

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Implementation of the Commercial Spectrum)
Enhancement Act and Modernization of the) WT Docket No. 05-211
Commission's Competitive Bidding Rules and)
Procedures)

**SECOND REPORT AND ORDER
AND SECOND FURTHER NOTICE OF PROPOSED RULE MAKING**

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By the Commission: Chairman Martin and Commissioner Copps issuing separate statements; and
Commissioner Adelstein approving in part, dissenting in part, and issuing a separate statement.

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I. INTRODUCTION

1. In this *Second Report and Order* and *Second Further Notice of Proposed Rule Making* (“*Second Further Notice*”), we address our rules concerning the eligibility of applicants and licensees for designated entity benefits. In the *Second Report and Order*, we modify our rules in order to increase our ability to ensure that the recipients of designated entity benefits are limited to those entities and for those purposes Congress intended.¹ In the *Second Further Notice*, we seek comment on a variety of additional measures that might further augment the effectiveness of our rules in this regard. We take all of these steps with the goal of enhancing our ability to carry out Congress’s dual directives with regard to designated entities: (1) that we ensure that designated entities are given the opportunity to participate in the provision of spectrum-based services;² and (2) that, in providing such opportunity, we prevent unjust enrichment.³ With regard to the second directive, our particular intention is to ensure that entities ineligible for designated entity incentives cannot circumvent our rules by obtaining those benefits indirectly, through their relationships with eligible entities.

2. In the *Further Notice of Proposed Rule Making* in this docket (“*Further Notice*”), we tentatively concluded that we should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a “material relationship” with a “large in-region incumbent wireless service provider.”⁴ We sought comment on how we should define the elements of such a restriction.⁵ We further sought comment on whether we should restrict the award of designated entity benefits where an otherwise qualified applicant has a “material relationship” with a large entity that has a significant interest in communications services, and if so, how we should define the elements of such a restriction.⁶

A. *Second Report and Order*

3. As discussed fully below, we revise our general competitive bidding rules (“Part 1” rules)⁷ governing benefits reserved for designated entities⁸ to include certain “material relationships” as

¹ “Designated entities” are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies. 47 C.F.R. § 1.2110(a). In an effort to eliminate some past inconsistency in nomenclature, we clarify that, unless otherwise noted, when referring to “designated entities,” we include as a subgroup “entrepreneurs” eligible to bid for “set-aside” broadband Personal Communications Service (“broadband PCS”) licenses offered in closed bidding. See *id.* §§ 1.2110(a), 24.709.

² 47 U.S.C. § 309(j)(4)(D); see also *id.* § 309(j)(3)(B).

³ *Id.* § 309(j)(4)(E); see also *id.* § 309(j)(3)(C).

⁴ Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, *Further Notice of Proposed Rule Making*, 21 FCC Rcd 1753 (2006) (“*Further Notice*”).

⁵ *Id.* at 1754-55 ¶ 1.

⁶ *Id.* In response, we received 37 comments and 18 reply comments. Two parties who filed initial comments in response to the Commission’s Public Notice relating to AWS auction procedures (AU-06-30) also raised issues with respect to the Commission’s designated entity program. We also received *ex parte* filings in response to the *Further Notice* from various parties including the Congressional Black Caucus, the U.S. Department of Justice and Council Tree. Appendix A contains a list of full and abbreviated names of commenting parties.

⁷ See 47 C.F.R. § 1.2101 *et. seq.*

⁸ See *id.* § 1.2110. The Commission establishes special small business size standards on a service-specific basis, (continued....)

factors in determining designated entity eligibility. Specifically, we adopt rules to limit the award of designated entity benefits, as explained in more detail below, to any applicant or licensee that has “impermissible material relationships” or an “attributable material relationship” created by certain agreements with one or more other entities for the lease or resale (including under a wholesale arrangement) of its spectrum capacity. These definitions of material relationships are necessary to strengthen our implementation of Congress’s directives with regard to designated entities and to ensure that, in accordance with the intent of Congress, every recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public.⁹

4. We also adopt rule modifications to strengthen our unjust enrichment rules so as to better deter entities from attempting to circumvent our designated entity eligibility requirements and to recapture designated entity benefits when ineligible entities control designated entity licenses or exert impermissible influence over a designated entity.¹⁰ Similarly, to ensure our continued ability to safeguard the award of designated entity benefits, we provide clarification regarding how the Commission will implement its rules concerning audits, and we refine our rules with respect to the reporting obligations of designated entities.

5. The rules we adopt today will apply to all determinations of eligibility for all designated entity benefits, including bidding credits and, as applicable, set-asides¹¹ and installment payments, unless

(...continued from previous page)

taking into consideration the characteristics and capital requirements of the particular service. 47 C.F.R. § 1.2110(c)(1). In the *Part 1 Fifth Report and Order*, the Commission, in light of the *Adarand* decision, declined to adopt special provisions for minority- and women-owned businesses but noted that minority- and women-owned businesses that qualify as small businesses may take advantage of the provisions the Commission has adopted for small businesses. Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, WT Docket No. 97-82, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Further Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15319 ¶ 48 (2000) (“*Part 1 Fifth Report and Order*”) (citing *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200, 227 (1995)). On several occasions, the Commission has declined to adopt bidding credits for large telephone companies that serve rural areas. See, e.g., Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket No. 93-253, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403, 457-58, 462-63 ¶¶ 100, 111 (1994) (“*Competitive Bidding Fifth MO&O*”); Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, *Order on Reconsideration of the Third Report and Order, Fifth Report and Order, and Fourth Notice of Proposed Rule Making*, 15 FCC Rcd 15293, 15320-21 ¶¶ 51-52 (2000); Reallocation and Service Rules for the 698-746 MHz Spectrum Band (Television Channels 52-59), GN Docket No. 01-74, *Report and Order*, 17 FCC Rcd 1022, 1090-91 ¶ 176 (2002). The Commission determines eligibility for its small business provisions based on an entity’s size determined pursuant to attribution rules. 47 C.F.R. § 1.2110(b)(1)-(3). But see Amendment of Part 1 of the Commission’s Rules – Competitive Bidding Procedures, *Second Order on Reconsideration of the Third Report and Order and Order on Reconsideration of the Fifth Report and Order*, 18 FCC Rcd 10180, 10191-94 ¶¶ 16-18 (2003) (establishing exemption for rural telephone cooperatives from the requirement that gross revenues of entities controlled by an applicant’s officers and directors be attributed to the applicant), *modified on reconsideration, Second Order on Reconsideration of the Fifth Report and Order*, 20 FCC Rcd 1942 (2005); 47 C.F.R. § 1.2110(b)(3)(iii) (exempting rural telephone cooperatives from attributing the gross revenues of its officers and directors).

⁹ In the legislative history of Section 309(j), Congress explains that the reason for imposing anti-trafficking restrictions and unjust enrichment payment obligations on entities that receive small business benefits is to deter “participation in the licensing process by those who have no intention of offering service to the public.” H.R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF. REP. NO. 103-213, at 483 (1993)).

¹⁰ See 47 C.F.R. § 1.2111.

¹¹ Broadband Personal Communications Services entrepreneurs will be subject to these new rules as described below.

excepted by the grandfathering provisions described in detail below.¹² These rules will be applied to any application filed to participate in auctions in which bidding begins after the effective date of the rules adopted herein and to all long-form applications filed by winning bidders after such auctions,¹³ as well as to all applications for an authorization, an assignment or transfer of control, a lease, or reports of events affecting a designated entity's ongoing eligibility,¹⁴ including "impermissible material relationships" or "attributable material relationships," filed on or after release of this *Second Report and Order*. These rules will become effective thirty days after their publication in the Federal Register.

B. *Second Further Notice of Proposed Rule Making*

6. In reviewing the record in this proceeding, including the requests of various parties to conduct a further inquiry,¹⁵ we issue this *Second Further Notice* to consider whether we should adopt additional restrictions, beyond those we adopt herein, to further safeguard the benefits reserved for designated entities.¹⁶

II. BACKGROUND

7. Throughout the history of the auctions program, the Commission has endeavored to carry out its Congressional directive to promote the involvement of designated entities in the provision of spectrum-based services.¹⁷ Congress recommended that the Commission, in assisting designated entities, consider the use of various mechanisms such as tax credits and bidding preferences.¹⁸ Yet, in so doing, Congress also mandated that the Commission safeguard the award of the benefits it distributed to "prevent unjust enrichment as a result of the methods employed to issue licenses."¹⁹

8. The challenge for the Commission in carrying out Congress's plan has always been to find a reasonable balance between the competing goals of, first, providing designated entities with reasonable flexibility in being able to obtain needed financing from investors and, second, ensuring that the rules effectively prevent entities ineligible for designated entity benefits from circumventing the intent of the rules by obtaining those benefits indirectly, through their investments in qualified businesses.²⁰ The changes in the Commission's designated entity rules over time have been the result of the Commission's continuing effort to maintain this balance effectively in the face of a rapidly evolving telecommunications industry, legislative changes, judicial decisions, and the demand of the public for greater access to wireless services.

9. The Commission's primary method of promoting the participation of designated entities in competitive bidding has been to award bidding credits – percentage discounts on winning bid amounts

¹² See discussion *infra* ¶¶ 28-30.

¹³ The rules adopted herein, therefore, will not apply to the upcoming auction of 800 MHz Air-Ground Radiotelephone Service licenses, scheduled to begin on May 10, 2006, nor to the Form 601 applications to be filed subsequent to the close of that auction by the winning bidders. See Auction of 800 MHz Air-Ground Radiotelephone Service Licenses Scheduled for May 10, 2006; Notice and Filing Requirements, Minimum Opening Bids, Upfront Payments and Other Procedures for Auction No. 65, *Public Notice*, 21 FCC Rcd 1278 (2006).

¹⁴ See discussion *infra* note 116 and accompanying text.

¹⁵ See, e.g., Comments of NHMC at 17-18; Reply Comments of Consumers Union at 1-2.

¹⁶ See *supra* note 8 (discussing the Commission's designated entity benefits).

¹⁷ See 47 U.S.C. § 309(j)(4)(D); see also 47 C.F.R. § 1.2110(a).

¹⁸ 47 U.S.C. § 309(j)(4)(D).

¹⁹ *Id.* § 309(j)(4)(E).

²⁰ See Implementation of Section 309(j) of the Communications Act - Competitive Bidding, PP Docket No. 93-253, *Fifth Report and Order*, 9 FCC Rcd 5532, 5582 ¶ 159 (1994) ("*Competitive Bidding Fifth Report and Order*").

– to small business applicants.²¹ The Commission also has utilized other incentives, such as installment payments and, in the broadband Personal Communications Services (“broadband PCS”), a license set-aside, to encourage designated entities to participate in spectrum auctions and in the provision of service.²² In order to qualify for these benefits, an applicant must demonstrate that its gross revenues (and, in some cases, its total assets), in combination with those of its “attributable” interest holders, fall below certain service-specific financial caps.²³ Thus, in determining eligibility for size-based benefits, it is critical to decide which investors’ gross revenues (and total assets) must be attributed.

