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July 16, 1999

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EX PARTE OR LATE FILED

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W., TW-A325
Washington, D.C. 20554

RECEIVED
JUL 16 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: **EX PARTE**
ET Docket No. 95-18

Dear Ms. Salas:

On Thursday, July 15, 1999, Francis Coleman and the undersigned, representing ICO Global Communications; Peter Hadinger of TRW and Norman Leventhal, both representing the ICO U.S. Service Group and Stanley Besen and Jan Acton of Charles River Associates, Inc. met in three separate meetings with (1) Dale Hatfield, Julius Knapp, Geraldine Matise, and Sean White, of the Office of Engineering and Technology, and Jonathan Levy and John Williams of the Office of Plans and Policy; (2) Linda Haller, Doug Webbink, Karl Kensinger, Chris Murphy, Howard Griboff, and Alex Roytblat of the International Bureau; and (3) Tom Sugrue, Diane Cornell, Tom Wasilewski, David Judelsohn, and Steve Markendorff of the Wireless Bureau to discuss the paper, "An Economic Analysis of Regulatory Takings and Just Compensation with an Application to Mobile Satellite Services," ("Just Compensation Paper") prepared by Messrs. Besen and Acton.

We explained that the compensation formula recommended in the Just Compensation Paper would ensure that incumbent licensees that must be relocated to other radio spectrum would receive compensation that leaves them neither better nor worse off as a result of relocation. We otherwise restricted our comments to the attached discussion outlines.

No. of Copies rec'd 0+1
List A B C D E

An original and one copy of this letter have been submitted to the Secretary of the Commission for inclusion in the public record, as required by Section 1.1206(b)(2) of the Commission's rules.

Sincerely,

Cheryl A. Tritt
Counsel to ICO Global Communications

Attachments

cc: Dale Hatfield (without attachments)
Julius Knapp (without attachments)
Geraldine Matise (without attachments)
Sean White (without attachments)
Jonathan Levy (without attachments)
John Williams (without attachments)
Linda Haller (without attachments)
Doug Webbink (without attachments)
Karl Kensinger (without attachments)
Chris Murphy (without attachments)
Howard Griboff (without attachments)
Alex Roytblat (without attachments)
Tom Sugrue (without attachments)
Diane Cornell (without attachments)
Tom Wasilewski (without attachments)
David Judelsohn (without attachments)
Steve Markendorff (without attachments)

July 15, 1999

# ECONOMICS, LEGAL PRECEDENT AND RELOCATION

- **Historical Perspective**

  - Why now? In discussions with incumbents over the last several months, we now realize that the existing "replacement" cost policy can not work for 2 GHz MSS.

  - In a single decision — PCS — the FCC, without meaningful discussion or analysis, decided that emerging technologies providing "comparable" facilities meant the replacement of existing equipment with entirely new facilities.

  - In ET Dkt 95-18, the FCC asks whether this same policy is appropriate for 2 GHz MSS.

- **Changed Circumstances Require Changed Policies**

  - Whereas PCS was a local service, MSS is national — indeed, global.

  - Whereas PCS was rolled out on a market-by-market basis as economic considerations justified the cost of relocation, this option is not available to MSS.

  - Whereas the earlier "replacement" cost policy allowed viable PCS entry (given that anticipated call volume could assimilate such expenses), a nationwide relocation on this basis would simply preclude MSS entry as its rate structure will not permit such assimilation.

  - "Comparable" facilities for incumbents will be provided by MSS, but without reliance on replacement costs as a means of doing so.

- **Economic Theory and FCC & Judicial Precedent Support the FCC's Stated Objective of "No better off, no worse off."**

  - Economic theory holds that the proper value for "comparability" is the economic value of the equipment — i.e., its *remaining useful life*. (See Charles River Associates Inc., June 18, 1999, "An Economic Analysis of Regulatory Takings and Just Compensation With an Application to Mobile Satellite Services.")

    — Whereas such theory takes account of what already has been used up, changes in prices, and changes in technology and productivity, full "replacement" costs do not.

  - FCC's OVS ruling (based on law of "partial taking," not tort law) makes clear that it is the "market" value both before and after the "taking" that sets the standard for just compensation.

