I was skeptical of the efficacy of many of these programs. At the same time, I consistently held that the legitimacy and enforceability of legal rights, once obtained and reviewed by a court, should not be questioned or denigrated based on their origin. Thus, after the D.C. Circuit Court of Appeals upheld the FCC’s designated entity small-business preferences for auctions in *Omnipoint Corp. v. FCC*, 78 F.3d 620, 316 (1996), there was little basis to oppose similar designated entities rules as a matter of law. The analysis and opinions I offer below are based on how to make FCC license allocations more efficient, given that DE programs are, and will likely remain, in effect.

B. Qualifications

I am president of Furchtgott-Roth Economic Enterprises, an economic consulting firm. I am a senior fellow at the Hudson Institute where I founded and head the Center for the Economics of the Internet. I am an adjunct professor of law at Brooklyn Law School where I teach a course on communications law.

I was a commissioner of the Federal Communications Commission (“FCC” or “Commission”) from November 1997 through the end of May 2001 while many of the provisions of the Telecommunications Act of 1996 were being implemented. In that capacity, I participated in all decisions of the Commission including those affecting spectrum auctions.

I have worked for many years as an economist. From June 2001 through March of 2003, I was a visiting fellow at the American Enterprise Institute for Public Policy Research (“AEI”) in Washington, DC. From 1995 to 1997, I was chief economist of the House Committee on Commerce where one of my responsibilities was to serve as one of the principal staff members helping to draft the Telecommunications Act of 1996.

My academic research concerns economics and regulation. I am the author or coauthor of four books: *A Tough Act to Follow?: The Telecommunications Act of 1996 and the Separation of Powers* (Washington, DC: American Enterprise Institute), 2006; *Cable TV: Regulation or Competition*, with R.W. Crandall, (Washington, DC: The Brookings Institution), 1996; *Economics of A Disaster: The Exxon Valdez Oil Spill*, with B.M. Owen, D.A. Argue, G.J. Hurdle, and G.R. Mosteller, (Westport, Connecticut: Quorum books), 1995; and *International Trade in Computer Software*, with S.E. Siwek, (Westport, Connecticut: Quorum Books), 1993.

I received a Ph.D. in economics from Stanford University and an S.B. in economics from MIT.

II. SUMMARY OF OPINIONS

Based on my experience as an FCC commissioner, my training and experience as an economist, my experience in the communications industry and my review of documents related to this proceeding, I reach the following broad conclusions:

- FCC DE rules should be consistent with statute;
- DE licenses are different, and of much lesser value, than non-DE licenses;
- Continuing through today, the FCC has for more than 20 years had a conscious effort to encourage large companies to invest in DEs; and
- Efficient allocation of spectrum is important to the American economy.

Below, I provide detailed comments on the questions raised in the Public Notice that support these conclusions.

III. FCC DE RULES SHOULD BE CONSISTENT WITH STATUTE

FCC rules for DEs should be consistent with statute. Many of the suggestions the Commission has received for attribution rules and small business policies do not appear to be derived from any, much less specific, statutory language. The Communications Act uses the series “small businesses, rural telephone companies, and businesses owned by members of minority groups and women,” today broadly classified as DEs, in four sentences in 47 U.S.C. 309(j):

- (1) In identifying classes of licenses and permits to be issued by competitive bidding, in specifying eligibility and other characteristics of such licenses and

permits, and in designing the methodologies for use under this subsection, the Commission shall include safeguards to protect the public interest in the use of the spectrum and shall seek to promote the purposes specified in section 151 of this title and the following objectives: 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;⁵

- (2) In prescribing regulations pursuant to paragraph (3), the Commission shall—
(C) consistent with the public interest, convenience, and necessity, the purposes of this chapter, and the characteristics of the proposed service, prescribe area designations and bandwidth assignments that promote ... (ii) economic opportunity for a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women;⁶
- (3) In prescribing regulations pursuant to paragraph (3), the Commission shall—
(D) ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures;⁷ and
- (4) The evaluation section for a report due in 1997.⁸

Given that the fourth mention was fulfilled in 1997, Section 309(j) has but three currently binding references to DEs.

The statutory language gives little leeway for the Commission to define DEs except that DEs are “applicants” in the first two sentences and entities “given the opportunity to participate in the provision of spectrum-based services” in the third sentence. Rural telephone companies are a defined term under the Communications Act.⁹

⁵ 47 U.S.C. 309(j)(3)(B).

⁶ 47 U.S.C. 309(j)(4)(C).

⁷ 47 U.S.C. 309(j)(4)(D).

⁸ 47 U.S.C. 309(j)(12).

⁹ See 47 U.S.C. 153 (44).

Small businesses are a defined term under many federal statutes, but are not specifically defined for 309(j). Since, *Adarand* the FCC has limited DEs primarily to small businesses and rural telephone companies.¹⁰

It is difficult to read the statute and find much ambiguity about eligibility to be a DE. The statutory language with respect to DEs has not changed in more than 20 years, and one might expect the Commission's DE and auction rules to be unchanging. But 47 CFR 1.2110, the primary rule on designated entities, has changed at least two dozen times, and nine times in the past fourteen years.¹¹ The changes in just this one set of rules have been the result of formal rulemakings as well as court orders. The current version, in the 2014 version of the CFR, has nearly 8,000 words, one of the longest sections in under Title 47. In addition, each auction has had its own set of rules, and DEs have been treated differently in many auctions.

Unlike the simplicity of statute, the Commission rules are complicated about who qualifies as a DE.¹² The Commission has attempted to narrow the definition of a DE in various ways as discussed below.