10. During the early years of the designated entity program, the Commission adopted often complicated attribution rules on a service-specific basis. For broadband PCS attribution, the Commission had a “general rule” – its financial caps²⁴ – and four exceptions to the rule.²⁵ Two of these exceptions came to be known as the “control group exceptions” – a 25 percent equity exception and a 49.9 percent equity exception.²⁶ Both exceptions required the applicant to form a “control group”²⁷ within which “qualifying investors”²⁸ owned at least 50.1 percent of the applicant’s voting interests.²⁹ Under the 25 percent equity exception, the applicant’s control group was required to own at least 25 percent of the applicant’s total equity; and, within the control group, qualifying investors were required to hold at least 15 percent of the applicant’s total equity.³⁰ Under the 49.9 percent equity exception, the applicant’s control group was required to own at least 50.1 percent of the applicant’s total equity; and, within the control group, qualifying investors were required to hold at least 30 percent of the applicant’s total equity.³¹ If these and certain other requirements were met, the gross revenues and total assets of non-controlling investors were not attributed to the applicant.³² These two exceptions to the general rule were widely used; however, the other two exceptions – one for publicly-traded corporations with widely dispersed voting stock ownership and the other for small business consortia³³ – were seldom invoked.

11. The Commission used the control group approach in broadband PCS for determinations of small business eligibility and also for determinations of “entrepreneur” eligibility. In broadband PCS,

²¹ See, e.g., Implementation of Section 309(j) of the Communications Act – Competitive Bidding, PP Docket No. 93-253, *Second Report and Order*, 9 FCC Rcd 2348, 2391-92 ¶¶ 241-44 (1994) (“*Competitive Bidding Second Report and Order*”).

²² See *id.* at 2389-91, 2392 ¶¶ 231-40, 245-48.

²³ See 47 C.F.R. § 1.2110(b).

²⁴ See *id.* § 24.709(a)(1)-(2).

²⁵ See *id.* § 24.709(b)(1)(i)-(iv).

²⁶ See *id.* § 24.709(b)(1)(iii), (iv).

²⁷ A control group is an entity, or a group of individuals or entities, that possesses *de jure* and *de facto* control of an applicant or licensee. See *id.* § 24.720(k).

²⁸ A qualifying investor is a person who is (or holds an interest in) a member of the applicant’s control group and whose gross revenues and total assets, when aggregated with those of all other attributable investors and affiliates, do not exceed the entrepreneurs’ block gross revenues and total assets limits. *Id.* § 24.720(n).

²⁹ *Id.* § 24.709(b)(1)(v)(A)(2), (b)(1)(vi)(A)(2). If the applicant was a partnership, the control group was required to hold all of its general partnership interests. *Id.*

³⁰ *Id.* § 24.709(b)(1)(v)(A), (b)(1)(v)(A)(1).

³¹ *Id.* § 24.709(b)(1)(vi)(A), (b)(1)(vi)(A)(1).

³² *Id.* § 24.709(b)(1)(iii)-(vi). The equity ownership requirements under both exceptions were somewhat relaxed for entities that had been operating and earning revenues for at least two years prior to December 31, 1994. *Id.* §§ 24.709 (b)(1)(v)(B), 24.709(b)(1)(vi)(B), 24.709(b)(6)(ii), 24.720(h).

³³ See *id.* § 24.709(b)(i), (ii).

the Commission originally “set aside” C and F block licenses for “entrepreneurs,”³⁴ small entities whose gross revenues and total assets, when aggregated with those of their attributable interest holders, fell below certain financial caps.³⁵ A variation of this control group approach was employed for narrowband PCS.³⁶ In determining whether applicants for the 900 MHz specialized mobile radio (“SMR”) service qualified as small businesses, the Commission attributed the revenues of parties holding partnership and other ownership interests and any stock interest amounting to 20 percent or more of the equity, or outstanding stock, or outstanding voting stock of the applicant.³⁷ For virtually all other services, the Commission used a “controlling interest”³⁸ or “controlling principal”³⁹ standard much like the attribution standard used today. Under this earlier standard, the Commission attributed to the applicant the gross revenues of its controlling interests and their affiliates in assessing whether the applicant was qualified to take advantage of the Commission’s small business provisions, such as bidding credits.⁴⁰

12. Since 2000, the Commission has applied the current “controlling interest” standard to all services when making attribution determinations.⁴¹ Under this standard, the Commission attributes to an applicant the gross revenues of it, its controlling interests, its affiliates, and the affiliates of the applicant’s controlling interests.⁴² A “controlling interest” includes individuals or entities, or groups of individuals or entities, that have control of the applicant under the principles of either *de jure* or *de facto* control.⁴³ *De jure* control is typically evidenced by the holding of greater than 50 percent of the voting stock of a corporation or, in the case of a partnership, general partnership interests.⁴⁴ *De facto* control is determined on a case-by-case basis⁴⁵ and includes the criteria set forth in *Ellis Thompson*.⁴⁶ Under the controlling

³⁴ In some non-PCS services, the Commission uses the term “entrepreneur” to refer to a level of small business eligibility for bidding credits. See, e.g., *id.* §§ 22.229, 27.702, 101.538, 101.1107, 101.1112, 101.1429.

³⁵ In the context of Broadband PCS, an applicant or licensee generally qualifies as an entrepreneur if it, together with its affiliates, persons or entities that hold interests in the applicant or licensee, and their affiliates, has combined total assets of less than \$500 million and has had combined gross revenues of less than \$125 million in each of the last two years. *Id.* § 24.709(a)(1).

³⁶ Under this standard, the gross revenues and affiliations of an investor in the applicant were not considered so long as the investor held 25 percent or less of the applicant’s passive equity and was not a member of the applicant’s control group. Amendment of Part 1 of the Commission’s Rules — Competitive Bidding Proceeding, WT Docket 97-60, Order, Memorandum Opinion and Order, and Notice of Proposed Rule Making, 12 FCC Rcd 5686, 5702 ¶ 26 (1997) (“Part 1 Order”).

³⁷ 47 C.F.R. § 90.814(g) (2001); see Part 1 Order, 12 FCC Rcd at 5703 ¶ 27.

³⁸ See, e.g., 47 C.F.R. §§ 1.948, 1.2105, 1.2110, 1.2112, 20.6, 21.38, 22.223, 22.225.

³⁹ See, e.g., *id.* §§ 1.2110, 22.223, 27.210, 90.814, 90.912, 90.1021, 101.1109.

⁴⁰ See Part 1 Order, 12 FCC Rcd at 5703 ¶ 27.

⁴¹ See generally Part 1 Fifth Report and Order, 15 FCC Rcd at 15293.

⁴² *Id.* at 15323 ¶ 59.

⁴³ 47 C.F.R. § 1.2110(c)(2).

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ In *Ellis Thompson*, the Commission identified the following factors used to determine control of a business: (1) use of facilities and equipment; (2) control of day-to-day operations; (3) control of policy decisions; (4) personnel responsibilities; (5) control of financial obligations; and (6) receipt of monies and profits. Application of Ellis Thompson Corporation, Memorandum Opinion and Order and Hearing Designation Order, 9 FCC Rcd 7138, 7138-7139 ¶ 9 (1994) (citing the Commission’s decision in *Intermountain Microwave*, Applications for Microwave Transfers to Teleprompter Approved with Warning, Public Notice, 12 FCC 2d 559 (1963) (“*Intermountain Microwave*”) (1963)). See also Application of Baker Creek Communications, L.P. for Authority to Construct and Operate Local Multipoint Distribution Services in Multiple Basic Trading Areas, Memorandum Opinion and Order, (continued....)

interest standard, the officers and directors of any applicant are considered to have a controlling interest in the applicant.⁴⁷ The Commission has declined to impose minimum equity requirements on controlling interests, believing that such requirements would dictate that a person or entity identified as a controlling interest must retain some level of equity in the applicant, thereby reducing the amount of equity the applicant could offer to non-controlling interests in exchange for financing and making it more difficult for the applicant to attract sufficient investment to compete in the marketplace.⁴⁸

13. In applying the controlling interest standard, the Commission's intent has been to provide designated entities with increased flexibility and simplicity in structuring their businesses, while continuing to ensure that size-based benefits are reserved solely for qualified entities. In making the change, the Commission acknowledged the complexity of the broadband PCS control group approach, emphasizing that the controlling interest standard would be "simpler" and "more straightforward to implement."⁴⁹ Also, the Commission explained, application of the controlling interest standard would allow "legitimate small businesses . . . to attract passive financing in a highly competitive and evolving telecommunications marketplace,"⁵⁰ while ensuring "that only those entities truly meriting small business status qualif[ied] for [the Commission's] small business provisions."⁵¹

III. SECOND REPORT AND ORDER

A. Background

14. In the *Further Notice*, we tentatively concluded that we should restrict the award of designated entity benefits to an otherwise qualified applicant where it has a "material relationship" with a "large in-region incumbent wireless service provider."⁵² We sought comment on how to define the specific elements of such a restriction.⁵³ Further, we sought comment on whether such a restriction on the award of designated entity benefits should apply where a designated entity applicant has a "material relationship" with a large entity that has a "significant interest in communication services," and whether we should include in such a definition a broad category of communications-related businesses or instead exclude or include certain types of entities.⁵⁴ In addition, we sought comment on whether we should adopt unjust enrichment provisions that would require reimbursement of designated entity benefits in the event that a designated entity makes a change in its material relationships or makes any other changes that would result in the loss of or change in its eligibility subsequent to acquiring a license with a designated

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13 FCC Rcd 18709 (Wireless Tel. Bur. 1998) (discussing in detail the factors constituting *de facto* control); Stephen F. Sewell, *Assignments and Transfers of Control of FCC Authorizations Under Section 310(d) of the Communications Act of 1934*, 43 FED. COMM. L.J. 277, 316-17 (1991).

⁴⁷ 47 C.F.R. 1.2110(c)(2)(ii)(F); *Part 1 Fifth Report and Order*, 15 FCC Rcd at 15325-26 ¶¶ 65-66.

⁴⁸ See *Part 1 Fifth Report and Order*, 15 FCC Rcd at 15325-26 ¶ 65.

⁴⁹ *Id.*

⁵⁰ Amendment of Part 1 of the Commission's Rules - Competitive Bidding Procedures, WT Docket No. 97-82, *Third Report and Order and Second Further Notice of Proposed Rule Making*, 13 FCC Rcd 374, 478 ¶ 186 (1997) ("*Part 1 Third Report and Order*").

⁵¹ *Part 1 Fifth Report and Order*, 15 FCC Rcd at 15293, 15323-24 ¶ 58.

⁵² *Further Notice*, 21 FCC Rcd at 1754-57 ¶¶ 1, 3-5.

⁵³ *Id.* at 1754-55, 1759-62 ¶¶ 1, 12-18.

