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July 17, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: WT Docket No. 97-82: Ex Parte Presentation

Dear Ms. Salas:

In recent reply comments and *ex parte* filings, several parties claiming to be designated entities have asserted that the Commission is compelled to continue the DE set aside program, in which some PCS spectrum will be reserved only for certain bidders and others will be excluded from seeking additional spectrum. Verizon Wireless believes that, to the contrary, continuing DE set asides (1) is not compelled by law, (2) would be arbitrary and unlawful in light of recent Commission decisions on auction policy, and (3) would trigger the same legal concerns that led the D.C. Circuit Court of Appeals to vacate a licensing regime in the *Bechtel* case.¹

Accordingly, Verizon Wireless urges the Commission to discard the set-aside program and make all C and F block licenses available in open bidding. It should use the standard auction rules for PCS, including, as in every other auction, bidding credits to promote entry by small businesses. As the Commission has repeatedly recognized, such action will provide ample opportunity for DEs to participate in upcoming PCS auctions and will fully comply with relevant statutes and policies. The alternative course – preclusive bidding rules that prevent interested bidders from bidding for some licenses altogether – would, we believe, be contrary to law.

Section 309(j) Does Not Require a Set-Aside

The C and F block set-asides are not required to fulfill a “Congressional mandate,” as some DEs have argued in this proceeding.² The goal of auctions in

¹ Bechtel v. FCC, 10 F.3d 875 (D.C. Cir. 1993).

² See Reply Comments of OPM Auction Co., at 3 (June 30, 2000).

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Section 309(j)(3)(C) is for the Commission to promote economic opportunity and competition and to ensure that new technologies are available to the public. The methods identified in this section are to avoid excessive concentration and to disseminate licenses among a “wide variety of applicants.” Small businesses are only *one* of the groups included. In other words, the statute does not have a *goal* of distributing licenses to small businesses.³ The focus is on competition and service to the public. Use of a set-aside to guarantee delivery of certain licenses to small businesses elevates the *means* to promote competition above the *goal* of competition itself.

Similarly, Section 309(j)(4)(D) requires the Commission to “ensure that small businesses . . . are given the opportunity to participate in the provision of spectrum-based services.” Some DEs have stated, incorrectly, that the opportunity required by this statute is “to win spectrum at the auction.”⁴ But, the plain language of Section 309(j)(4)(D) requires neither the use of set-asides nor victories at auctions, rather, it requires providing an opportunity for DEs to participate.

No one here is arguing that DEs should not be entitled to participate, and they clearly should be. The issue is, rather, whether they should be entitled to participate *to the exclusion of others*. Some DEs assert that this step is necessary if they are to win. Putting aside that this is not what the law says, one of the major legal problems the Commission would face were it to accept this argument is that it has rejected the same argument many times before.

The FCC Has Held That Bidding Credits Provide Adequate Opportunities for DEs

In deciding how to provide these opportunities for small businesses, the Commission has repeatedly rejected the use of set-asides, finding that bidding credits fully meet the statute’s goals and are sufficient to advance DE entry.

- The Commission stated this principle in the order adopting rules for the Wireless Communications Service: “[W]e do not believe . . . set-asides to be necessary to ensure opportunities for participation by

³ See Reply Comments of BellSouth Corp., at 3 (June 30, 2000); Reply Comments of SBC Communications, at 2-3 (June 30, 2000).

⁴ Reply Comments of OPM Auction Co., at 3 (June 30, 2000).

designated entities in light of the substantial bidding credits as well as the partitioning and disaggregation rules we are adopting.”⁵

- Similarly, for the 800 MHz SMR auction, the Commission was presented with exactly the same argument as here from DEs, but *refused* to adopt an entrepreneurs’ block. “[C]ontrary to the contention of some commenters that an entrepreneurs’ block is required to ensure small businesses will be able to obtain licenses, we believe that small businesses will have significant opportunity to compete for licenses given the bidding credits we adopt herein.”⁶
- The Commission has also determined that use of bidding credits fulfills the statutory mandate of Section 309(j). When the Commission adopted generic auction rules for Part 1, it agreed that “increased bidding credits will allow responsible small bidders with appropriately tailored business plans to secure adequate private financing to be successful in future auctions. . . . We believe that the rules we adopt below . . . regarding the use of bidding credits for small business applicants in future auctions will both fulfill the mandate of Section 309(j) to provide small businesses with the opportunity to participate in auctions and ensure that new services are offered to the public without delay.”⁷
- The same policy was used earlier this year to establish bidding credits, *but not set asides*, for the 700 MHz band auction, because “[a]s noted in the Part I proceeding, we believe that this approach will provide adequate opportunity for small businesses of varying sizes to participate in spectrum auctions.”⁸

For the past four years, the use of bidding credits has been the practice for all auctions. That practice was based on express findings that set asides should *not* be

⁵ Amendment of the Commission’s Rules to Establish Part 27, the Wireless Communications Service (“WCS”), 12 FCC Rcd 10785, 10882 (1997).