1. Attributable material relationship

One method the FCC uses to limit DEs is to “attribute” ownership interest based on commercial relationships with various other entities *just for designated entities*. Thus,

¹⁰ *Adarand Constructors v. Pena* (93-1841), 515 U.S. 200 (1995). In this case, the Supreme Court held that racial classifications needed to meet a “strict scrutiny” standard. Rather than subject the DE program to this standard, the FCC adopted a non-racial standard of small businesses. See, e.g., FCC 00-159, Second Report and Order and Second Further Notice of Proposed Rulemaking, paragraphs 35-38, released May 18, 2000.

¹¹ Author's calculation based on 47 CFR 1.2110.

¹² At this time, I do not address the added layers of complexity created by the necessary system of informal rulemaking through Bureau letters to parties in response to specific inquiries.

in 47 CFR 1.2110, the Commission has created an “attributable material relationship” if a designated entity “has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant’s or licensee’s licenses.”¹³ This is a rule that does not apply in other parts of the Communications Act. Licensees in the normal course of business may have “arrangements” for more than 25% of spectrum capacity without regulatory consequences.

The concept of “attributable material relationship” is not found in the Communications Act. Even phrases beginning with “attributable” are rare in the Communications Act¹⁴ and are never used to construct a different and lesser class of licensees. The “attributable material relationship” creates a presumption of affiliation. The “attributable material relationship” rules add a layer of complexity to an already complicated set of FCC rules on affiliation and control and appears to be aimed at codifying *de facto* control.¹⁵ The terms “control” and “*de facto* control” appear in many parts of the FCC rules for different purposes. The FCC has no single definition for either term.

2. *Varied statutory and regulatory interpretations of control*

The Communications Act has several references to “control” but none to “*de facto* control” or “*de jure* control.” “Control” by itself is a statutory concept, but “*de facto* control” is a term of regulatory art usually used to help interpret various statutory

¹³ 47 CFR 1.2110(b)(3)(iv). This provision was adopted by the Commission in 2006. See FCC 06-52.

¹⁴ 47 U.S.C. 224(d); 252(d)(3); 309(j)(8)(D); 309(j)(16)(B); 533(f)(1); 542(f); 543(b)(4); 548(b); 548(c)(2); 548(j); 553(c); 605(e); 923(g)(3); and 926(c).

¹⁵ The term “*de facto* control” appears 3 times in 47 CFR 1.2110.

requirements for corporate “control” or “ownership” under the Act. More than 40 different sections of the Act contain the word control, not always in the context of corporate control and ownership.¹⁶ It is consequently not surprising that the FCC has no single interpretation of *de facto* control.

The FCC has developed different rules for control and *de facto* control to address different sections of the Act and different policy objectives. FCC and court interpretations of control under different sections of the Act have been the subject of substantial proceedings with ever-changing rules including broadcast ownership, foreign ownership,¹⁷ Bell Operating Company obligations for affiliates,¹⁸ FCC treatments of mergers and acquisitions, and auctions.

The interpretation of “*de facto* control” for purposes of this proceeding is to support interpretations of “control” under Section 309(j) of the Communications Act. Even for the purposes of this one section, the definitions of *de facto* control have changed over time.

3. *Novel circumstances of control*

The FCC is not in an adversarial relationship with licensees. The FCC does not always address issues of control or *de facto* control in an inflexible manner. It is aware of the varied circumstances of corporate governance, and it has even worked closely with corporations to erect elaborate corporate structures to comply with the nuances of FCC

¹⁶ These sections include: 2, 3, 4, 8, 215, 218, 219, 223, 224, 227, 229, 230, 271, 273, 274, 275, 301, 307, 309, 310, 313, 314, 319, 327, 335, 351, 360, 363, 392, 395, 396, 398, 692, 612, 613, 621, 623, 624, 625, 630, 634, 652, and 706.

¹⁷ For the evolution of the interpretation of foreign ownership and control rules, see J. G. Sidak, *Foreign Investment in American Telecommunications*, (Chicago: University of Chicago Press), 1997.

¹⁸ See various Section 271 applications.

control rules.¹⁹ Except in instances where the FCC has reason to believe that an applicant has purposefully misled the FCC, or has been uncooperative,²⁰ or engaged in other forms of illegal activity,²¹ the FCC tends to seek cooperative solutions rather than inflexibly apply rigid rules.

4. *Evaluation of de facto control of licenses*

The FCC has long been aware of the complexity of its rules with respect to the status of affiliates and *de facto* control for designated entities.²² Although the FCC discussed *de facto* control in orders establishing auction rules, it did little to incorporate *de facto* control directly into auction rules until 2000. The 2007 attributable material relationship provisions of 47 CF 1.2110 established initial bright line tests for *de facto* control, but even these tests were ultimately subject to Commission review under a “totality of circumstances” review.²³

¹⁹ See, e.g., acquisition of GTE by BellAtlantic and the construction of Genuity to hold interLATA assets, FCC 00-221, *In re Application of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, Memorandum Opinion and Order, June 16, 2000. For foreign ownership structure, see FCC 01-142, *VoiceStream Wireless Corporation, Powertel, Inc., Transferors, And Deutsche Telekom AG, Transferee, for Consent to Transfer Control of Licenses and Authorizations Pursuant to Sections 214 and 310(d) of the Communications Act*, Memorandum Opinion and Order, April 24, 2001.

²⁰ See, e.g., *Commercial Realty, St. Pete, Inc.* FCC, 96-400, Memorandum Opinion and Order, October 21, 1996.

²¹ *Contemporary Media, Inc.*, FCC Rcd 14437, 1998.

²² FCC 94-178, *In the Matter of Implementing Section 309(j) of the Communications Act – Competitive Bidding*, Fifth Report and Order, June 29, 1994, paragraphs 201-217.

²³ See, e.g., FCC 14-103, Order, released July 23, 2014, waiving 25% attributable material relationship rule for Grain Management, LLC. In discussing *de facto* control, the Commission (footnote 4) relied on *Intermountain Microwave*. I recognize, and do not disagree with, the dissents of Comm. Pai and Comm. O’Rielly.