⁵⁴ *Id.* at 1754-55, 1762-63 ¶¶ 1, 19.

entity benefit.⁵⁵ Finally, in the *Further Notice*, we sought comment on changes to the Commission's auction application rules to facilitate the application of any rule modifications to upcoming auctions.⁵⁶

B. Material Relationship

15. As discussed fully below, we revise our Part 1 rules to consider certain relationships as factors in determining designated entity eligibility. In so doing, we seek to improve our ability to achieve Congress's directives with regard to designated entities and to ensure that, in accordance with the intent of Congress, every recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public.⁵⁷ Specifically, except as grandfathered below, an applicant or licensee has "impermissible material relationships" when it has agreements with one or more other entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 50 percent of its spectrum capacity of any individual license. Such "impermissible material relationships" render the applicant or licensee (i) ineligible for the award of designated entity benefits, and (ii) subject to unjust enrichment on a license-by-license basis. Furthermore, except as grandfathered below, an applicant or licensee has an "attributable material relationship" when it has one or more agreements with any individual entity, including entities and individuals attributable to that entity, for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any individual license that is held by the applicant or licensee. The "attributable material relationship" with that entity will be attributed to the applicant or licensee for the purposes of determining the applicant's or licensee's (i) eligibility for designated entity benefits, and (ii) liability for unjust enrichment on a license-by-license basis.

16. *Further Notice*. To define "material relationship," the *Further Notice* sought comment on the specific nature of the types of additional relationships that should trigger a restriction on the availability of designated entity benefits.⁵⁸ For instance, Council Tree initially proposed that the Commission should restrict a designated entity applicant's "material relationships," including both financial and operational agreements, in order to more carefully ensure that designated entity benefits are awarded only to bona fide eligible entities.⁵⁹ In this regard, we sought comment on what might constitute a "material financial" or "material operational" relationship. Moreover, insofar as our current rules already attribute the gross revenues of those that have relationships with designated entity applicants that confer either *de jure* and *de facto* control, we also sought comment on the type of attribution standard that we should apply to any rule modification.⁶⁰

17. The *Further Notice* also sought comment on whether restricting certain agreements as a "material relationship" would be too harsh or unnecessarily limit a designated entity applicant's ability to gain access to capital or industry expertise.⁶¹ Additionally, the *Further Notice* sought comment on

⁵⁵ *Id.* at 1763 ¶ 20.

⁵⁶ *Id.* at 1763-64 ¶ 21.

⁵⁷ In the legislative history of Section 309(j), Congress explains that the reason for imposing anti-trafficking restrictions and unjust enrichment payment obligations on entities that receive small business benefits is to deter "participation in the licensing process by those who have no intention of offering service to the public." H.R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF. REP. NO. 103-213, at 483 (1993)).

⁵⁸ *Further Notice*, 21 FCC Rcd at 1760 ¶ 13.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 1761 ¶ 15.

whether there might be instances where the existence of either a “material financial agreement” or a “material operational agreement” might be appropriate and might not raise issues of undue influence.⁶² In this regard, the *Further Notice* asked whether the Commission should allow designated entity applicants to obtain a bidding credit or other benefits if they had only a “material financial agreement” or only a “material operational agreement” but not both, and what factors we should consider in determining the types of relationships that might not adversely affect an applicant’s designated entity eligibility.⁶³ Finally, we sought comment on whether a spectrum leasing arrangement should be defined as a “material relationship,” and whether we should consider any other arrangements for the purposes of such a definition.⁶⁴

18. *Comments.* Commenters are generally split regarding the level of specificity with which the Commission should define “material relationship.” Several commenters urge the Commission to narrowly tailor the definition so as not to “inadvertently hinder the flow of capital” to designated entity applicants.⁶⁵ For example, Wirefree Partners argues that the Commission should “narrowly and specifically define what constitutes a material relationship” because “[s]mall businesses need the flexibility to enter into reasonable commercial agreements with other participants in the communications industry.”⁶⁶ Others maintain that the reach of the Commission’s policies should be very broad and that we should define “material relationship” to include both financial and operational agreements.⁶⁷ For example, Council Tree and other proponents of a broad definition maintain that the definition of material relationship should include, “without limitation, management agreements, trademark license agreements, joint marketing agreements, future interest agreements (such as puts, calls, options, and warrants), and long-term *de facto* and spectrum manager leasing arrangements.”⁶⁸

19. Rural service providers oppose the proposal to define “material relationship” in a manner that would preclude small businesses from entering into operational agreements with large wireless carriers.⁶⁹ As explained by one commenter, many small and rural wireless companies “have entered into management, marketing or other non-equity arrangements with large wireless carriers which enable them to provide quality wireless services to the rural areas they are licensed to serve.”⁷⁰ Another commenter

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 1761 ¶ 16.

⁶⁵ See, e.g., Comments of STX at 2; see also Comments of Antares at 4 (“the Commission needs to balance the public policy goal of continuing to encourage small business participation within the wireless industry against the very real need for qualified small businesses to raise capital in order to participate in wireless service auctions.”); Comments of Cook Inlet at 3 (“it is particularly challenging for small companies to obtain access to financial resources necessary to support bidding and paying for even one license in a given auction, much less to construct and operate a system within the time frame mandated by the Commission’s rules.”); Comments of NAB at 2 (“If the Commission were to adopt unnecessarily restrictive DE rules, small businesses would be more limited in their ability to raise capital and attract investors.”); Reply Comments of Ericsson at 2-3 (arguing that the Commission should not constrain access to manufacturer financing).

⁶⁶ Comments of Wirefree Partners at 7.

⁶⁷ See, e.g., Comments of Council Tree at 52; Comments of Leap at 15; Comments of MMTC at 2, 9.

⁶⁸ Comments of Council Tree at 52. See also *Further Notice*, 21 FCC Rcd at 1761 ¶ 9. A number of commenters also generally appeared to support the premise of Council Tree’s proposals without specifically commenting on how the Commission might define “material relationship.” See, e.g., Comments of MobiPCS at 1; Comments of Suncom at 1; Comments of USCC at 2-3, 5.

⁶⁹ See, e.g., Comments of NTCA at 7-8; Comments of RTG at 4-5.

⁷⁰ Comments of John Staurulakis, Inc. at 3.

notes that “the Commission should not consider roaming agreements evidence of a ‘material relationship’ since to do so would eliminate almost every small rural carrier from enjoying DE status.”⁷¹

20. In seeking comment on spectrum leasing, we asked “what, if any standard should be used to determine whether spectrum leasing is a material relationship for the purpose of any additional restriction on the availability of designated entity benefits that we might adopt.”⁷² A few commenters argued that the Commission should not reverse the guidance provided in the *Secondary Markets* proceeding.⁷³ As noted above, a number of others generally agreed that the Commission should adopt Council Tree’s proposal for material relationships, presumably including its suggestion that leasing should be included in the types of material relationships that should trigger a Commission restriction of the award of designated entity benefits.⁷⁴

21. *Discussion.* In defining “material relationship,” we seek to balance a designated entity applicant’s need for flexibility to structure its business relationships against our statutory obligation to award these small business benefits only to entities intended by statute to be eligible. In our experience in administering the designated entity program over the last several years, we have witnessed a growing number of complex agreements between designated entities and those with whom they choose to enter into financial and operational relationships. Although some of these agreements may have contributed to the wireless industry becoming a thriving sector of the nation’s economy, the relationships underpinning such contracts underscore the need for stricter regulatory parameters to ensure, as Congress intended, that: (1) benefits are awarded to provide opportunities for designated entities to become robust independent facilities-based service providers with the ability to provide new and innovative services to the public; and (2) the Commission employs methods to prevent unjust enrichment.⁷⁵

22. We agree with commenters that certain agreements have the potential to significantly influence a designated entity licensee’s decisions regarding its provision of service and, therefore, also have the potential to be abused, absent the appropriate safeguards. Yet, we also recognize the concerns of many, especially rural carriers, that argue that small businesses face practical difficulties in providing service and that stress that designated entity licensees must have the ability to enter into operational contracts, such as roaming, interconnection, and switch-sharing, with other, often large, providers in order to be in a position to provide valuable telecommunications service to the public.⁷⁶

23. In considering how to evaluate which specific relationships should trigger additional eligibility restrictions, we conclude that certain agreements, by their very nature, are generally inconsistent with an applicant’s or licensee’s ability to achieve or maintain designated entity eligibility because they are inconsistent with Congress’s legislative intent. In this regard, where an agreement concerns the actual use of the designated entity’s spectrum capacity, it is the agreement, as opposed to the party with whom it is entered into, that causes the relationship to be ripe for abuse and creates the potential for the relationship to impede a designated entity’s ability to become a facilities-based provider, as intended by Congress.

⁷¹ Comments of RTG at 5.

⁷² *Further Notice*, 21 FCC Rcd at 1761 ¶ 16.

⁷³ See, e.g., Comments of Wirefree Partners at 8-9; Comments of CTIA at 4.

⁷⁴ See, e.g., Comments of Council Tree at 52; see generally Comments of MobiPCS at 1; Comments of Suncom at 1; Comments of USCC at 2-3, 5.

⁷⁵ See, e.g., Comments of MMTC at 6 (“some of the largest national incumbent wireless carriers have received from their DE partners exclusive access to valuable spectrum and network capacity that otherwise could have been used to offer new services and induce the national wireless incumbents to better respond to the needs of the marketplace.”).

⁷⁶ See, e.g., Comments of RTG at 5.

24. As we indicated in the *Secondary Markets Second Report and Order*, “Congress specifically intended that, in order to prevent unjust enrichment, the licensee receiving designated entity benefits actually provide facilities-based services as authorized by its license.”⁷⁷ In that proceeding, the Commission stated that leasing by a designated entity licensee of “substantially all of the spectrum capacity of the licensee” would cause attribution that would likely lead to a loss of eligibility, and that the leasing of a “small portion” of such capacity where there was no other relationship between the parties likely would not result in a finding of attribution.⁷⁸ Although at least one commenter argues that the Commission’s existing leasing rules provide adequate protection to ensure that the relationship between the parties “remains one of contract and not control,”⁷⁹ as articulated in the *Further Notice* and this decision, we are modifying our rules to include additional safeguards to our designated eligibility determinations that look beyond controlling relationships to those that have the potential to influence a designated entity in a manner contrary to that intended by Congress.