⁶ Amendment of Part 90 of the Commission’s Rules to Facilitate Future Development of SMR Systems in the 800 MHz Frequency Band, 12 FCC Rcd 19079, 19171-72 (1997) (footnote omitted).

⁷ Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, 13 FCC Rcd 374, 400 (1997) (footnote omitted).

⁸ Service Rules for the 746-764 MHz and 776-794 MHz Bands, and Revisions to Part 27 of the Commission’s Rules, 15 FCC Rcd 476, 530 (2000).

adopted. Nothing in the record here provides a factual or legal basis for why the C and F block PCS licenses should be treated differently. Doing so would thus be arbitrary on its face. Such a reversal for this auction would appear to constitute inconsistent and arbitrary agency action.

Some DEs have argued for retention of the set-aside noting that, six years ago, the Commission decided that a set-aside for DEs was appropriate for PCS.⁹ But, based on its experience with multiple auctions over the course of the last five years, the Commission has explicitly abandoned that policy, recognizing that “bidding credits without a set-aside enable small businesses to compete effectively in open auctions, even auctions of broadband PCS licenses.” FNPRM, ¶ 40.

Even if a set-aside were once appropriate, caselaw makes abundantly clear the Commission cannot adhere to rules when the original assumptions for those rules are no longer valid or have been overtaken by new facts.¹⁰ Although several DEs refer to a “covenant” with them, that concept would violate this caselaw because it would tie the Commission based on what it did in the past, not on what current facts require it to do. Moreover, there is no basis in the Communications Act, the applicable rules, or precedent for any such “covenant.” The history of the set aside program would, if anything, compel the Commission to abandon it, not keep it.

Continuing PCS Set Asides Would Be Contrary to Bechtel

In the landmark *Bechtel* case, the U.S. Court of Appeals for the D.C. Circuit declared as unlawful a Commission licensing program which granted preferences to certain applicants for new broadcast facilities. The program had been based on the belief that these preferences would achieve certain goals, such as participation by station owners in programming decisions. The court, however, found that the record did not establish the necessary connection between the means (preferential licensing policies) and the ends (local programming). It stated, “The ability to pick persons and firms who will be ‘successful’ at delivering any kind of service is a rare one, however success might be defined.”¹¹ But the difficulty of predicting success

⁹ See Reply Comments of Carolina PCS I Limited Partnership, at 1-2 (June 30, 2000); Reply Comments of Northcoast Communications, LLC, at 10 (June 30, 2000).

¹⁰ Geller v. FCC, 610 F.2d 973, 978-80 (D.C. Cir. 1979); Meredith Corp. v. FCC, 809 F.2d 863, 872-74 (D.C. Cir. 1987); Bechtel v. FCC, 957 F.2d 873, 881 (D.C. Cir. 1992) (“it is settled law that an agency may be forced to reexamine its approach ‘if a significant factual predicate of a prior decision . . . has been removed’”).

¹¹ See Bechtel v. FCC, 10 F.3d 875, 886 (D.C. Cir. 1993).

does not justify a licensing program that is “peculiarly without foundation.”¹² The court found that the record on which the Commission attempted to justify its licensing policies failed to establish the factual basis that supported the Commission’s assumptions.

Similarly, PCS license set-asides are contrary to the Commission’s experience and policies. Moreover, the rules governing the set-asides do not promote the rationale on which they are based. As a result, adhering to the set-aside to select licensees of PCS spectrum suffers from the same flaws as the Commission’s adherence to the integration criterion for comparative broadcast licensing, found arbitrary and capricious in *Bechtel*.