Both in its rules related to *de facto* control and in its adjudication of disputes with respect to *de facto* control, the FCC begins its analyses of *de facto* control of licenses by emphasizing that the evaluations are inherently fact-based and will be considered on a case-by-case basis. The FCC also often notes that these evaluations are based on the “totality of the circumstances” with information provided by all sides to a dispute, rather than a simple pigeon-hole exercise based on a few isolated facts culled by one side of a dispute.

Over the years, the FCC has documented several analyses of *de facto* control, and from these one can learn about some of the considerations that the FCC makes. In addition, legal practitioners and others learn informally from current FCC staff about changing and often undocumented interpretations of Commission rules. Based on both the documented and undocumented guidance, legal practitioners and others make reasoned judgments about the application of FCC rules to various corporate structures and *de facto* control. Of course, only the Commission and the courts are the final interpreters of FCC rules.

Many FCC *de facto* control reviews of wireless licenses begin with the six factors from the *Intermountain Microwave (Intermountain)* case in 1963²⁴ to determine if there has been an improper transfer of *de facto* control under Section 310(d). These factors are:

- (1) Who controls daily operations?
- (2) Who is in charge of employment, supervision, and dismissal of personnel?
- (3) Does the licensee have unfettered use of all facilities and equipment?
- (4) Who is in charge of the payment of financing obligations, including expenses arising out of operating?
- (5) Who receives monies and profits from the operation of the facilities? and
- (6) Who determines and carries out the policy decisions, including preparing and filing applications with the Commission?

²⁴ *Intermountain Microwave*, 12 F.C.C.2d. 559 (1963).

The FCC and its bureaus have applied *Intermountain* in many different ways over the past several decades.²⁵ The FCC recognizes that the *Intermountain* factors are only guidelines evaluated on a case-by-case basis and that there is no “exact formula” for determining control issues.²⁶ The FCC, as it noted in *Baker Creek*, is aware that these factors may not be applicable in all circumstances and that each factor should be evaluated on the totality of circumstances.²⁷

The FCC’s interpretation of *de facto* control for purposes of auction licenses is not simply an identical interpretation of *Intermountain* for other wireless licenses. The entire construction of *Intermountain* was to evaluate under Section 310(d) improper transfer of control of an *existing* license; it is an *ex post* evaluation of whether previously legitimate control has been improperly transferred without FCC approval. The auction rules implementing 309(j) require the FCC to evaluate *ex ante* whether an applicant has *de facto* control of licenses in the first instance. The analysis for DEs is even more complicated. As noted above, DEs by statute are “applicants” and thus inherently involve *ex ante* decisions.

²⁵ For just a few of the FCC’s recent reliances on *Intermountain Microwave*, see FCC 14-103, Order, Grain Management Waiver; FCC 13-93, Memorandum Opinion and Order, released July 23, 2014; EchoStar Satellite Operating Company related to moving the EchoStar 6 satellite, released July 9, 2013; FCC 13-50, Second Report and Order, Review of Foreign Ownership Policies, released April 18, 2013.

²⁶ See Grain Management Waiver.

²⁷ *Baker Creek Communications*, Memorandum Opinion and Order, by chief of Public Safety and Wireless Division, 13 FCC Rcd 18709, September 22, 1998, particularly at paragraphs 7-9.

5. *Facilities-based services*

The NPRM raises the prospect of DE rules being “facilities-based.”²⁸ Yet the Communications Act does not refer to any “facilities-based” limitations on licensees or services,²⁹ much less specifically in 309(j) for designated entities. Many FCC licenses are not limited to offering “facilities-based” services. The NPRM discusses limitations on DEs to be “facilities-based” supposedly found in Congressional conference reports.³⁰ These limitations are not in statute and do not likely reflect Congressional intent.³¹ Imposition of a facilities-based standard interferes with the most fundamental aspects of the economic theory of the firm: the economic decision of a firm to perform a service inside the firm or contract for the service outside the firm.³² If a firm were prohibited from

²⁸ NPRM, paragraphs 13-26.

²⁹ The term facilities-based appears but twice in the Communications Act: 47 U.S.C. 271(c)(1)(A) and 47 U.S.C. 1303(b)(3). Neither reference restricts any FCC licensee.

³⁰ NPRM, paragraphs 13-26.

³¹ There are 535 members of Congress who have an opportunity to vote on a bill, and a President who signs the bill. To associate anything outside the law itself as “Congressional intent” is an exercise in divination. Anyone who has worked as a Congressional staff member drafting Conference Reports is well aware of the extraordinary difference between statutory language and a Congressional report. The former is the law; the latter is not. While conference reports provide historical context, they do not substitute, in whole or in part, for statutory language. Where statute is silent, one cannot reasonably selectively search conference reports, speeches, or other Congressional documents to give voice to a law. If Congress had meant a statute to require a certain class of license to be facilities-based, Congress could and certainly would have written that requirement into statute. Where the statute is silent, one must conclude that is exactly what Congress intended as well as it what it wrote. Indeed, conference report language sometimes contains suggestions that were specifically not adopted by the conferees as statutory language. Where conference report language introduces concepts that are not in the statutory language, it is as likely as not the report language does not represent the intent of Congress. Finally, the NPRM language cited (p. 79) is language accompanying a House amendment and was not specifically incorporated in the Conference Report. It is simply not dispositive of facilities-based restrictions. The language is not in the statute; it is not in the Conference Report; even if it were, it does not require facilities-based services.

³² R. Coase, “The Nature of the Firm,” *Economica*, vol. 4, 1937, pp. 386–405.

contracting outside the firm for many types of services, as would be the case with a facilities-based requirement for FCC DE licenses, the firm would lack one of the fundamental choices that characterize firms in Coasian framework. Requiring that firms behave exclusively in a certain manner, such as owning their own facilities, is not a form of economic deregulation; it is a rigid form of economic regulation. It is required neither by statute nor economic rationality.

