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BY HAND DELIVERY

Mr. William Maher
Chief, Wireline Competition Bureau

Mr. Donald Abelson
Chief, International Bureau

Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Regulatory Escrow and Management Agreement Arrangements under Section 214 of the Communications Act, as Amended, and Part 63 of the Commission's Rules

WC Docket Nos. 04-13, 04-18;
File Nos. ITC-ASG-20040126-00029, ITC-ASG-20040112-00012

Dear Messrs. Maher and Abelson:

In considering the application for consent to transfer control of telecommunications assets from Cable & Wireless USA, Inc., Debtor-in-Possession ("C&W"), to Savvis Asset Holdings, Inc. ("Savvis"), Level 3 Communications, LLC ("Level 3"), requests that the Commission rule on the legality of two specific devices used in that transaction: a "pre-closing" regulatory escrow and "pre-closing" management agreement. Level 3 does not oppose the streamlining of the C&W-Savvis application, nor does it oppose the transfer of control of telecommunications facilities from C&W to Savvis. Nevertheless, Level 3 seeks Commission guidance regarding the permissibility of these devices, which are becoming increasingly common in carrier bankruptcies and auctions. Given the Commission's lack of clear guidance regarding the use of these devices and the likelihood that they will be used in the near future in other bankruptcies and auctions, it is important that the Commission give guidance to Level 3, other carriers, debtors, and the bankruptcy courts about the manner in which the Commission views such mechanisms.

Initial bidders have used regulatory escrow and "pre-closing" management agreements to increase their chances of prevailing at bankruptcy auctions for common carrier assets by entering into regulatory escrow and/or management agreement arrangements with the debtor carriers. The bankruptcy auction process gives bidders an incentive to use such arrangements to facilitate the earliest possible final closing date, while asserting that these interim efforts to transfer operating responsibilities to the purchaser and to obtain payment for the creditors nevertheless comply with prior Commission consent requirements contained in Section 214 of the Communications Act, as amended ("Section 214"), and Part 63 of the Commission's rules ("Part 63"). Sellers in bankruptcy, likewise, are highly incentivized to use such mechanisms to shift both regulatory risk of closing and financial responsibility of the pre-closing period to buyers. Although Savvis was not the initial bidder for C&W's assets, C&W required all bidders in the bankruptcy auction to agree to abide by regulatory escrow and management agreement arrangements similar to those in the purchase agreement negotiated between C&W and the "stalking horse" bidder, Gores Asset Holdings, Inc.

The Commission has never expressly approved the use of such arrangements pursuant to Section 214 or Part 63, and its extensive case law with respect to premature transfers of control and pre-closing management agreements creates uncertainty as to the legal propriety of such arrangements. To ensure that no potential bidder is disadvantaged in these bankruptcy auctions, and to provide sellers, bidders, and the bankruptcy courts with a clear sense of what is required under Section 214 and Part 63, Level 3 hereby requests that the Wireline Competition and International Bureaus specifically rule as to whether the regulatory escrow and management agreement arrangements used by C&W and Savvis comply with Section 214 and Part 63 and the criteria under which the Bureaus will evaluate similar mechanisms in the future.

Although Level 3 does not oppose the ultimate transfer of control of telecommunications facilities from C&W to Savvis, it does seek clarification from the Commission so that all participants in future private auctions—whether inside or outside of the bankruptcy process—may bid with a common understanding of the Commission's rules. To the extent the Commission believes that the regulatory escrow and management agreement arrangements in the C&W-Savvis transaction are consistent with the Commission's rules, it should state so clearly; to the extent it does not, it should so state now, to prevent such arrangements from being used in the future, when the public interest (including national security) consequences may be less benign. As discussed below, arrangements similar to those employed by C&W and Savvis and other buyers and sellers in previous bankruptcies would be difficult to unwind if a substantially similar agreement were used in a future transaction that presented public interest concerns. In certain circumstances, moreover, these types of agreements might allow public interest harms to manifest themselves before the Commission had the opportunity to consider the transfer application. Conversely, if the Commission believes that the regulatory escrow and management agreement arrangements used in the C&W-Savvis transaction comport with Section 214 and Part 63, it should so declare publicly so that all potential acquirers of telecommunications assets proceed with a common understanding of the relevant laws and regulations.