25. Building on our *Secondary Markets* policies and in consideration of the record we have before us, we modify our rules regarding eligibility for designated entity benefits for applicants or licensees that have agreements that create material relationships, as defined and explained herein. Specifically, except as grandfathered below,⁸⁰ we conclude that an applicant or licensee has “impermissible material relationships” when it has agreements with one or more other entities for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 50 percent of its spectrum capacity of any individual license. Such “impermissible material relationships” render the applicant or licensee (i) ineligible for the award of designated entity benefits, and (ii) subject to unjust enrichment on a license-by-license basis. Furthermore, except as grandfathered below,⁸¹ we find that an applicant or licensee has an “attributable material relationship” when it has one or more agreements with any individual entity, including entities and individuals attributable to that entity, for the lease (under either spectrum manager or *de facto* transfer leasing arrangements) or resale (including under a wholesale arrangement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any individual license that is held by the applicant or licensee.⁸² The “attributable material relationship” with that entity will be attributed to the applicant or licensee for the purposes of determining the applicant’s or licensee’s (i) eligibility for designated entity benefits, and (ii) liability for unjust enrichment on a license-by-license basis.⁸³

⁷⁷ Promoting Efficient Use of Spectrum through Elimination of Barriers to the Development of Secondary Markets, WT Docket No. 00-230, *Second Report and Order, Order on Reconsideration, and Second Further Notice of Proposed Rulemaking*, 19 FCC Rcd 17503, 17538, 17541, 17544 ¶¶ 71, 76, 82 (2004) (“*Secondary Markets Second Report and Order*”).

⁷⁸ *Id.* at 17541-42 ¶ 77.

⁷⁹ Comments of Wirefree Partners at 8.

⁸⁰ See discussion *infra* ¶¶ 28-30.

⁸¹ See *id.*

⁸² If a designated entity licensee disaggregates its license, determinations of impermissible and attributable material relationships will be made based upon its remaining spectrum license. For example, if a designated entity licensee disaggregates 5 MHz of a 10 MHz license, it cannot have spectrum leasing or resale arrangements for more than 2.5 MHz of spectrum, pursuant to the “impermissible material relationships” restriction, and any spectrum leasing or resale arrangements with one individual entity for more than 1.25 MHz of spectrum will result in the attribution of revenues and assets, pursuant to the “attributable material relationships” restriction.

⁸³ During the first five years of the license term, broadband PCS entrepreneurs that have not yet met their five-year construction requirements will be prohibited from entering into any impermissible material relationships with entities of any size. They will also be prohibited from entering into attributable material relationships if those relationships bring their attributable gross revenues or total assets above the financial caps established in section 24.709. After build-out or the first five years of the license term, broadband PCS entrepreneurs that are participating in the installment payment plan and enter into impermissible or attributable material relationships will be subject to

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26. As stated above, our experience in administering the designated entity program and our review of the record developed in response to our *Further Notice* leads us to conclude that these definitions of material relationship are necessary to ensure that the recipient of our designated entity benefits is an entity that uses its licenses to directly provide facilities-based telecommunications services for the benefit of the public; that the Commission employs methods to prevent unjust enrichment; and that our statutory-based benefits are awarded only to those that Congress intended to receive them.

27. Spectrum manager and *de facto* transfer leasing agreements and resale agreements (including wholesale arrangements) with a single entity for 25 percent and less of the designated entity licensee's total spectrum capacity on a license-by-license basis, or cumulative agreements with multiple entities for 50 percent or less of a designated entity licensee's total spectrum capacity on a license-by-license basis will continue to be reviewed under our existing designated entity eligibility rules and, pursuant to existing rules and policies, may result in unjust enrichment obligations.⁸⁴ Through the decisions we make today, we will ensure that a designated entity licensee will preserve at least half of its spectrum capacity of each of its licenses for which it has been awarded and retained designated entity benefits for the provision of service as a facilities-based provider for the benefit of the public, while still having flexibility to engage in agreements that are intended to provide it with access to valuable capital, thus better furthering the goals of the statutory designated entity program.

28. *Grandfathering and Applicability of Material Relationships.* Recognizing that there are numerous agreements in existence that might fall within our newly defined "impermissible material relationships" and "attributable material relationship," we will apply these eligibility restrictions on a prospective basis. Therefore, we will not employ our new restrictions to reconsider any designated entity benefits previously awarded to licensees prior to the release date of this *Second Report and Order* or to determine designated entity benefits in an application for a license, an authorization, or an assignment or transfer of control or a spectrum lease that was filed with the Commission before the release date of this *Second Report and Order* that is still pending approval. Accordingly, we will grandfather the existence of impermissible and attributable material relationships that were in existence before the release date of this *Second Report and Order* for the purposes of assessing unjust enrichment payments on benefits previously awarded or pending award, as discussed above. In assessing the imposition of unjust enrichment for future events, if any, we will consider unjust enrichment implications on a license-by-license basis.

29. Such relationships, are not, however, generally grandfathered for the purposes of determining an applicant's eligibility for the award of designated entity benefits in future auctions or for the purposes of determining eligibility for benefits in the context of an assignment, transfer of control, spectrum lease or reportable eligibility event after the release date of this *Second Report and Order*. Except as limited by our grandfathering provisions, the rules we adopt today will apply to all determinations of eligibility for all designated entity benefits with regard to any application filed to participate in auctions in which bidding begins after the effective date of the rules, as well as to all applications for an authorization, an assignment or transfer of control, a spectrum lease, or reports of events affecting a designated entity's ongoing eligibility filed on or after the release date of this *Second Report and Order*.⁸⁵ Grandfathering the eligibility of all prior designated entity structures that involve

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installment payment unjust enrichment pursuant to section 1.2111(c). See 47 C.F.R. §§ 1.2110, 1.2111, 24.709, 24.839.

⁸⁴ See *Secondary Markets Second Report and Order*, 19 FCC Rcd at 17538, 17541, 17544 ¶¶ 71, 76, 82.

⁸⁵ For example, if an applicant seeking to participate in an upcoming auction has an existing impermissible material relationship on a single license, it will be ineligible for the award of designated entity benefits in that auction, regardless of the significance of that one license in terms of the applicant's revenue or the scope of its operations. This is true even if the impermissible material relationship was entered into prior to the release of this order and thus grandfathered for purposes of unjust enrichment. Similarly, if it is an attributable material relationship at issue, then

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impermissible and/or attributable material relationships would allow these designated entities to continue to acquire additional licenses and designated entity benefits using a structure that the Commission has determined would permit a third party to leverage improper influence over a designated entity in a manner that is inconsistent with the Congressional purposes for the designated entity program. Applying our rules in this manner is consistent with how the Commission currently determines an applicant's eligibility for designated entity benefits and how it applies its unjust enrichment obligations.

30. To address concerns of several commenters, we will, however, grandfather certain relationships that were in existence before the release date of this *Second Report and Order* in the context of eligibility for future benefits. Specifically, an applicant will not be considered to be ineligible for benefits based solely on an "attributable material relationship" or "impermissible material relationships" of certain of its affiliates (as specifically defined in section 1.2110(c)(5)(i)(C)), provided that the agreement that forms the basis of the affiliate's "attributable material relationship" or "impermissible material relationship" is otherwise in compliance with the Commission's designated entity eligibility rules, was entered into prior to the release date of this *Second Report and Order*, and is subject to a contractual prohibition that prevents the affiliate from contributing to the designated entity's total financing. The purpose of this grandfathering is to provide a means for controlling interests of existing designated entities to have an ability to seek the award of designated entity benefits in future auctions or to acquire designated entity licenses in the secondary market through new and independent affiliates, even if it is affiliated with an existing designated entity that has impermissible and/or attributable material relationships that were in existence prior to the release date of the decision.⁸⁶ The attribution rules are not affected by this grandfathering.⁸⁷ In taking this action, we seek to ensure that the additional eligibility requirements we adopt today do not unnecessarily restrict applicants seeking designated entity benefits for relationships that were previously permissible under our rules.

C. Unjust Enrichment

31. We also make changes to our unjust enrichment rules to provide additional safeguards designed to better ensure that designated entity benefits go to their intended beneficiaries.⁸⁸ As discussed below, one of our primary objectives in administering our designated entity program is to prevent unjust enrichment.⁸⁹ Accordingly, in conjunction with the eligibility restrictions we adopt above, we also modify our rules and strengthen our unjust enrichment schedule for licenses acquired with bidding credits.

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the gross revenues of the entity with which the applicant has such a relationship are counted against the applicant and may affect its eligibility.

⁸⁶ For example, Newco is an applicant seeking designated entity status in an auction in which bidding begins after the effective date of the rules. Investor is a controlling interest of Newco. Investor also is a controlling interest of Existing DE. Existing DE previously was awarded designated entity benefits and has impermissible material relationships based on leasing agreements entered into before the release date of this order with a third party, Lessee, that were in compliance with the Commission's eligibility standards prior to the effective date of the rules adopted herein. In this example, Newco would not be prohibited from acquiring designated entity benefits solely because of the existing impermissible material relationships of its affiliate, Existing DE. Newco, Investor, and Existing DE, however, would need to enter into a contractual prohibition that prevents Existing DE from contributing to the total financing of Newco.

⁸⁷ See 47 C.F.R. § 1.2110(b). Under the example in the preceding note, Newco would have to attribute the gross revenues of its affiliate, Existing DE, in establishing eligibility for designated entity benefits, but would not have to attribute the gross revenue of Lessee.

⁸⁸ See *id.* § 1.2111(b)-(e).

⁸⁹ See 47 U.S.C. § 309(j)(4)(E); see also *id.* § 309(j)(3)(C).

32. *Further Notice.* In the *Further Notice*, we sought comment on whether we should adopt revisions to our unjust enrichment rules, as proposed by Council Tree,⁹⁰ or whether we should adopt other revisions to our unjust enrichment rules.⁹¹ The Commission also asked whether reimbursement obligations should apply if a licensee takes on new investment, or also where it enters into any new financial or operational relationship that would render the licensee ineligible for a bidding credit.⁹² Pursuant to any eligibility restriction that we might adopt, we asked over what portion of the license term such unjust enrichment provisions should apply.⁹³

33. Additionally, we sought comment in the *Further Notice* on Council Tree's proposal that an unjust enrichment payment should not be required in the case of "natural growth" of the revenues attributed to an incumbent carrier above the established benchmark.⁹⁴ Instead, Council Tree suggests that the reimbursement obligation should apply only where the licensee takes on new investment, or enters into any operational agreement, that would have disqualified the licensee for the bidding credit at the time of the licensee's initial application.⁹⁵

34. *Comments.* Of the commenters discussing proposed changes in the unjust enrichment policies, some contend that the Commission should continue to apply the current unjust enrichment standard.⁹⁶ These entities argue that the current unjust enrichment rules are sufficient and provide adequate protection. Thus, they conclude that no increased regulation is needed or appropriate.⁹⁷

35. Other commenters argue for the implementation of stricter unjust enrichment rules.⁹⁸ STX supports "stricter unjust enrichment rules so that the U.S. Treasury may be made whole in the event that a designated entity turns out to have been merely a front organized to secure bidding credits for a large incumbent wireless service provider."⁹⁹ MMTC suggests that the Commission should consider adjusting its reimbursement obligations to require 100 percent of the value of the bidding credit.¹⁰⁰ MMTC further suggests that "the Commission should consider expanding the unjust enrichment standard to encompass the entire license term and not just the first five years."¹⁰¹

36. *Discussion.* We agree with MMTC and STX that adoption of stricter unjust enrichment rules, applicable to all designated entities, will promote the objectives of the designated entity program. The designated entity and unjust enrichment rules were adopted to ensure the creation of new

⁹⁰ Council Tree suggested a reimbursement obligation on a licensee that acquires a license with a bidding credit and subsequently, in the first five years of its license term, makes a change in its "material relationships" that would result in its loss of eligibility for the bidding credit, or seeks to assign or transfer control of the license to an entity that would not qualify for the same level of bidding credits, pursuant to any eligibility restriction that we adopt. *Further Notice*, 21 FCC Rcd at 1763 ¶ 20; Council Tree Proposal at 15.