5. *The FCC supports small businesses outside of 309(j)*

The designated entity program is only one of many efforts by the FCC to enhance opportunities for small businesses and disadvantaged entities. The Commission supports an Office of Communications Business Opportunities (OCBO) which addresses opportunities for small and disadvantaged businesses.³³ The OCBO website has a link to FCC auctions, but auctions are just one of many areas where the FCC actively promotes small businesses. Some of these programs have a statutory basis.³⁴ For others, the FCC initiated the program on its own.³⁵

³³ “Our office, known as OCBO, serves as the principal advisor to the Chairman and the Commissioners on issues, rulemakings, and policies affecting small, women, and minority-owned communications businesses. We also represent the FCC in various matters coordinated with the U.S. Small Business Administration, including those involving the Regulatory Flexibility and Small Business Acts.”

<https://www.fcc.gov/office-communications-business-opportunities>.

³⁴ In addition to the designated entity program under 309(j), other small business programs under the Communications Act include sections 257 and 614.

³⁵ See, e.g., FCC 97-370, In the Matter of Amendment of Part 25 of the Commission's Rules to Establish Rules and Policies Pertaining to the Second Processing Round of the Non-Voice, Non-Geostationary Mobile Satellite Service, adopted October 8, 1997, Appendix D.

IV. DE LICENSES ARE DIFFERENT, AND OF MUCH LESSER VALUE, THAN NON-DE LICENSES

The net result of the Commission rules is that DE licenses are different and less valuable than non-DE licenses particularly for two reasons: the 5-year holding period and the 25% lease limitation. A holder of a non-DE license would not exchange it with a similar DE license without substantial compensation.

At auction, DEs receive a 25% bidding discount. Partly, the discount reflects the DE eligibility. But, partly the 25% discount also reflects the lesser value of the DE license. No rational bidder would pay full price to be encumbered with the DE restrictions.

V. CONTINUING THROUGH TODAY, THE FCC HAS FOR MORE THAN 20 YEARS HAD A CONSCIOUS EFFORT TO ENCOURAGE LARGE COMPANIES TO INVEST IN DEs

Even though DE licenses are less valuable than non-DE licenses, the DE licenses still have value. By itself, with no more than an average of \$40 million in revenue, a DE has limited borrowing capacity. Rational commercial banking lenders simply will not lend large sums to a small company with limited financial resources. Left by themselves, DEs with limited financial resources would be able to compete only for licenses of correspondingly limited value. If even successful at acquiring spectrum at auction, DEs will have limited capital resources to invest in network equipment and other assets and services necessary to provide communications services. To enable DEs to survive and compete, the Commission has long had a policy of permitting large companies to invest in DEs, at least to the extent that control of the DE is not transferred.

Even with impairments, DE licenses and DEs themselves still may have substantial value to larger companies, even within the wireless industry, seeking to diversify their

portfolio of assets. Thus, U.S. Cellular, and quite likely other companies, would like to invest in DEs with DE licenses. In turn, U.S. Cellular and similar companies, in addition to financial resources, offer valuable characteristics to a DE. These characteristics, which could be shared, may include network facilities in place, customers in place, operations in place, and all of the benefits associated with a business in an industry characterized by substantial economies of scale. In economic terms, a combined large-company-DE team can offer services at a lower cost than either operating alone. The challenge has been for the FCC to write rules that would permit such joint cost reductions while retaining the DE's control over licenses.

Over more than 20 years, the FCC has had two diametrically opposite choices: (1) write rules such that DEs may receive no financial support from larger companies; or (2) write rules that encourage larger companies to provide financial support to DEs consistent with the FCC's *de facto* control tests. Over those more than 20 years, the Commission has consistently supported the latter approach—allowing and even encouraging investments in DEs. This approach has allowed companies such as U.S. Cellular to at least contemplate a DE auction strategy, even if such strategies have not always worked at auction.

The FCC's effort to permit businesses of any size, including large businesses, to invest in small businesses was not coincidental. The FCC encouraged large companies to invest in designated entities. Problems associated with an absence of sophisticated financial backers were discovered in Auction 2. The FCC conducted Auction 2 for Interactive Video and Data Services (IVDS) by oral outcry on July 28, and 29, 1994.³⁶ Bidding credits of 25 percent were available to businesses owned by women and

³⁶ See http://wireless.fcc.gov/auctions/default.htm?job=auction_summary&id=2.

minorities, and installment payments were available to small businesses.³⁷ The auction primarily attracted small businesses without substantial passive financial investment. Within months of the auction, it became clear that installment payment deadlines would broadly be missed.³⁸ Many years later, the FCC was still attempting to resolve the resulting chaos for the small business Auction 2 “winners.”³⁹

The Commission has made its preference clear for much of the past 20 years. Since 1994, the FCC has consistently structured its rules, particularly its affiliate rules, to enable large companies to make substantial investments in DEs. The affiliate rules, peculiar to DEs, are constructed to enable large investments in DEs not to affect the control status of licenses.

The word “affiliate” appears many times in at least 30 different sections of the Communications Act and not with the same meaning in each instance.⁴⁰ In Section 3 on Definitions, “affiliate” is the first defined term and means:

The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For purposes of this paragraph, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent.⁴¹

³⁷ Ibid.

³⁸ The FCC issued a public notice regarding grace periods for installment payments for the IVDS auction. See FCC, “Grace Period for IVDS Auction Licensees,” DA 95-1617, June 26, 1995.

³⁹ As recently as 2010, 16 years after the IVDS auction, the FCC was still handling claims from disappointed bidders. See, e.g., FCC 10-149, IVDS On-Line Partnership, Memorandum Opinion and Order, released August 11, 2010.