Under Section 363 of the U.S. Bankruptcy Code, a debtor may sell some or all of its assets free and clear of liens, subject to bankruptcy court approval. It has become common practice for the debtor to negotiate a purchase agreement with an initial bidder, known as the "stalking horse." Often, the stalking horse negotiates favorable bidding procedures with the debtor to enhance the chances that the stalking horse's offer will be declared the highest and best, although such bidding procedures must be approved by the bankruptcy court. Pursuant to those procedures, competing bidders often are given the opportunity to bid against the stalking horse's baseline proposal at an auction that is generally run by the debtor and its financial advisors. The bankruptcy court itself does not conduct the auction, although the court must approve the results and confirm the winning bidder as the purchaser. Although parties (including, among others, the Commission and other potential or actual bidders) may petition the court to reject the results of the auction on a variety of grounds, there is a strong disincentive for the court to do so, as it would require a new auction and expensive delay. And there is enormous pressure on all parties to close the transaction as quickly as possible in order to conserve the bankruptcy estate for creditors, to prevent further operating losses, and to ensure continuity of service to customers.

In at least two recent carrier bankruptcies, including the "stalking horse" bid for the C&W sale, the debtor has executed with a stalking-horse bidder a purchase agreement containing regulatory escrow provisions and/or a draft management agreement.[1] In the C&W-Savvis transaction, the transaction "closes" into a regulatory escrow prior to the issuance of a Commission notice or order granting consent to consummate the transaction.[2] The purchase consideration and the assets to be transferred are all placed into escrow, subject to a second and final "closing," which occurs after the Commission has approved the transfer. After the purchase consideration and the assets are placed into escrow, the debtor continues ostensibly to own the assets, but the parties activate a management agreement granting the purchaser significant rights to operate the business and the escrowed assets prior to the grant of FCC consent, at which time

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1 *See* Cable & Wireless USA, Inc., Case No. 03-13711 (GCG) (Bankr. D. Del., filed Dec. 8, 2003); Allegiance Telecom, Inc., Case No. 03-13057 (RDD) (Bankr. S.D. N.Y., filed May 14, 2003).

2 *See* Cable & Wireless USA, Inc., and Gores Asset Holdings, Inc., for Authority Pursuant to Section 214 of the Communications Act of 1934, as Amended, Joint Application to Transfer Certain Assets of an Authorized Domestic and International Carrier, WC Docket No. 04-7, File No. ITC-ASG-20040114-00088, at 6 n.4 (filed Jan. 14, 2004) ("C&W-Gores App.") (stating that "[t]o the extent that the required regulatory approvals are not in place by the time that other closing conditions are met, it is anticipated that the parties will conduct an initial closing into escrow and that legal title and operational control of C&W USA's regulated assets will transfer as requisite regulatory approvals are obtained."); Asset Purchase Agreement between and among Cable & Wireless USA, Inc., Cable & Wireless Internet Services, Inc., and Savvis Asset Holdings, Inc., §§ 12.4(a), 15.1 (Jan.23, 2004), Case No. 03-13711 (Bankr. D. Del.) ("C&W-Savvis APA"), excerpts of which comprise Attachment 1 to this letter.

the regulatory escrow and management agreements terminate, and the transaction closes with the transfer of the purchase price and legal title to the assets.[3] In the proposed Allegiance-Qwest transaction, the parties simply activate a management agreement prior to the grant of FCC consent.[4] Under either scenario, the purchaser bears significant (and, in some cases, total) responsibility for the profits and losses of the business following the initial "closing," when the management agreement is activated.

Despite numerous caveats in the management agreements stating that the debtor will retain legal control over its assets, these agreements grant to the purchaser use of the debtor's facilities and equipment, significant degrees of control over employees and daily operations, substantial say in policy decisions, and significant financial rights and obligations. Particularly if, under the management agreements, successful bidders must shoulder the responsibility for the financial performance of the debtor pre-closing, such successful bidders have strong incentives to assert control and restructure operations as quickly as possible in order to stem the losses that placed the debtor into bankruptcy in the first place. While the case for such agreements may be stronger in cases in which the debtor has no cash available and service to customers could be shut down absent a management agreement, that does not appear to be the case in the present instance or several other recent examples.

In each of these recent cases, the parties did not seek express FCC approval in advance of executing the escrow and/or management agreement arrangements, merely footnoting in their

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3 *See, e.g.*, Form of Management Agreement between and among Cable & Wireless USA, Inc., Cable & Wireless Internet Services, Inc., and Gores Asset Holdings, Inc., § 2(a) (Dec. 6, 2003), attached as Exhibit C to Asset Purchase Agreement between and among Cable & Wireless USA, Inc., Cable & Wireless Internet Services, Inc., and Savvis Asset Holdings, Inc. (Dec. 7, 2003), Case No. 03-13711 (Bankr. D. Del.), and as Attachment 2 to this letter. C&W and Savvis have not filed their management either with the Commission or the bankruptcy court.