⁹¹ *Further Notice*, 21 FCC Rcd at 1763 ¶ 20.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*; Council Tree Proposal at 16.

⁹⁶ See, e.g., Comments of Aloha Partners at 5; Comments of Carroll Wireless at 8; Comments of Wirefree Partners at 14-15; Comments of Council Tree at 59.

⁹⁷ See, e.g., Comments of Aloha at 5; Comments of Carroll Wireless at 8.

⁹⁸ See, e.g., Comments of STX at 2; Comments of U.S. Wirefree at 4; Comments of MMTC at 15; Comments of Council Tree at 15-16.

⁹⁹ Comments of STX at 2.

¹⁰⁰ Comments of MMTC at 15.

¹⁰¹ *Id.*

telecommunications businesses owned by small businesses that will continue to provide spectrum-based services.¹⁰² In addition, the unjust enrichment rules provide a deterrent to speculation and participation in the licensing process by those who do not intend to offer service to the public, or who intend to use bidding credits to obtain a license at a discount and later to sell it at the full market price for a windfall profit.¹⁰³ By extending the unjust enrichment period to ten years, we increase the probability that the designated entity will develop to be a competitive facilities-based service provider.

37. We adopt the following ten-year unjust enrichment schedule for licenses acquired with bidding credits. For the first five years of the license term, if a designated entity loses its eligibility for a bidding credit for any reason,¹⁰⁴ including but not limited to, entering into an “impermissible material relationship” or an “attributable material relationship,” seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that does not qualify for bidding credits, 100 percent of the bidding credit, plus interest, is owed. For years six and seven of the license term, 75 percent of the bidding credit, plus interest, is owed. For years eight and nine, 50 percent of the bidding credit, plus interest, is owed, and for year ten, 25 percent of the bidding credit, plus interest, is owed. If a designated entity loses its eligibility for the same level of bidding credit that it originally received for any reason,¹⁰⁵ including but not limited to, entering into an “impermissible material relationship” or an “attributable material relationship,” seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that does not qualify for the same level of bidding credits, this unjust enrichment schedule will be applied to the difference between the original bidding credit and the bidding credit for which the designated entity, assignee, or assignor is eligible.¹⁰⁶

38. In addition to revising the unjust enrichment payment schedule, we will impose a requirement that the Commission must be reimbursed for the entire bidding credit amount owed, plus interest, if a designated entity loses its eligibility for a bidding credit for any reason,¹⁰⁷ including but not limited to, entering into an “impermissible material relationship” or an “attributable material relationship,” seeking to assign or transfer control of a license, or entering into a *de facto* transfer lease with an entity that is not eligible for bidding credits prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the license term have been met.¹⁰⁸ For example, if a designated entity seeks to assign a license with a bidding credit to an entity that is not

¹⁰² *Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2394 ¶ 258.

¹⁰³ *Id.* at 2385, 2394 ¶¶ 211, 259. See also H.R. REP. NO. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. CONF. REP. NO. 103-213, at 483 (1993)); *Secondary Markets Second Report and Order*, 19 FCC Rcd at 17538 ¶ 71.

¹⁰⁴ See discussion *infra* note 116 and accompanying text.

¹⁰⁵ See discussion *infra* note 116 and accompanying text.

¹⁰⁶ We also note that the provisions of section 1.2112(e) of the Commission’s rules may also apply. 47 C.F.R. § 1.2112(e) (discussing the assessment of unjust enrichment in the context of the partition and/or disaggregation of licenses).

¹⁰⁷ See *id.*

¹⁰⁸ Licensees may, under section 1.946(e) of our rules, request an extension of time to meet the applicable construction requirements. 47 C.F.R. § 1.946(e). Additionally, licensees may also request a waiver of the construction requirement, and this request must meet the requirements of section 1.925 of our rules. 47 C.F.R. § 1.925. We note that we will undertake careful scrutiny of requests for extension of the construction requirements filed by designated entities consistent with our rules, obligations under the Communications Act, and legal precedent, and that we will consider, as part of our review, whether the extension request is an effort to defeat the objectives of our designated entity program. If a designated entity is successful in obtaining an extension of the construction requirements beyond the initial license term, the requirement that the Commission must be reimbursed for the entire bidding credit amount, plus interest, prior to the filing of the notification informing the Commission that the applicable construction requirements will continue to apply until such notifications are filed.

eligible for bidding credits eight years after the grant of the license and prior to the filing of the construction notification, 100 percent of the bidding credit, plus interest, will be owed, rather than the 50 percent unjust enrichment payment that would have been due had the construction notification been on file with the Commission, pursuant to the revised unjust enrichment schedule, above.

39. We impose the above-mentioned reimbursement obligations on any licensee that acquires licenses with bidding credits and subsequently loses its eligibility for a bidding credit for any reason because the implementation of such a policy is consistent with the policies underlying the Commission's designated entity and unjust enrichment requirements. By expanding the unjust enrichment period and requiring full payment of the bidding credit until a license has been constructed, we are fulfilling Congress's mandate that designated entities are given the opportunity to participate in the provision of spectrum-based services, while ensuring that entities that are not eligible for designated entity benefits cannot benefit from the designated entity program by acquiring the licenses or entering into impermissible or attributable material relationships with a designated entity after it acquires a license at auction or in the secondary market.¹⁰⁹

40. We agree with Council Tree's proposal that unjust enrichment payments should not be required for licenses held by the designated entity in the case of "natural" or "permissible" growth of the gross revenues of either a designated entity or an investor in a designated entity. Currently, there are no permissible growth provisions associated with bidding credits.¹¹⁰ However, Commission practice has been that a designated entity will not owe unjust enrichment for its licenses if the designated entity's increased gross revenues, or the increased gross revenues of any controlling interest or affiliate, are due to nonattributable equity investments, debt financing, revenue from operations or other investments, business development, or expanded service.¹¹¹ Commission precedent states that the Commission evaluates an applicant's or licensee's eligibility for designated entity benefits and determines whether unjust enrichment is owed at the time the relevant application or notification (e.g., transfer of control or assignment) is filed.¹¹² Under the policies adopted in this *Second Report and Order*, the Commission similarly would evaluate an applicant's or licensee's eligibility for designated entity benefit at the time it files an application regarding a reportable eligibility event, as required in the new section 1.2114 that we adopt herein. Thus, if the designated entity seeks to acquire licenses on the secondary market or in future auctions, all of the designated entity's gross revenues, along with the gross revenues of its controlling interests and affiliates, will be attributed to the designated entity.¹¹³

¹⁰⁹ See 47 U.S.C § 309(j)(4)(E); see also *id.* § 309(j)(3)(C).

¹¹⁰ We note that, although the Commission did not adopt a permissible growth exception for bidding credit unjust enrichment, it did adopt a permissible growth exception for set-aside, or closed bidding, licenses and installment payments. Compare 47 C.F.R. § 1.2111(d) with *id.* §§ 1.2111(c)(2), and *id.* § 24.709(a)(2).

¹¹¹ Cf. 47 C.F.R. § 1.2111(c)(2) (establishing that "permissible growth" does not result in unjust enrichment in the context of installment payments); *id.* § 24.709(a)(2) (establishing that permissible growth does not result in the loss of eligibility to hold set-aside, or closed bidding, licenses).

¹¹² See Applications of TeleCorp PCS, Inc., Tritel, Inc, and Indus, Inc., WT Docket No. 00-1589, *Memorandum Opinion and Order*, 16 FCC Rcd 3716, 3737 ¶ 49 (Wireless Tele. Bur. 2000) ("*TeleCorp-Tritel Order*"); D&E Communications, Inc., *Order*, 15 FCC Rcd 61, 67 ¶ 12 (Auctions & Ind. Analysis Div., Wireless Tele. Bur. 1999) ("*D&E Communications*").

¹¹³ See Amendment of Commission's Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licenses, WT Docket No. 97-8200-1589, *Memorandum Opinion and Order*, 14 FCC Rcd 20543, 20545-46 ¶¶ 6-8 (1999); see also *TeleCorp-Tritel Order*, 16 FCC Rcd at 3734 ¶ 46; *D&E Communications*, 15 FCC Rcd at 67 ¶ 12.

41. Finally, we agree with Cook Inlet's general concern that retroactive penalties not be imposed upon pre-existing designated entities. Thus, as discussed fully above, we grandfather the applicability of these rules under certain circumstances.¹¹⁴

D. Implementation

42. In this section, we explain how we intend to utilize the tools for preventing abuse of the designated entity program that are already at our disposal in our rules, and we describe certain minor rule modifications that we adopt in order to make these tools more effective. To achieve this purpose, we will use the following combination of existing and new measures to ensure that designated entity incentives benefit solely those parties intended to receive them under both our rules and section 309(j) of the Communications Act of 1934, as amended ("Communications Act"). First, we will review the agreements to which designated entity applicants and licensees are parties. Second, we will require that applicants and licensees seek advance Commission approval for all events that might affect their ongoing eligibility for designated entity benefits. Third, we will impose periodic reporting requirements on designated entities. Fourth, we will conduct audits, including random audits, of those claiming designated entity benefits. In this section we also provide guidance as to how our rules and procedures should be followed by applicants for the upcoming Advanced Wireless Services ("AWS") auction.

43. *Review of Agreements.* In applying our controlling interest standard, Commission staff has carefully reviewed agreements between applicants claiming designated entity status and other existing wireless carriers. In these cases, staff has usually undertaken discussions with such designated entity applicants in order to obtain revisions to agreements to ensure that entities with whom they have partnered are not an attributable controlling interest or affiliate obviating the applicant's eligibility for designated entity benefits. This review is necessarily specific to each relationship, since no two sets of agreements and no two sets of factual circumstances are exactly the same.

44. In light of the steps we are taking in this *Second Report and Order* to aid our ability to ensure that only eligible entities obtain designated entity benefits, we will undertake a thorough review of the long-form application (FCC Form 601) filed by every winning bidder claiming designated entity benefits and will carefully review all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant. This review remains essential to our assessment of designated entity eligibility under the controlling interest standard and will be even more critical in ensuring that the rules and policies adopted in this *Second Report and Order* are fully effectuated. Thus, we will require that all designated entity applicants that are winning bidders at an auction file all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant as part of the long-form application (FCC Form 601). In order to implement this rule, we delegate to the Bureau the authority to determine the method for designated entities to submit the appropriate and relevant documents. We note, however, that no licenses will be granted until all relevant contracts, agreements, letters of intent, and other such documents affecting that applicant are finalized.