⁴⁰ Specifically, it appears in 47 U.S.C., Sections 153, 222, 223, 224, 228, 251, 260, 271, 272, 273, 274, 275, 325, 522, 532, 533, 534, 535, 536, 541, 543, 544(a), 548, 549, 572, 573, 1103, 1104, 1108,

⁴¹ 47 U.S.C. 153 (1).

Yet, just a few paragraphs later, “affiliate” appears to have a different meaning for purposes of Bell Operating Companies.⁴² In some sections of the Act, “affiliate” has a specific definition,⁴³ in others it is undefined. The term “affiliate” does not appear in Section 309(j). An “affiliate” is sometimes used by itself and sometimes in conjunction with undefined terms under the Act such as “subsidiary” and “associate company.”⁴⁴

The Securities and Exchange Commission, for purposes of securities laws, has its own set of definitions of “affiliate” and other terms.⁴⁵ “Affiliate” appears in many different rules in the CFR promulgated by the FCC. In some instances the term is defined; in others it is not.

Some of the FCC definitions of “affiliate” include concepts of either ownership or control⁴⁶ while others include just control,⁴⁷ and other definitions may have other variations.

For purposes of designated entities in auctions, the FCC uses only the concept of “control,” not “ownership,” as part of the definition of “affiliate.”⁴⁸ The Section 1.2110 interpretation of “affiliate” is an extraordinarily complicated definition that has evolved over time. This definition enables fewer entities to be considered as affiliates of a license applicant than would be the case if the FCC simply used the Section 3 definition of “affiliate” under the Act.

⁴² 47 U.S.C. 153 (4)(C).

⁴³ See, e.g., 47 U.S.C. 274.

⁴⁴ See 47 U.S.C. 224 (g).

⁴⁵ See 17 CFR 240.12b-2, October, 2004.

⁴⁶ 47 U.S.C. 153 (1).

⁴⁷ See definitions of affiliate in various versions of 47 CFR 1.2110.

⁴⁸ 47 CFR 1.2110.

The FCC appears to have defined affiliate of designated entity for the specific purpose of permitting expansive investments:

In adopting these affiliation rules, we emphasize that these rules will not be applied in a manner that defeats the objectives of our attribution rules. Our attribution rules expressly permit applicants to disregard the gross revenues, total assets and net worth of passive investors, provided that an eligible control group has *de facto* and *de jure* control of the applicant. Our attribution rules are designed to preserve control of the applicant by eligible entities, yet allow investment in the applicant by entities that do not meet the size restrictions in our rules. Therefore, so long as the requirements of our attribution rules are met, the affiliation rules will not be used to defeat the underlying policy objectives of allowing such passive investors. More specifically, if a control group has *de facto* and *de jure* control of the applicant, we shall not construe the affiliation rules in a manner that causes the interests of passive investors to be attributed to the applicant.⁴⁹

The FCC drafted these relaxed ownership and attribution rules specifically to *encourage* large businesses to facilitate small businesses in obtaining FCC licenses through auctions.⁵⁰ As a result of the designated entity program, more licenses were assigned to small businesses than would likely have been the case otherwise.⁵¹

⁴⁹ FCC, In the Matter of Implementing Section 309(j) of the Communications Act – Competitive Bidding, Fifth Report and Order, June 29, 1994, paragraphs 205. Much of the discussion of control presented in FCC memoranda and orders is not directly reflected in FCC rules.

⁵⁰ “Because this step gives large companies, who are otherwise ineligible to bid in the entrepreneurs' blocks, a significant incentive to "partner" with minority and women-owned firms, it will enhance the likelihood that these designated entities will be both successful in the auctions and become viable, long-term competitors in the PCS industry.” FCC, In the Matter of Implementing Section 309(j) of the Communications Act – Competitive Bidding, Fifth Report and Order, June 29, 1994, at paragraph 161.

⁵¹ The FCC provided for a natural experiment demonstrating this result. For example, Auction 4, the A and B Block licenses, had no bidding preferences or other advantages for small businesses. The 18 winning bidders were primarily if not exclusively large businesses. In contrast, the FCC reserved several auctions (Auctions 5, 10, 11, and 22) for small businesses. Other auctions, such as LMDS, had small business advantages which resulted in substantial small business participation.

VI. EFFICIENT ALLOCATION OF SPECTRUM IS IMPORTANT TO THE AMERICAN ECONOMY

Spectrum is important to the large and rapidly growing wireless industry, and thus important to the American economy.⁵² Without spectrum, no wireless services would be available.

For the American economy or any economy to succeed, it is not sufficient that spectrum is merely available. Spectrum must also be efficiently allocated. Like other resources in an economy, spectrum can be allocated efficiently or inefficiently. The development and growth of wireless services will likely be more costly and less economically successful in countries with inefficient allocation of spectrum than in countries with efficient allocations of spectrum.

Efficient allocation means that market forces, rather than non-market forces, shape the allocation of spectrum. Spectrum should be put to its best and highest use. If spectrum could be put to better uses, market forces would allow spectrum to migrate to those better uses.

Economists often view property and associated contract rights in spectrum as facilitating its efficient allocation. Five characteristics help define the extent of property rights in any assets: (1) excludability; (2) ability to determine use of the asset; (3) ability to benefit from the use of the asset; (4) ability to transfer and exchange the asset; and (5) absence of large administrative and transaction costs associated with holding and selling an asset.

⁵² For a review of the contribution of the wireless industry to the American economy, see H. Furchtgott-Roth, "The Wireless Sector: A Key to Economic Growth in America," report prepared for CTIA, 2009.