  - Long-standing judicial precedent interpreting the law of eminent domain, likewise makes clear that "just compensation" for incumbents' facilities is the *fair market value* of such facilities (generally based on the equipments' remaining useful life). (See IUSG Ex Parte, ET Docket No. 95-18, June 21, 1999.)

- **<u>Implementation of the Remaining Useful Life Standard</u>**

  - The Charles River Associates formula (see CRA Analysis at 15) provides the proper economic valuation, but may require broad estimates of equipment life.

  - On the other hand, book depreciation — more readily ascertainable — may provide a useful surrogate.

  - In either case, MSS would pay incumbents the cash equivalent of the value derived by these principles.

    — Significantly, this allows incumbents to modernize at their own pace and with equipment suitable to their particular needs (e.g., digital or fiber optic replacement).

TALKING POINTS FOR

# AN ECONOMIC ANALYSIS OF REGULATORY TAKINGS AND JUST COMPENSATION WITH AN APPLICATION TO MOBILE SATELLITE SERVICES

Jan Paul Acton
Stanley M. Besen

Charles River Associates Incorporated

July 15. 1999

The FCC's goals for compensating incumbents were based in its own precedents as well as sound legal and economic principals. The proposed implementation for MSS does not achieve these goals. The General Compensation Formula developed in our study remedies this

The FCC's goal in the Emerging Technologies Docket was to make incumbents no better and no worse off.

> "In sum, our goal is to ensure that incumbents are no worse off than they would be if relocation were not required, not to guarantee incumbents superior systems at the expense of the PCS licensees." Cost Sharing First R&O/Further NOPR. Para. 32.

The implementation proposed for MSS goes beyond making incumbents whole and instead makes them better off.

- It gives them brand new systems in place of partly used up systems; this is too generous.

This matters because if entrants are required to pay too much, it will retard or eliminate the development of MSS. This is contrary to what the FCC intended.

A more faithful implementation of the FCC's goals has two elements:

1. It allows entrants to pay cash compensation, rather than building a system for incumbents.

- Providing cash compensation is always better for incumbents than providing equipment of equal value. The recipient can select the speed and form of system implementation that best suits his needs.

2. It bases the cash payment on the lower of

   (a) the cost of modifying the incumbent's current equipment or

   (b) the (correctly calculated) market value of any equipment that must be replaced plus the cost, if any, of additional equipment required to operate at the new frequency.

FCC and legal precedent support this approach.

Sound economic theory supports this.

- The theory of just compensation (developed for regulatory takings and other applications of eminent domain) looks to the market value of the equipment that is taken or lost in such circumstances.

The approach can be implemented in a fair and feasible manner.

- We make conservative assumptions that favor incumbents.

- The approach is administratively tractable.

Key Elements of the Proposed GENERAL COMPENSATION FORMULA

- Compensate incumbents for remaining service life of the equipment.
  - Incumbents share in the costs to the extent that the existing equipment has been used.

- Adjust for price changes and productivity changes since original equipment was purchased.

- Adjust for benefit or penalty in moving to new spectrum band.
  - Incumbents share in the costs if new equipment has improved functionality.
  - Entrants pay for added costs of operating in new band.

- Entrants pay for additional equipment if needed in new spectrum band.

The GENERAL COMPENSATION FORMULA

Compensation = C ((n-m)/n) $(1+ p-r)^m$ $(1+\lambda)$, where

C is the original cost of equipment;

n is the original useful life of equipment;

m is the number of years equipment has been in service;

p is the annual rate of increase in equipment prices;

r is the annual rate of equipment productivity improvement; and

$\lambda$ is the cost penalty $(1+\lambda>1)$ or benefit $(1+\lambda<1)$ of moving to the new band.

A further simplification may be possible.

- We understand that prices for BAS equipment have generally stayed the same or fallen in inflation-adjusted terms for a given level of functionality and that functionality generally has stayed the same or has improved with more recent equipment.

- Under these circumstances, and assuming that new equipment is no more expensive than the old equipment and that it lasts at least as long as old equipment, then

  - Just compensation requires paying incumbents no more than the value of the remaining useful life of their existing equipment.

  - Incumbents are guaranteed to be made no worse off under this level of compensation.