45. Further, we will also thoroughly review all relevant contracts, agreements, letters of intent, and other such documents affecting an applicant, which claims designated entity eligibility, seeking to acquire licenses with designated entity benefits in the secondary market (e.g., transfers of control, assignments, spectrum manager leases). Commission staff has requested such documents from entities acquiring designated entity licenses in the secondary market, especially when the applicant is a newly-created entity that has not been passed on as a designated entity in the past or where it appears that the corporate structure of a designated entity has changed. Thus, we will, as we have in the past, request designated entity applicants to forward copies of their agreements to Commission staff for review.

¹¹⁴ See discussion *supra* ¶¶ 28-30 (discussing the grandfathering of impermissible and attributable material relationships that were in existence before the release date of this *Second Report and Order* for the purposes of assessing unjust enrichment penalties on benefits previously awarded).

46. *Event-Based and Annual Reporting Requirements.* In light of the changes that we are making to the designated entity rules, the Commission will require additional information from applicants and licensees in order to ensure compliance with the policies and rules adopted herein. We also hereby adopt rules as shown in Appendix B, authorizing modifications to be made, as necessary, to and the creation, if necessary, of FCC forms to implement the rule changes adopted herein. Although many of these rule changes are minor, we highlight the following changes to our rules. Specifically, we adopt a new rule, section 1.2114, to require that designated entities seek approval¹¹⁵ for any event in which they are involved that might affect their ongoing eligibility,¹¹⁶ even if the event would not have triggered a reporting requirement under our rules.¹¹⁷ Such events – known as “reportable eligibility events” – will also include those that result in an “impermissible material relationship” or an “attributable material relationship.” We note that applications seeking approval of these “reportable eligibility events” will be considered substantial (*i.e.*, not *pro forma*) pursuant to the Commission’s rules or precedent and will not be approved until any applicable unjust enrichment is paid.

47. Additionally, we will revise section 1.2110 of the Commission’s rule to require designated entity licensees to file an annual report with the Commission, which will, at a minimum, include a list and summaries of all agreements and arrangements (including proposed agreements and arrangements) that relate to eligibility for designated entity benefits. In addition to a summary of each agreement or arrangement, this list must include the parties (including affiliates, controlling interests, and affiliates of controlling interests) to each agreement or arrangement, as well as the dates on which the parties entered into each agreement or arrangement. Annual reports will be filed no later than, and up to five business days before, the anniversary of the designated entity’s license grant.¹¹⁸

48. We consider adoption of these reporting requirements to be a foreseeable component of the designated entity eligibility rules we adopt today, and we believe them to be necessary to the successful implementation of these rules. We also consider these requirements to be an extension of the existing responsibility of designated entities to retain and make available, on an ongoing basis, all agreements related to their eligibility.¹¹⁹ Furthermore, we delegate to the Bureau the authority to implement the necessary modifications to FCC forms and the Universal Licensing System (ULS) to implement these rule changes and to determine the content of, and filing procedures for, the new annual filing requirement.

49. *Audits.* Pursuant to our existing rules, the Commission has broad power to conduct audits at any time and for any reason, including at random, of applicants and licensees claiming designated entity benefits.¹²⁰ In its comments, MMTC urges the Commission to employ its existing audit power and

¹¹⁵ Obtaining prior approval for events that could possible effect an entity’s designated entity eligibility is consistent with our practices for reviewing applications for the assignment or transfer of control of designated entity licenses. See 47 C.F.R. § 1.948(c)(1)(i).

¹¹⁶ Such events include changes in the ownership structure of the designated entity and agreements (*e.g.*, management, credit, trademark, marketing, and facilities agreements) entered into between designated entity licensees and third parties that the Commission has not previously reviewed. New section 1.2114(c) provides that such filings will be treated as if they are transfer of control applications under section 1.1102 for purposes of determining the appropriate application fees.

¹¹⁷ 47 C.F.R. § 1.948(j).

¹¹⁸ The record supports such an approach. See, *e.g.* Comments of Cook Inlet at 21 (suggesting that the Commission require each designated entity to submit an annual report detailing the actions it took during the past period with respect to the licenses it holds as well as any actions taken by its limited financial partners. It believes that the Commission would have some empirical evidence of the degree of day-to-day control actually exercised by the parties who purport to be in *de facto* control of these designated entity licensees).

¹¹⁹ See 47 C.F.R. § 1.2110(j).

¹²⁰ See *id.* § 1.2110(j), (n).

regularly conduct random audits to “uncover manipulation of the [designated entity] program irrespective of the type of business in which a [designated entity] applicant’s partner is engaged.”¹²¹ MMTC recommends that these audits “incorporate site visits to offices and physical plants, interviews with staff and meaningful inquiries into the management of the licenses,” explaining that these efforts would be “more likely to yield discoveries of improper activity than cursory paper-base[d] audits which would allow the audited entity to craft creative responses to audit requests.”¹²² Cook Inlet, in suggesting the imposition of periodic reporting requirements, noted above, explains that such requirements, along with “the possibility of a further audit[,] might dissuade some abuse of the Commission’s rules. . . .”¹²³

50. We agree that our audit authority is an effective method by which to ascertain the initial and ongoing eligibility of the claimants of designated entity benefits. Applicants and licensees should therefore understand that the Commission can and will audit their continued designated entity eligibility as circumstances may necessitate or at will. Moreover, based on the significance of the upcoming AWS auction, we commit to audit the eligibility of every designated entity that wins a license in that auction at least once during the initial license term. In order to effectively conduct these audits, we delegate to the Bureau the authority to implement and create procedures to perform such audits.

51. *Pending Auction Provisions.* As noted in the *Further Notice*, we intend any changes adopted in this proceeding to apply to AWS licenses currently scheduled to be offered in an auction beginning June 29, 2006.¹²⁴ We noted that in light of the current auction schedule, any changes that we adopt in this proceeding may become effective after the deadline for filing applications to participate in that auction. We sought comment on our proposal to require applicants to amend their applications on or after the effective date of the rule changes with a statement declaring, under penalty of perjury, that the applicant is qualified as a designated entity pursuant to section 1.2110 of the Commission’s rules effective as of the date of the statement.¹²⁵ We also noted that in the event applicants fail to file such a statement pursuant to procedures announced by public notice, they will be ineligible to qualify as a designated entity.¹²⁶

52. The vast majority of commenters did not address this issue.¹²⁷ Under Commission rules, applicants asserting designated entity eligibility in a Commission auction are required to declare, under penalty of perjury, that they are qualified as a designated entity under section 1.2110 of the Commission’s

¹²¹ Comments of MMTC at 13-14.

¹²² *Id.* at 14.

¹²³ Comments of Cook Inlet at 21.

¹²⁴ Auction of Advanced Wireless Services Licenses Scheduled for June 29, 2006, Comment Sought on Reserve Prices or Minimum Opening Bids and Other Procedures, AU Docket No. 06-30, *Public Notice*, 21 FCC Rcd 794 (2006).

¹²⁵ *Cf.* 47 C.F.R. 1.2105(a)(2)(iv) (parallel statement currently required as of the date of filing the short-form application). Pursuant to its delegated authority to conduct auctions, the Wireless Telecommunications Bureau will establish any detailed procedures necessary for making required amendments and announce such procedures by public notice. *See id.* §§ 0.131, 0.331.

¹²⁶ As noted in the *Further Notice*, while prior certifications may be a prerequisite to eligibility, applicants still must demonstrate compliance with all applicable Commission rules, including eligibility for any bidding credits, at the time the Commission is ready to grant a license, regardless of previously applicable rules. *See Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission’s Competitive Bidding Rules and Procedures, Report and Order*, 21 FCC Rcd 891, 909 n.84 (2006); *see also Celtronix Telemetry, Inc. v. FCC*, 272 F.3d 585, 587 (D.C. Cir. 2001), *cert. denied*, 536 U.S. 923 (2002) (affirming Commission application of installment payment rules that were revised after initial grant of license).

¹²⁷ While CTIA expresses some concern regarding the amendment of short form applications, the public interest benefits associated with requiring entities to amend their applications and certify that they are qualified as a designated entity pursuant to our modified rules, outweigh any concerns raised in the record.

rules.¹²⁸ After reviewing the record and considering the public interest benefits associated with our proposal, we will require entities applying as designated entities to amend their applications for the AWS auction on or after the effective date of the rule changes with a statement declaring, under penalty of perjury, that the applicant is qualified as a designated entity pursuant to section 1.2110 of the Commission's rules effective as of the date of the statement.

IV. SECOND FURTHER NOTICE OF PROPOSED RULE MAKING

53. As noted above, in reviewing the record in this proceeding, including the requests of various parties to conduct a further inquiry,¹²⁹ we issue this *Second Further Notice* to consider whether we should modify further our general competitive bidding rules¹³⁰ governing benefits reserved for designated entities.¹³¹

54. Specifically, we seek further guidance on whether the Commission should implement additional safeguards beyond those we adopt today to ensure that our designated entity benefits are awarded to the entities and for the purposes intended by Congress. Additionally, we are seeking comment to obtain additional economic evidence regarding how and under what circumstances an entity's size might affect its relationships and agreements with designated entity applicants and licensees. As discussed fully below, we therefore seek further comment on whether we should adopt additional rule changes that would restrict the award of designated entity benefits under certain circumstances and in connection with relationships with certain entities.

A. Defining the Class

55. *Further Notice.* In the *Further Notice*, we sought comment on Council Tree's suggestion for defining the elements of an eligibility restriction to apply to those that Council Tree referred to as "large in region incumbent wireless providers" that had "average gross wireless revenues"¹³² for the preceding three years exceeding \$5 billion. We sought comment on this proposed benchmark and whether it was a useful element for consideration if we adopt our tentative conclusion to modify our Part 1 rules to include additional restrictions on the availability of designated entity benefits. We asked whether \$5 billion was an appropriate level at which to set the benchmark to define those with whom a designated entity applicant's material relationships would trigger a restriction on the award of benefits. In contemplating this proposal, we sought comment on whether we should consider "gross wireless revenues" as suggested by Council Tree or instead whether we should generally consider "gross revenues" as defined in section 1.2110(n) of the Commission's rules.¹³³

56. The *Further Notice* also sought comment on whether we should instead apply the restriction to the award of designated entity benefits where an applicant had a material relationship with "entities with significant interests in communications services" in order to extend the scope of such a restriction to a broader category of businesses such as voice or data providers, content providers, equipment manufacturers, other media interests, and/or facilities or non-facilities based communications services providers. We sought comment on whether all of these entities should be included as part of our definition of "entities with significant interests in communications services" or whether we should consider excluding some of these entities from our proposed definition. We also sought comment on whether we should consider including other entities as part of our proposed definition.