4 Allegiance Telecom, Inc., Debtor-In-Possession and Qwest Communications International, Inc., Joint Application for Consent to Assignment of Assets, WC Docket No. 04-13, File No. ITC-ASG-20040112-00012, at 10 n.13 (filed Dec. 31, 2003) ("Allegiance-Qwest App.") at 10 n.13 (stating that "[i]f and to the extent the Applicants have not obtained all required approvals and consents prior to the conclusion of the proceedings before the Bankruptcy Court, Qwest has agreed to provide certain management and related services to Allegiance on an interim basis in order to ensure that Allegiance will be able to provide continuous service to its existing customers until such approvals or consents are received"); Asset Purchase Agreement by and among Allegiance Telecom, Inc., and the Other Sellers Named Herein, jointly and severally as Sellers, and Qwest Communications, International, Inc., as Buyer, §§ 2.5, 6.2(b) (Dec. 18, 2003) ("Allegiance-Qwest APA"); Form of Management Agreements, attached as Exhibit C to Allegiance-Qwest App. and as Exhibit I to the Allegiance-Qwest APA.

applications for Commission consent that the parties would engage in such arrangements.[5] Moreover, the debtors represented to the respective bankruptcy courts, creditors, and potential bidders that the arrangements were legally permissible under Section 214 and Part 63, and that the Commission had approved the use of such arrangements in similar circumstances. During the auction process, the debtors effectively required competing bidders (by penalizing competing bids) to agree to use regulatory escrow and/or management agreement arrangements.[6] Thus, a competing bidder is faced with the dilemma of either accepting the regulatory escrow and/or management agreement arrangements agreed to by the stalking horse or being eliminated from bidding.

Although regulatory escrow and management agreement arrangements are becoming increasingly commonplace, the Commission does not appear ever to have directly expressed approval for the use of such arrangements pursuant to Section 214 or Part 63. Moreover, the Commission's extensive case law on premature transfers of control and management agreements suggests that—without further guidance from the Commission—there remains legal risk in doing so for bidders in bankruptcy proceedings and other auctions.

Under Section 214, a carrier must obtain a certificate of public convenience and necessity from the FCC before closing a transaction for a substantial transfer of control of common carrier assets or transfer of control or assignment of an FCC authorization under Section 214.[7] In 2002, the FCC clarified its transfer-of-control rules for domestic common carriers to state that all transfers of common carrier assets require prior FCC consent.[8] And the FCC has long required

[5] *See* C&W-Gores App. at 6 n.4; Allegiance-Qwest App. at 10 n.13.

[6] *See* Application of Cable & Wireless USA, Inc. (Debtor-in-Possession) and Savvis Asset Holdings, Inc., Pursuant to Section 214 of the Communications Act, as Amended, and Sections 63.04 and 63.24 of the Commission's Rules for Authorization to Transfer Control of Certain Assets, WC Docket No. 04-18, File No. ITC-ASG-20040126-00029 (filed Jan. 26, 2004).

[7] *See* 47 U.S.C. § 214(a) (stating that "[n]o carrier shall undertake the construction of a new line or any extension of any line, or shall acquire or operate any line or extension thereof, or shall engage in transmission over or by means of such additional or extended line, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line").

[8] 47 C.F.R. § 63.03 (stating that "[a]ny domestic carrier that seeks to transfer control of lines or authorization to operate pursuant to section 214 of the Communications Act of 1934, as amended, shall be subject to the . . . procedures [specified in section 63.03]"). For streamlined applications, "[u]nless otherwise notified by the Commission, an applicant is permitted to transfer control of the domestic lines or authorization to operate on the 31st day after the date of the public notice listing a domestic section 214 transfer of control application as accepted for filing as a streamlined application, but only in accordance with the operations proposed in its application." 47 C.F.R. § 63.03(a). For non-streamlined

that a U.S. international carrier obtain prior FCC approval before transferring control of common carrier assets or transferring control of, or assigning, an international Section 214 authorization used to provide services between the United States and foreign points.[9] The Commission has stated that carriers must therefore obtain Commission approval before closing their transaction or otherwise transferring control of the assets.[10]

The Commission has long noted that there is no exact formula by which control of licensed assets can be determined and that control is a factual matter that the Commission evaluates on a case-by-case basis.[11] Moreover, the Commission has indicated that it disfavors arrangements where prospective purchasers assume management functions prior to the grant of Commission consent for the acquisition transaction.[12]

The Commission's actions in the Williams Communications bankruptcy in 2002 introduce further uncertainty regarding the use of regulatory escrow and management agreement arrangements, particularly when there is no imminent threat of service disruption. In that

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applications, the Commission will issue a public notice "that states the reason for removal or non-streamlined treatment, and indicates the expected timeframe for Commission action on the application. Except in extraordinary circumstances, final action on the application should be expected no later than 180 days from public notice that the application has been accepted for filing. 47 C.F.R. § 63.03(c)(2).