The United States generally has an efficient allocation of spectrum. Most commercial assets including licensed spectrum have (1) rights to exclude other users and limitations on interference; (2) flexibility of use of the license in the short-term and substantial reallocation of spectrum in the long-run such as the restructuring of the broadcast band; (3) few limitations on profiting from the commercial use of spectrum; (4) processes to buy and sell licensed spectrum; and (5) with some exceptions, an absence of extraordinary costs associated with holding and transferring spectrum licenses. Each of these characteristics is vital to the efficient allocation of spectrum.

A. *Low transactions costs are important to an efficient allocation of spectrum*

These characteristics for an efficient allocation of spectrum are also consistent with a competitive market even in the presence of some externalities. An entity with a new technological use for spectrum, more valuable than current technological uses, can with sufficient financial resources reasonably expect to be able to obtain spectrum for the new use. In such a market, the Commission need not worry that specific initial allocations will be good or bad for economic activity; as long as the efficiency conditions are met, and as long as transactions costs do not interfere with efficient transaction, the same result should obtain.⁵³

The example that Ronald Coase examined of competing FCC broadcast licenses is as insightful today as it was more than 50 years ago. Although wealth distribution will depend on initial allocation, the use of the broadcast license in the most valuable market does not depend on the initial allocation as long as property rights are well defined and as

⁵³ This efficiency outcome invariant to initial allocations is usually attributed to R. Coase. "The Federal Communications Commission," *Journal of Law and Economics*, Vol. 2, pp. 1-40. "The Problem of Social Cost". *Journal of Law and Economics* Vol. 3, pp. 1-44.

long as transaction costs are not overwhelming. The same is true for any type of FCC license.

Currently, FCC license structure departs from the efficient outcome in a Coasian market in at least two fundamental ways, both controlled by the FCC: (1) different bundles of property rights; and (2) different transactions costs.

Not all spectrum licenses in the United States have the same bundle of property rights. Each band of spectrum has different sets of licenses, each with peculiar characteristics defined by the band. In addition, the FCC assigns different and lesser property rights to licenses assigned to designated entities through spectrum auctions.⁵⁴ For a period of usually five years, the license assigned to a designated has limitations on (1) commercial leasing arrangements and the identities of parties to whom spectrum may be leased, and (2) transfer of the license and the profits from the transfer of the license. Of the five spectrum property rights described above, at least four—determination of use, ability to profit from the license, ability to transact the license, and low administrative and transactions costs—are limited for DE licenses.⁵⁵

An entity seeking to lease or to purchase the rights to a license can usually do so at lower transactions costs when the counterparty is not a designated entity holding a license

⁵⁴ 47 U.S.C. 1. This is not to say that initial allocations do not affect wealth transfers; they do. But if governmental concerns are primarily with ensuring that the most efficient technological applications are reached, initial allocations matter little in an economy with no or low transactions costs.

⁵⁵ Licenses assigned to designated entities have much higher administrative costs and transactions costs. These different and lesser license assignments require regulatory management not associated with other licenses. Efforts to either buy or sell such licenses are subject to higher transaction costs and potentially substantial penalties. The higher transactions costs are entirely the construction of FCC regulations.

subject to the post-auction restrictions. The net result invariably is that licenses assigned by auction to designated entities are, as a result of special restrictions attached to them, less sensitive to market forces and less efficiently allocated than comparable licenses not assigned to designated entities. All other factors being equal, a license assigned to a DE will be less intensively and less efficiently used than a similar license assigned to a non-DE.

Rather than a single-tier of licenses, is there any economic value in having a two-tiered system of licenses: one with post-auction restrictions and one without? The primary explanation offered is that the restrictions on licenses assigned to designated entities are necessary to limit “unjust enrichment.”

B. Our federal government has many programs for small businesses

Our federal government has many programs to assist small businesses. The programs are so many and so varied that the Small Business Administration provides an online tool to assist small businesses find information on available loans and grants.⁵⁶ Although it is impossible to generalize about all federal programs for small businesses, it does seem that the conditions of DE programs in FCC auctions are more restrictive than most. Although once their eligibility ends businesses can no longer avail themselves of the benefits of federal programs, businesses do not necessarily have to reimburse the federal government for some or all of the federal benefits if the company is sold.⁵⁷ For example, if a business that has received universal service fund benefits in the past were to be acquired by a company that is ineligible for those benefits, the newly merged company does not

⁵⁶ <http://business.usa.gov/access-financing>.

⁵⁷ Contrast unjust enrichment provisions in 47 CFR 1.2111.

reimburse the federal government for past USF benefits. Actual requirements vary by program. Similarly, it is not the case that all federal small business programs require small businesses to limit transactions with larger companies in the manner that the FCC does.⁵⁸ Nor do all federal small business programs have the detailed reporting requirements of the FCC for DEs.⁵⁹

C. Our federal government has many programs for social purposes without inferior qualities or higher transactions costs

Our federal government has many programs for public policy purposes without redefining property rights or increasing transactions costs.⁶⁰ The federal government offers Pell Grants and other forms of financial assistance to college students. Indeed, students with access to federal financial aid may displace some students not requiring financial aid in admission to a college. College students who rely on federal support are not granted encumbered degrees. Relative to other college graduates, those who received federal aid are not limited in the types of jobs they may seek. Low-income individuals who receive Medicaid medical services are not encumbered in how they live their lives after receiving medical care. Typically, individuals who receive federal benefits do not have to reimburse the federal government for those benefits when their circumstances change.⁶¹ The federal government provides a wide range of tax incentives including tax credits for individuals

⁵⁸ 47 CFR 1.2110.

⁵⁹ 47 CFR 1.2112.

⁶⁰ Here I am not addressing whether these or any federal social programs are necessary or a good policy. Rather, I examine whether, conditional on the existence of a social program, it is good policy for the federal program to lessen the quality of the benefit or encumber the subsequent activities of the recipient.