Like broadcast integration, the Commission “has accumulated no evidence to indicate that [the PCS set-aside] achieves even one of the benefits that the Commission attributes to [the set-aside and] . . . the predictions at the root of the [] policy seem rather implausible.”¹³ The PCS set-aside is designed to place licenses into the hands of small businesses so that the public can receive competitive services from companies other than large incumbents. But, after four years, there are few small businesses who have actually entered into the CMRS market. SBC Communications pointed out that the Commission’s own statistics show, as of May 2000, only five C and F block licensees of markets with 700,000 or more pops were operational, and only 28 of the 1208 C and F block licensees, approximately 2.3%, were operational.¹⁴

Like the integration criterion, even if the set-aside placed licenses into the hands of entrepreneurs, there will be no permanent effect justifying use of the policy, because licensees are not required to adhere to their proposals on a permanent basis. This same problem contributed to the court’s invalidation of the integration program in *Bechtel*.¹⁵

The new rules proposed in this proceeding would, moreover, no longer assure that service will be provided by DEs. The Commission proposes that as soon as a DE licensee meets some minimal build-out requirement, it can transfer the license

¹² *Id.* at 887.

¹³ *Id.* at 880.

¹⁴ *See Comments of SBC Communications*, at 4 (June 22, 2000) (citing FCC buildout statistics).

¹⁵ *See Bechtel v. FCC*, 10 F.3d at 879.

to whomever will pay the most for it.¹⁶ FNPRM, ¶ 44. In other words, in the future, the set-aside will not be used as a means to promote DE entry; rather, it will be a vehicle to promote DE enrichment. Not surprisingly, DEs are using this proposal as the basis for lifting the transfer restrictions altogether.¹⁷ After all, if DEs are no longer required to provide service, why should they be required to hold on to the licenses?

Also like integration credit, the set-aside program creates an incentive for applicants and the Commission to rely on a façade of entrepreneurship rather than the actual facts.¹⁸ In particular, the C block grandfather rule (47 C.F.R. § 24.709(b)(9)(i)) could be read to make any company, no matter what its financial status, eligible to bid on “entrepreneur” licenses as long as it participated in first C block auction. This rule allows the Commission to conduct a closed auction, deny companies which value more spectrum even a chance to win it, and yet award *no* licenses at all to entities that meet the DE eligibility requirements.

In summary, the Commission’s proposals for the C and F block set-asides are not tailored to fulfill its rationale of making PCS available to the public from small businesses. Like the integration policy, these set-asides are fundamentally flawed and contrary to judicially-imposed guidelines for spectrum licensing policies.

¹⁶ Some DEs ask that this proposal be extended to an internal reorganization. See Comments of Carolina PCS, at 7 (June 22, 2000). The proposal itself and these extensions eviscerate the validity of any DE set-aside.

¹⁷ See Comments of Cook Inlet Region, at 3 (June 22, 2000) (terminating the license holding rules will allow entrepreneurs “to sell non-complementary licenses in order to raise capital that is needed to bid in Auction No. 35, to purchase licenses in the secondary market, or to build out other markets”).

¹⁸ See Bechtel v. FCC, 10 F.3d at 887. Compare Comments on or, in the Alternative, Petition to Deny of Nextel Communications, Inc., File Nos. 0000110639, 0000110695 (May 26, 2000) (objecting to financial qualifications of Leap Wireless International to qualify as entrepreneur) with Consolidated Opposition of Leap Wireless International, Inc. (June 8, 2000) (explaining why, under the Commission’s rules, Leap’s gross revenue should be determined with older, audited financial statements rather than more recent 10-Q financial statements).

The PCS Set-Aside Should Not Continue

The Commission should abandon the C and F block set-asides for future PCS auctions. Having compiled a record in this proceeding, the Commission is now obligated to act on that record, and not to retain policies that it no longer follows or that are contrary to binding precedent. An *open* auction, with bidding credits for small businesses, will make PCS licenses accessible to a wide variety of companies and ensure that all who bid, including entrepreneurs, will do so because they value the spectrum as a means of serving the public.

Pursuant to Section 1.1206(b)(1) of the Commission's Rules, two copies of this letter have been submitted for inclusion in the above-referenced docket.

Very truly yours,

A handwritten signature in black ink that reads "John T. Scott". The signature is written in a cursive, slightly slanted style.

John T. Scott

cc: The Honorable William Kennard
The Honorable Harold Furchtgott-Roth
The Honorable Susan Ness
The Honorable Michael Powell
The Honorable Gloria Tristani
Christopher J. Wright
Thomas Sugrue
James D. Schlichting
Kathleen O'Brien Ham
Audrey Bashkin
Paul Murray