¹²⁸ See 47 C.F.R. § 1.2105(a)(2)(iv).

¹²⁹ See, e.g., Comments of NHMC at 17-18; Reply Comments of Consumers Union at 1-2.

¹³⁰ See 47 C.F.R. § 1.2101 *et seq.*

¹³¹ See *supra* note 8 (discussing the Commission's designated entity benefits).

¹³² Council Tree's proposal does not include a definition of "average gross wireless revenues."

¹³³ 47 C.F.R. § 1.2110(n).

57. *Comments.* Commenters were generally divided regarding how the Commission should define this particular element of its rule modification. Those commenters who supported the proposal in the *Further Notice* to define the class to include “large incumbent wireless service providers” were divided on the thresholds that we should consider. Some commenters advocated defining the term “large” in accordance with financial thresholds,¹³⁴ while others supported a threshold based on subscription levels.¹³⁵ Some commenters who supported using financial thresholds advocated a restriction based upon average gross revenues for the preceding three years exceeding \$5 billion.¹³⁶ One commenter believed that the threshold should be \$1 billion.¹³⁷ Commenters were split on whether we should consider “gross wireless revenues” or generally consider “gross revenues” as defined in section 1.2110(n) of the Commission’s rules.¹³⁸ Commenters that opposed the use of a \$5 billion revenue threshold believed that this threshold was arbitrary, with no factual or public interest basis.¹³⁹

58. Several commenters argued that if the Commission adopted any additional eligibility restrictions, it should extend the scope of the prohibition beyond “large incumbent wireless service providers.” For example, T-Mobile argued that no justification exists for excluding large, multinational conglomerates from the prohibition. It suggested that if the Commission’s goal is to ensure small business bidders are actually small businesses, excluding large corporations defeats the proposed designated entity rule reform.¹⁴⁰ Similarly, Verizon Wireless asserted that prohibiting partnerships with large, incumbent wireless service providers, but not other wireless carriers or companies, will not impact the legitimacy of a designated entity or fulfill the Commission’s goals. If the Commission opts to impose restrictions on designated entities, Verizon Wireless stated the proposed changes should affect all designated entities and all of the designated entity’s partners.¹⁴¹ In addition, USCC suggested that the same adverse effects that can occur in designated entity relationships with national incumbent wireless service providers can also occur with the nation’s largest voice and data providers, content providers, media interests, equipment manufacturers and facilities based and non-facilities based communication services providers.¹⁴²

59. *Second Further Notice.* We acknowledge that voice, data, and video services are converging and are being offered as bundled service packages. These bundled service offerings may include wireline, wireless, cable and or DBS services along with the required equipment such as handsets and receivers. In light of the continuing dynamic technological developments and convergence occurring in the communications marketplace, we seek comment on the appropriate class of entity, if any, that should trigger to trigger any additional restriction we may adopt regarding relationships with designated

¹³⁴ See, e.g., Comments of Council Tree at 33; Comments of Leap at 15; Comments of MetroPCS at 9.

¹³⁵ See, e.g., Comments of MMTTC at 9.

¹³⁶ See, e.g., Comments of Council Tree at 33; Comments of Leap at 15; Comments of MetroPCS at 9. These commenters believe that this threshold is an objective measure to address carriers with operations that can be characterized as national in scope and scale, and that designated entities who partner with companies meeting this threshold are the least likely to provide services that compete with the service provided by these large companies.

¹³⁷ See, e.g., Comments of Centennial at 6.

¹³⁸ See, e.g., Comments of Council Tree at 33-34; Comments of USCC at 10 (advocating the use of gross wireless revenues).

¹³⁹ See, e.g., Comments of CTIA at 3, 5, 11; Comments of T-Mobile at 9; Comments of Verizon Wireless at 19-20 (“If the Commission wished to set a threshold for strategic investment in designated entities, it should set the standard at the level it adopted for the Entrepreneurs Block, which is \$125 million in revenues measured over two preceding years.”).

¹⁴⁰ Comments of T-Mobile at 8.

¹⁴¹ Comments of Verizon Wireless at 4-6.

¹⁴² Comments of USCC at 11-13.

entities. For instance, would the Commission be better positioned to achieve its statutory mandates if it defined such an entity to include one that is subject to the Commission's jurisdiction under Titles I, II, III, or VI of the Communications Act, including any of the entity's controlling interests or affiliates as those terms are defined in section 1.2110 of the Commission's rules (herein after "attributable communications entity"). Insofar as this definition captures a varied class of potential partners, including not only entities that have CMRS spectrum, but also wireline, broadcast, cable, satellite, and VoIP providers, would restricting certain relationships between designated entities and such a class better safeguard the award of designated entity benefits?

60. We seek comment on whether adopting a definition of a class of entities with whom a designated entity's agreements might trigger additional restrictions for designated entity benefits will better ensure that the Commission can continue to award such benefits to entities that Congress intended. Does one class of entities have a greater incentive and/or ability than another to attempt to acquire licenses at below market prices by using agreements with a designated entity?

61. We also seek comment on the financial threshold that we should consider in defining the appropriate class of entity that would trigger an eligibility restriction. As noted above, commenters were divided on the appropriate financial threshold. We seek further comment on the proposed financial benchmarks raised by the commenters. Should we consider a financial threshold of \$5 billion in annual gross revenues as advocated by various parties or lower thresholds such as \$1 billion or \$125 million as suggested by other commenters? Is the entity's size in terms of either its gross revenues or some other benchmark relevant to its incentive and/or ability to enter into agreements with a designated entity in a manner designed to gain access to benefits it is otherwise not eligible to obtain? We also seek comment on whether an entity's size is relevant to its incentive and/or ability to influence the designated entity with respect to the type and scope of the service it might provide as well as relevant economic analysis to support such arguments.

62. Similarly, we seek comment on whether we should define a class of entities based on its particular spectrum interests, for instance those that have licenses for "commercial mobile radio services spectrum" ("CMRS spectrum"). If we were to define a class in this manner, should we define CMRS spectrum to include "any spectrum for which the service specific rules permit the provision of commercial mobile radio services" as that term is defined in section 20.9 of the Commission's rules?¹⁴³ We also seek comment on whether an entity's existing spectrum interests are relevant to the likelihood of it seeking to influence the designated entity with respect to the type and scope of the service it might provide as well as relevant economic analysis to support such arguments. If we determine to base any additional safeguards upon an entity's particular spectrum interests, should we consider including spectrum other than CMRS spectrum for the purposes of such restrictions? If so, what spectrum and why is it more or less relevant than other types of spectrum?

B. In-Region Limitation for Class of Entities

63. *Further Notice.* In the *Further Notice*, we sought comment on whether geographic overlap should be an element in establishing any additional restriction on the availability of designated entity benefits for entities that have a "material relationship"¹⁴⁴ with a large wireless service provider. We also sought comment on whether we should apply a different, or any, geographic standard if we extend the restriction on designated entity benefits to applicants that have material relationships with "entities with significant interests in communications services." In addition, we asked whether we should apply the standard set forth in the former spectrum aggregation rule to define the geographic overlap,¹⁴⁵ as

¹⁴³ 47 C.F.R. § 20.9.

¹⁴⁴ Letter from Messrs. Steve C. Hillard and George T. Laub, Council Tree Communications, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission, WT Docket Nos. 02-353, 04-356, RM-10956 (June 13, 2005) (Council Tree *ex parte*).

¹⁴⁵ 47 C.F.R. ¶ 20.6(c) (sunset January 1, 2003).

proposed by Council Tree, or if we should adopt a different definition of geographic overlap. Further, we sought comment on how the Commission should implement such a restriction if we determined that a significant geographic overlap did exist. We asked whether an incumbent should be allowed to divest its interest in the subject service area to allow a designated entity applicant to maintain eligibility for a bidding credit, and if so, within what time period should we require the divestiture. We also sought comment on whether the application of the standard set forth in Section 20.6(c) of the Commission's rules or any other geographic overlap restriction would place an undue administrative burden on the Commission, making it difficult to monitor an applicant's compliance with any adopted geographic overlap restriction.¹⁴⁶

64. *Comments.* In response to the *Further Notice*, the Commission received comments both in support of and against an in-region element to any further designated entity restrictions. Some commenters agree that geographic overlap should be an element in establishing any additional restriction on the availability of designated entity benefits.¹⁴⁷ Generally, the proponents of a geographic overlap element state that any additional restriction should address the dominance of service providers in their existing service regions.¹⁴⁸ They argue that Commission regulations designed to promote competition and diversity have generally included geographic components.¹⁴⁹ They further argue that such an in-region component is necessary because designated entities will not compete against a large wireless provider investor in-region.¹⁵⁰ A few commenters also argue that the in-region component should be extended to include wireline carriers, because the presence of the wireline provider in region translates into the loss of a direct competitor.¹⁵¹

65. Many of these commenters suggest using the significant overlap, attributable interest, and divestiture standards from the sunset CMRS spectrum aggregation limit pursuant to section 20.6(c)(2) of the Commission's rules.¹⁵² They assert that a new rule could provide that "significant overlap of an AWS-1 licensed service area and CGSA(s) . . . or SMR or PCS service area(s) occurs when at least 10 percent of the population of the AWS-1 licensed service area for the counties contained therein, as determined by the latest decennial census figures as compiled by the Bureau of Census, is within the CGSA(s) and/or SMR and/or PCS and/or AWS-1 service area(s)."¹⁵³ Other commenters argue that the Commission cannot "simply readopt [an] old rule" without reviewing the appropriateness of the overlap definition in light of current market conditions.¹⁵⁴ Similarly, USCC suggests that using the section 20.6 standard is no longer an adequate metric for the emerging generation of mobile services that include voice, data, video and other broadband capabilities.¹⁵⁵ USCC proposes that the Commission, in defining

¹⁴⁶ *Further Notice*, 21 FCC Rcd at 1762 ¶ 18.

¹⁴⁷ See, e.g., Comments of Council Tree at 43; Comments of Leap at 6, 15-16; Comments of MMTTC at 9-10; Comments of USCC at 9; Comments of Wirefree Partners at 11; Comments of Centennial at 8-9; Comments of STX at 3; Comments of Antares at 5-6.

¹⁴⁸ See, e.g., Comments of Council Tree at 42.

¹⁴⁹ See, e.g., *id.*; Comments of NAB at 3.

¹⁵⁰ See, e.g., Comments of Council Tree at 42.

¹⁵¹ See, e.g., Reply Comments of Blooston at 5; Comments of NHMC at 12.

¹⁵² See, e.g., Comments of Council Tree at 43; Comments of MMTTC at 9-10; Comments of USCC at 9; Comments of Wirefree Partners at 11; Comments of Centennial at 8-9; Comments of STX at 3.

¹⁵³ Comments of Council Tree at 44.