⁶¹ Of course, there are some exceptions, such as military academy or ROTC students who, in exchange for college tuition and expenses, commit to serve in the military but then choose not to do so.

and businesses to engage in specific economic activities. Rarely do these programs require a reimbursement of benefits when an asset is sold or when the individual or entity is no longer eligible for the tax benefit. Nor do these tax benefits limit economic activities.

For these and other federal social programs, *eligibility to receive* a federal benefit is entirely separate from *activities or behavior* the individual may engage in subsequent to receiving the federal benefit. This separation is both socially beneficial and economically efficient. For most federal social programs, the statutory requirement is that the federal benefit is worthwhile even when the recipient cannot afford to pay for it. Except as specifically required by statute, the recipient is not required to reimburse the federal government as part of a loan. College graduates who received federally-subsidized loans and grants are not required to repay the federal government for the cost of the program, even for individuals who one day become high-income earners. So too with practically every form of social program. Once the benefit is received, the recipient is not encumbered in future activities.

This separation between receipt of a federal benefit and the subsequent behavior of the individual is economically efficient. Most federal programs, including DE programs, do not create a liability on the balance sheet of an individual or other entity to the federal government.⁶² For these programs, the federal government is not a creditor. As the federal government does not seek to be repaid, it has no strict interest in placing conditions on the behavior of the beneficiary. Consequently, the federal government does not encumber the behavior of most beneficiaries, and the federal government does not

⁶² Obviously, some federal loan programs do create a liability. The designated entity programs at the FCC do not create liabilities to individuals or companies.

increase the costs for such individuals to engage in practically any form of transaction.

The FCC's DE program is different. The federal government encumbers the DEs with costly reporting requirements and restrictions on economic behavior that both distort and limit behavior. These distortions and limitations ultimately make the allocation and the use of spectrum less efficient. The FCC should strive to correct these downfalls.

D. Attribution Rules and Small Business Policies Should be Simple and Should not be changed Substantially

The Public Notice seeks comments on several issues related to attribution rules.⁶³ I will not address each of these issues in detail, but I offer a few overarching concepts the Commission should consider.

1. Keep it simple

Over the course of 9 paragraphs, the Public Notice weaves through many concepts of designated entity eligibility and the attributable material relationship (AMR) rule that likely confuse the uninitiated reader.⁶⁴ Only those of us who have experienced many different auctions appreciate both the subtlety and complexity of Commission rules and practice. Although the statutory guidance on designated entities is just a few sentences in 309(j), and although the generic rules governing designated entities are contained in just a few, but lengthy sections of the CFR,⁶⁵ each wireless service has its own set of rules, and each auction has its own auction-specific rules and informal rules and guidance. Combine these with bureau opinion letters peculiar to a specific wireless service and a specific auction, and participants in each auction face unique written and informal rules and unique interpretations for how designated entities may participate in the auction. Complex and ever-changing rules increase the cost of participating in FCC proceedings, including FCC auctions. Surely making complex rules even more complex, the inadvertent outcome of many of the suggestions discussed in the Public Notice, would likely discourage participation in FCC auctions by both designated and other entities. Not only would they

⁶³ Public Notice, paragraphs 4- 12.

⁶⁴ Ibid.

⁶⁵ 47 CFR 1.2110 – 1.2113.

see this particular set of proposed rules as overly complex, potential participants may also be discouraged that a future Commission may make rules even more complex in the future. As a result, the FCC should strive for simplicity and reject many of the proposed changes.

2. *Avoid accounting and service metrics*

The Public Notice discusses various proposed modifications to the AMR and the DE eligibility rules. Some of the proposed modifications are based on shares of spectrum leases, shares of revenues, measures of equity, measures of revenue, and other accounting concepts. Few if any the proposals have any statutory foundation. Some of the tests proposed for DE eligibility might make some sense if the Commission were lender or otherwise sought a security interest in the DE. But the FCC is not a lender. It has, or at least should have, no interest in the behavior of the DE outside of the context of the auction. At best, some of the proposed DE rules would encourage companies to hire corporate attorneys to construct corporate entities that could conform to the artificial Commission rules. At worst, small businesses will be discouraged from participating in the auctions altogether. That outcome would be at odds with the specific policy guidance in the Communications Act.

3. *Avoid segregating two types of licenses*

Many of the proposals in the NPRM and the Public Notice would further segregate licenses into two categories: those subject to special DE rules and those that are not. Longer holding periods for DE licenses, continuation of the attributable material relationship rules, and restrictions on the property rights and economic choices for DE

licenses will limit the usefulness and value of DE licenses relative to non-DE licenses. As noted above, the two separate categories of licenses limit the likelihood of reaching efficient allocations.

4. *Avoid imposing conditions on DEs that do not apply to other licensees*

It is not just the Public Notice contemplates two types of license, it contemplates more difficult conditions on the DE licenses. Many of the suggestions in the Public Notice would impose conditions on DE licenses that do not apply to other licenses. For example, some proposals would require different facilities-based services from DE licenses than from non-DE-based licenses.⁶⁶ I assume that everyone prefers facilities-based providers, but neither the statute nor Commission rules outside the context of DEs require facilities-based services for licenses generally.

VII. COMMENTS ON ATTRIBUTION RULES AND SMALL BUSINESS POLICIES

Below, I present comments on specific questions raised in the Public Notice.

A. *Paragraph 4*

In paragraph 4 of the Public Notice, the Commission reviews various proposed changes from the NPRM to attribution rules and small business eligibility. I believe the Commission has proposed the correct two-pronged approach of “(1) meets the applicable small business size standard, and (2) retains control over the spectrum associated with the licenses for which it seeks small business benefits.”⁶⁷ The control standard has primarily animated evaluations of license transfers at the FCC since *Intermountain Microwave* in

⁶⁶ Public Notice, paragraph 9.

⁶⁷ Public Notice, paragraph 4.