9 47 C.F.R. § 63.24(e); (stating with respect to non-*pro forma* transactions that "the proposed assignee or transferee must apply to the Commission for authority prior to consummation or the proposed assignment or transfer of control"); 47 C.F.R. § 63.24(a) (stating that an international section 214 authorization may be assigned, or control of such authorization may be transferred by the transfer of control of any entity holding such authorization to another party, whether voluntarily or involuntarily, directly or indirectly, only on application and prior approval by the Commission").

10 *IDB Comm's Group, Inc.*, *Memorandum Opinion and Order*, 10 FCC Rcd. 1110, 1114-15 (1994).

11 *See, e.g., Weston Properties XVIII Limited Partnership,* 8 FCC Rcd. 1783, 1784 (1993) (stating that the Commission looks to "whether a new entity or individual has obtained the right to determine the basic operating policies of the station"). The Commission has considered unauthorized or premature transfers of control most commonly in cases arising under 47 U.S.C. § 309(d), which governs radio licenses. But the Commission takes a similar analytical approach to transfers-of-control issues across the various services. *See Regulation of International Common Carrier Services, Report and Order*, 7 FCC Rcd. 7331, 7333 n.28 (1993).

12 *New West Broadcasting Systems, Inc.*, 7 FCC Rcd. 5556, 5556 (1992), *citing Fine Arts Broadcasting*, 57 FCC 2d 108 (1975); *KLIP(FM)*, 9 FCC Rcd. 6155, 6158 n.11 (1994); *Radio Management Services, Receiver (Assignor) and Clear Channel Communications, Inc. (Assignee)*, 7 FCC Rcd. 2959, 2963 (1992).

proceeding, the debtor and prospective purchaser expressly sought Commission approval to transfer control common carrier assets on a special temporary authority ("STA") basis prior to Commission approval of their pending application (based on concerns that Williams' creditors could seize Williams' operating capital). Nevertheless, even under the threat of immediate service disruption, the Commission admonished the parties for their "apparent disregard of the basic requirements of the Act and the Commission's rules in connection with the negotiation of the proposed transaction and the conduct of the licensee before the Commission."[13] And although the Commission ultimately granted the requested STA, the Commission indicated that it would disfavor such an approach in the future.[14] By contrast, under the regulatory escrow and management agreement arrangements referenced in this letter, the debtor and the seller have not even sought an STA, nor has the Commission taken action in similar cases that have arisen subsequent to the Williams proceeding.

It remains unclear how regulatory escrow and management agreements dovetail with the Commission's transaction review process. In transactions that raise substantive concerns with respect to the transferee—unlike the C&W-Savvis transaction—the Commission's review process permits the Commission to evaluate whether transferees have the requisite qualifications and character to be Commission licensees and whether the transaction complies with the relevant ownership limitations. And perhaps most significantly, the Commission considers whether a transaction would compromise the national security, law enforcement or international trade interests of the U.S. Government—interests that are typically assessed in interagency review processes during a pending transfer or assignment application. A management agreement that grants the transferee responsibility for operating telecommunications facilities prior to the transfer of legal title may prejudge the Commission's assessment of the transferee's suitability (which Level 3 does not question or challenge with respect to Savvis) and the need for any safeguard conditions, giving the transferee a free hand to operate sensitive facilities or to access sensitive national security, industrial, or customer proprietary information prior to, rather than following, Commission review. Moreover, were the Commission ever to refuse transaction consent after the parties had executed regulatory escrow and or management agreement arrangements, the Commission would find it nearly impossible to unwind those arrangements, especially in a bankruptcy context, where the seller may then be incapable of operating the telecommunications assets or may even have ceased to exist.

Consequently, Level 3 requests that in any order or notice issued by the Wireline Competition and International Bureaus approving the C&W-Savvis transaction, the bureaus

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13 *See* Letter from D'wana Terry and Michelle Carey to Leigh Roderick and David Martin, WB Docket No. 02-320 (Oct. 11, 2002).

14 *Id.* (stating, "This is not the first time that the Commission has been faced in recent months with a licensee that has neglected to consider its obligations under the Commission's rules. We reiterate that licensees are required to comply with all aspects of their obligations under the Act and the Commission's rules, including those pertaining to appropriate timing and filing obligations for licensees").

provide guidance to reduce the legal uncertainties surrounding regulatory escrow and management agreement arrangements. Such guidance would also reduce the potential for gamesmanship in carrier bankruptcies, which could otherwise disadvantage bidders seeking strict compliance with Section 214 and Part 63. Such guidance will provide prospective bidders with the clarity they need to allow them to appropriately evaluate the impact of the regulatory approval process when they consider their bids. Such guidance would also clarify for the bankruptcy courts the role of the Commission's regulatory processes in disposing of regulated carrier assets.

Should you have any questions regarding this letter, please contact me by telephone at +1 720 888 2516 or by e-mail at Bill.Hunt@level3.com.

Respectfully submitted,

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