¹⁵⁴ Comments of Verizon Wireless at 17 (noting that this standard was created in a different spectrum environment, one in which there were two cellular providers and 50 MHz available in each market.). See also Comments of USCC at 9.

¹⁵⁵ Comments of USCC at 9.

in-region, adopt a threshold based on the total MHz-Pops of attributable cellular, PCS, SMR and AWS spectrum held by an entity that has in-region CMRS spectrum in the relevant geographic market. Consequently, USCC asserts that an entity that has in-region CMRS spectrum would be deemed to have a "significant geographic overlap," if it has more than 30 MHz of combined cellular, PCS, SMR, and AWS holdings in the 10 percent overlap area, as defined by section 20.6(c) of the Commission's rules.¹⁵⁶

66. Other commenters state that significant overlap should not be a factor in determining eligibility for small business benefits.¹⁵⁷ For example, DOJ argues that the restriction should apply equally to any affiliate of a designated entity whether "the affiliate is a large in-region wireless provider, an out-of-region wireless provider (which includes carriers seeking to expand their coverage footprint), or entities with significant interests in other communications services."¹⁵⁸ CTIA alleges that an in-region component is discriminatory as it favors wireless, wireline and non-communications competitors over "in market" providers without any evidence of market concentration.¹⁵⁹ CTIA further argues that the in-region element is unnecessary, because most large service providers would be barred from entering into relationships with designated entities due to the 10 percent population overlap threshold proposed in the *Further Notice*.¹⁶⁰

67. Many of the opponents of an in-region component argue that consideration of significant geographic overlap is not necessary to achieving the Commission's goals.¹⁶¹ For instance, Verizon Wireless states that "restricting a designated entity's ability to partner with an incumbent, but not with other wireless carriers or companies will have no impact on whether that designated entity is legitimate or whether the Commission's objectives for small businesses are fulfilled."¹⁶² MetroPCS alleges that national carriers should be excluded by the restriction even if a designated entity, associated with a large carrier, acquired spectrum in a market where it currently holds spectrum, because the designated entity is less likely to introduce innovative products and services.¹⁶³ Another commenter argues that we should not allow large carriers to neutralize what may be the critical advantage to a new, independent entrant and that a large carrier that desires to establish an in-region presence can participate in the auction directly.¹⁶⁴ One commenter also states that an in-region component would only create a source of abuse or confusion involving the proper calculation of overlap areas.¹⁶⁵

68. *Second Further Notice.* In this *Second Further Notice*, we seek further comment on whether we should adopt an in-region component to defining relationships with any particular class or type of entity that trigger additional eligibility restrictions. We request that commenters address whether adopting an in-region component to the restriction of relationships furthers the objectives of the designated entity program. We seek comment as to whether the in-region component will ensure that licensees receiving small business benefits will be independent, facilities-based service providers. We ask commenters to discuss how the in-region element will ensure that designated entities are free from

¹⁵⁶ *Id.*

¹⁵⁷ See, e.g., Comments of MetroPCS at 10; Comments of NHMC at 3, 4; Comments of CTIA at 11-14; Comments of U.S. Wirefree at 3; Reply Comments of Consumers Union at 2-3; Comments of Verizon Wireless at 6; U.S. Department of Justice *ex parte* at 6.

¹⁵⁸ U.S. Department of Justice *ex parte* at 6.

¹⁵⁹ Comments of CTIA at 1-2.

¹⁶⁰ *Id.* at 13-14.

¹⁶¹ See, e.g., Comments of U.S. Wirefree at 3; Comments of MetroPCS at 10; Comments of Verizon Wireless at 6.

¹⁶² Comments of Verizon Wireless at 6.

¹⁶³ Comments of MetroPCS at 10.

¹⁶⁴ Comments of NMHC at 8.

¹⁶⁵ Comments of U.S. Wirefree at 3-4.

undue influence from either larger or self interested entities with whom they enter into relationships. We request that commenters discuss whether the in-region component should apply to all definitions of additional eligibility restrictions and if not, commenters should explain why the in-region component should be defined or applied differently. We also seek comment on whether all entities with in-region spectrum interests have the same ability and incentive to leverage an inappropriate level of influence over a designated entity with which it has financial and/or operational arrangements. We seek comment on how the in-region component protects this program from being subject to potential abuse from those restricted entities that might seek to craft relationships with designated entity applicants in a manner intended to serve their self interests.¹⁶⁶

69. Assuming we do adopt an in-region component to any additional eligibility restrictions, we seek comment as to whether we should find that a “geographic overlap” that triggers the in-region restriction occurs when there is *any* overlap between the licensed service areas of the entity that has in-region spectrum, with whom the designated entity applicant has a “material relationship,” or any affiliate of the entity that has in-region spectrum as defined in section 1.2110 of the Commission’s rules,¹⁶⁷ and the licensed service area to be acquired by the designated entity applicant. Should this restriction apply only to particular types of spectrum – for example, only CMRS spectrum? We also seek further discussion of how the “significant overlap” standard set forth in the former spectrum aggregation limit would apply if it were adopted.¹⁶⁸ Generally, under that provision, “significant overlap” occurred when there was an overlap of at least ten percent of the population within the affected service areas.¹⁶⁹ That significant overlap standard, however, at times was problematic to apply in particular cases, for instance, because of difficulty in determining the relevant service area.¹⁷⁰ The Commission has stated that as a general matter it is preferable to have rules for wireless spectrum that facilitate ease of compliance and administrative efficiency.¹⁷¹ Commenters addressing this issue should discuss whether reliance on the “significant overlap” test from the spectrum aggregation rule, or some variant of this test, could be crafted to facilitate ease of compliance and administrative efficiency. We also ask if the adoption of that standard would be appropriate in today’s marketplace.¹⁷² The intent of the spectrum aggregation limit at its inception was to create a competitive marketplace for CMRS as PCS licenses were being introduced. We now have a competitive wireless marketplace and any revisions to the designated entity rules that we seek

¹⁶⁶ *Secondary Markets Second Report and Order*, 19 FCC Rcd at 17538 ¶¶ 71, 72 (citing H.R. Rep. No. 103-111, at 257-58 (1993) (Conference Agreement adopted House provisions, in relevant part, with amendments. H.R. Conf. Rep. No. 103-213, at 483 (1993))).

¹⁶⁷ 47 C.F.R. § 1.2110(c)(5).

¹⁶⁸ *Id.* § 20.6(c).

¹⁶⁹ *Further Notice*, 21 FCC Rcd at 1762 ¶ 18 (citing 47 C.F.R. § 20.6(c)).

¹⁷⁰ For example, the rule used the term “PCS licensed service area” for determining the presence of “significant overlap” with other PCS, cellular or SMR service areas. 47 C.F.R. § 20.6(c)(1). PCS spectrum, however, is licensed on both an MTA and BTA basis, and licensees have further partitioned these areas into smaller geographic areas, which may be defined by pre-existing geographic boundaries (e.g., county lines) or may be defined by the parties to a partitioning application. Licensees and applicants often faced confusion in assessing significant overlap as to which “service area” – which of the originally defined geographic areas (if there was more than one) and/or the partitioned area – should be used as the denominator.

¹⁷¹ See 1998 Biennial Regulatory Review Spectrum Aggregation Limits for Wireless Telecommunications Carriers, WT Docket No. 98-205, *Report and Order*, 15 FCC Rcd 9219, 9226 ¶ 11 (1999).

¹⁷² That standard was developed in conjunction with the implementation of a 45 MHz spectrum cap, as a simplified version of the Herfindahl-Hirschman Index using spectrum capacity as the measurement of market share, to limit the amount of license spectrum capacity that any one entity could have. See Amendment of Parts 20 and 24 of the Commission’s Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap, WT Docket No. 96-59, *Report and Order*, 11 FCC Rcd 7824, 7869-70 ¶ 96 (1996).

to implement are for the purpose of ensuring that designated entity benefits do not flow to ineligible entities.

70. Further, we seek comment as to whether the adoption of an in-region component to any of any additional eligibility restrictions will be burdensome to implement. Specifically, we recognize that defining the geographic areas of the variety of services provided by certain entities will be complicated. Thus, we ask that commenters discuss how the in-region definition would take into account the different, and sometimes difficult to determine, geographic area of services provided by varying entities and how these areas of service should be compared to the Commission's wireless licensing areas.

71. *Divestiture.* Most entities responding to the *Further Notice* declined to discuss whether a restricted entity should be allowed to divest its interest in the subject service area to allow a designated entity applicant to maintain eligibility for designated entity benefits. Thus, we seek comment as to whether any class of entities on which any additional eligibility restriction is based should be allowed to divest its interest in the subject service area to allow a designated entity applicant to maintain eligibility for benefits. We also seek comment as to whether the Commission should adopt divestiture provisions similar to those found in the eliminated spectrum aggregation limit rules.¹⁷³ Moreover, we seek comment on the opinions of some commenters responding to the *Further Notice* that divestiture should not be permitted as it will "significantly complicate the auction process," lead to post-auction petitions and challenges that could delay the deployment of spectrum,¹⁷⁴ and allow restricted entities "to game the system by divesting *after* the auction when it can compare the merits of what it has won with what it holds already."¹⁷⁵

72. If we were to allow divestitures, we seek comment as to how such divestitures should be implemented. We seek comment as to how long restricted entities that choose divestiture will be given to divest (*e.g.*, 60 days, 90 days, or 180 days), what commences the divestiture period (*e.g.*, the close of the auction, the public notice announcing the winning bidders, or the filing of the FCC Form 601), and would the restricted entity be allowed to market the spectrum or should such marketing be done by a trustee. Further, we seek comment as to whether the award of designated entity licenses should be withheld until the restricted entity files the applications to divest or until the transaction to sell the divestiture spectrum has been consummated.¹⁷⁶ We also seek comment as to whether the Commission should receive reports detailing the progress made in identifying a buyer for the divestiture spectrum and how often such reports should be filed.

73. Finally, we ask commenters to discuss what should occur if the restricted entity that has in-region spectrum fails to divest. We seek comment as to whether the designated entity must purchase the license without the benefit of the bidding credit and be subject to the Commission's default rules. We also seek comment as to whether the requirement for a designated entity to purchase the license without the bidding credit maintains auction integrity and ensures that entities with in-region CMRS spectrum are not able to game the auction process. What if the designated entity benefit at issue concerns eligibility for auction participation such as in the context of auctions for set-aside spectrum licenses?

C. Material Relationships

74. *Further Notice.* In examining whether certain relationships should be relevant to an applicant or licensee's ability to be eligible for designated entity benefits, the *Further Notice* sought

¹⁷³ See Comments of Council Tree at 45 (citing 47 C.F.R. § 20.6(e)).

¹⁷⁴ See Comments of MetroPCS at 11.

¹⁷⁵ Comments of Centennial at 8-9 (emphasis in original).

¹⁷⁶ We would consider adopting such a divestiture procedure because we want to ensure that there is an identified buyer for the divestiture spectrum prior to the grant of the designated entity license.