1963.⁶⁸ Only since 2006 has the Commission, erroneously, partially abandoned the control standard. Outside of the context of DEs, the FCC still relies on the concept of control. Of course, it is helpful to have bright-line tests, but those tests must make economic and common sense. The current bright-line test under the attributable material relationship makes no economic sense; it prohibits DEs, unlike all non-DE entities, from entering into commercial wholesale and leasing beyond a 25% threshold. The test may have bright line, but it illuminates economic illogic and a costly form of regulation that serves no purpose but to impeded efficient transactions in wireless markets. Similarly, the Commission correctly proposes to modify the secondary markets rules to conform to a *de facto* control standard.⁶⁹

The Commission states that “parties supporting the elimination of the AMR rule should explain how eliminating or loosening the restriction will promote competition and ensure small business participation in spectrum-based services, while guarding against ineligible entities’ acquiring small business benefits.”⁷⁰ As explained earlier in these comments, the AMR rule creates a second-class form of spectrum license, one that is less sensitive to market forces and likely less efficiently allocated. Eliminating the AMR rule will likely lead to greater participation by small businesses in spectrum auctions than otherwise. It impossible to “ensure small business participation” because that participation depends on many factors outside the AMR rules. Thus, if hypothetically, auction participants must post a \$10 billion bond, few if any small businesses would participate, regardless of the AMR rules. The 5-year holding under 1.2111 would continue to “guard[

⁶⁸ Intermountain Microwave.

⁶⁹ Public Notice, paragraph 4.

⁷⁰ Public Notice, paragraph 4.

] against ineligible entities' acquiring small business benefits.”

B. Paragraphs 5 and 6

In paragraph 5, the Public Notice asks: “In light of these and similar comments, we seek further comment on how much of a DE’s spectrum it should be able to lease or resell without having to attribute the revenues of its lessees or resellers.” As discussed above, just as the FCC generally has no limitations on transactions by non-DE parties, the FCC should have no limitations on the amount of spectrum that a DE “should be able to lease or resell without having to attribute the revenues of its lessees or resellers.”⁷¹ While possibly well-intended, the proposals to limit the use of DE spectrum would harm the economic efficiency of spectrum markets.

The Commission asks questions that reveal an inclination to regulate spectrum further: “Is there a different percentage threshold, either higher or lower, that would better serve the Commission’s statutory goals? Should the Commission instead reinstate an absolute limit on the percentage of a DE’s spectrum that it may lease or resell?”⁷² Any limitation, higher or lower, on economic activity would not serve the Commission’s statutory goals. The Commission’s search for a specific threshold should not be confused with the hypothetical existence of a correct, non-zero threshold. No beneficial threshold exists. Any regulatory threshold would be both arbitrary and economically harmful.

C. Paragraphs 7 through 9

The Commission asks: “some parties suggest that the Commission should consider whether to distinguish between pure spectrum leasing arrangements and network

⁷¹ Public Notice, paragraph 6.

⁷² Ibid.

facilities-based wholesale arrangements when evaluating whether to retain the AMR rule.”⁷³ Similar suggestions are made in paragraph 8 but with preferences to leasing arrangements to some but not all DEs. Paragraph 9 raises the suggestion of requiring DEs to offer facilities-based services.

There is no statutory or economic foundation to make any of these distinctions. As discussed above, the purported foundation for requiring facilities-based services simply cannot be found in the statute. The economic foundation is even weaker. Such distinctions would only serve to undermine the fundamental decisions of a firm to provide a service internally in a firm or to contract it out.⁷⁴ Firms of all sizes, including major communications companies, have many choices with respect to equipment and services including: (1) to invest in their own equipment; (2) to lease equipment from others; (3) to purchase services from others; (4) to lease their own equipment to others; and (5) to offer services to others. A facilities-based requirement would limit the economic choices available to a firm and compel it to invest in equipment that an unregulated firm might rationally choose not to invest in. A facilities-based service requirement would support neither the statutory objectives with respect to warehousing or unjust enrichment. Warehousing is addressed directly by build-out requirements, which are not identical to facilities-based service requirements. Unjust enrichment is addressed by holding periods. A facilities-based requirement would address neither.

D. Paragraphs 10 and 11

I have reviewed the many proposals in paragraphs 10 and 11 of the Public Notice.

⁷³ Public Notice, paragraph 7.

⁷⁴ See R. Coase, “The Nature of the Firm.”

Most of the proposals would violate the various principles that I articulated above, such as simplicity and avoiding different classes of license rights based solely on the identity of the licensee.⁷⁵ Most of the proposals appear to be awkward tests for control. They beg the question of why not use a control analysis similar to *Intermountain Microwave*, which the Commission appears to rely on as the ultimate test in any event.

E. Paragraph 16

The Commission seeks comments on altering the length and conditions on the holding period for DE licenses. Missing from the record in my view is any convincing evidence that the current 5-year period is deficient and has led to unambiguous and predictable instances of “unjust enrichment.” Longer holding periods would increase both the cost and the risk of participating in the DE program consequently reducing participation in the DE program. The statutory requirements for the Commission to address “unjust enrichment” are not tied DE licenses. To the extent there are problems with the 5-year period, any evidence of those problems remains at best anecdotal and at worst speculative. Other proposals that include forfeitures and additional economic limitations on license serve no useful economic purpose.

VIII. CONCLUSION

As it considers revising its DE rules, I urge the Commission to consider the four broad conclusions of this report:

- FCC DE rules should be consistent with statute;
- DE licenses are different, and of much lesser value, than non-DE licenses;

⁷⁵ It appears that proposals 10(f) and 10(g) might actually simplify rules.

- Continuing through today, the FCC has for more than 20 years had a conscious effort to encourage large companies to invest in DEs; and
- Efficient allocation of spectrum is important to the American economy.