

APPENDIX D

Initial Regulatory Flexibility Analysis

As required by the Regulatory Flexibility Act (RFA),²²⁴ the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the policies and rules proposed in the *Second Further Notice of Proposed Rule Making* (“*Second Further Notice*”). Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments provided in this *Second Further Notice*. The Commission will send a copy of the *Second Further Notice*, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).²²⁵ In addition, the *Second Further Notice* and the IRFA (or summaries thereof) will be published in the Federal Register.²²⁶

A. Need for, and Objectives of, the Proposed Rules

The initial *Further Notice* in this proceeding tentatively concluded that it 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.” The Commission sought comment on how it should define the elements of such a restriction. Based on the Commission’s experience in administering the designated entity program and the record developed in response to the *Further Notice*, this *Second Further Notice* seeks further comment on those issues, including 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. The *Second Further Notice* also seeks comment on whether the Commission should adopt additional rule changes that would restrict the award of designated entity benefits under certain circumstances and in connection with relationships with certain types of entities and individuals with high personal net worth, including whether and how in-region relationships and personal net worth should be considered in determining eligibility for designated entity benefits.

Over the last decade, the Commission has engaged in numerous rulemakings and adjudicatory investigations to prevent companies from circumventing the objectives of the designated entity eligibility rules.²²⁷ To that end, in determining whether to award designated entity benefits, the Commission adopted a strict eligibility standard that focused on whether the applicant maintained control of the corporate entity.²²⁸ The Commission’s objective in employing such a standard was “to deter the establishment of sham companies in a manner that permits easy resolution of eligibility issues without the delay of administrative hearings.”²²⁹ The Commission intends its small business provisions to be available only to bona fide small businesses.

²²⁴ See generally 5 U.S.C. § 603. The RFA, see 5 U.S.C. §§ 601 – 612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

²²⁵ See 5 U.S.C. § 603(a).

²²⁶ See *id.*

²²⁷ See, e.g., *Competitive Bidding Second Report and Order*, 9 FCC Rcd 2348 (1994); *Part 1 Fifth Report and Order*, 15 FCC Rcd 15293 (2000); *Application of ClearComm, L.P., Memorandum Opinion and Order*, 16 FCC Rcd 18627 (2001).

²²⁸ *Competitive Bidding Second Report and Order*, 9 FCC Rcd at 2396 ¶ 277.

²²⁹ *Id.* at 2397 ¶ 278.

B. Legal Basis

The proposed actions are authorized under Sections 4(i), 303(r), and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. Sections 154(i), 303(r), and 309(j).

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.²³⁰ The RFA generally defines the term “small entity” as having the same meaning as the terms “small organization,” “small business,” and “small governmental jurisdiction.”²³¹ The term “small business” has the same meaning as the term “small business concern” under the Small Business Act.²³² A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.

A small organization is generally “any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.”²³³ Nationwide, as of 2002, there were approximately 1.6 million small organizations.²³⁴ The term “small governmental jurisdiction” is defined as “governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand.”²³⁵ Census Bureau data for 2002 indicate that there were 87,525 local governmental jurisdictions in the United States.²³⁶ We estimate that, of this total, 84,377 entities were “small governmental jurisdictions.”²³⁷ Thus, we estimate that most governmental jurisdictions are small. Nationwide, there are a total of approximately 22.4 million small businesses, according to SBA data.²³⁸

Any proposed changes or additions to the Commission’s Part 1 rules that may be made as a result of the *Second Further Notice* would be of general applicability to all services, applying to all entities of any size that apply to participate in Commission auctions. Accordingly, this IRFA provides a general analysis of the impact of the proposals on small businesses rather than a service by service analysis. The number of entities that may apply to participate in future Commission auctions is unknown. The number of small businesses that have participated in prior auctions has varied. In all of our auctions held to date, 1,975 out of a total of 3,545 qualified bidders either have claimed eligibility for small business bidding credits or have self-reported their status as small businesses as that term has been defined under rules

²³⁰ 5 U.S.C. § 603(b)(3).

²³¹ *Id.* § 601(6).

²³² *Id.* § 601(3) (incorporating by reference the definition of “small business concern” in the Small Business Act, 15 U.S.C. § 632). Pursuant to the RFA, the statutory definition of a small business applies “unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register.” *Id.* § 601(3).

²³³ *Id.* § 601(4).

²³⁴ Independent Sector, *The New Nonprofit Almanac & Desk Reference* (2002).

²³⁵ 5 U.S.C. § 601(5).

²³⁶ U.S. Census Bureau, *Statistical Abstract of the United States: 2006*, Section 8, page 272, Table 415.

²³⁷ We assume that the villages, school districts, and special districts are small, and total 48,558. *See* U.S. Census Bureau, *Statistical Abstract of the United States: 2006*, section 8, page 273, Table 417. For 2002, Census Bureau data indicate that the total number of county, municipal, and township governments nationwide was 38,967, of which 35,819 were small. *Id.*

²³⁸ *See* SBA, *Programs and Services*, SBA Pamphlet No. CO-0028, at 40 (July 2002).

adopted by the Commission for specific services.²³⁹ In addition, we note that, as a general matter, the number of winning bidders that qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments or transfers, unjust enrichment issues are implicated.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

The Commission will not require additional reporting, recordkeeping or other compliance requirements pursuant to this *Second Further Notice*.

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule or any part thereof for small entities.²⁴⁰

The initial *Further Notice* in this proceeding tentatively concluded that it 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.” The Commission sought comment on how it should define the elements of such a restriction. Based on the Commission’s experience in administering the designated entity program and the record developed in response to the *Further Notice*, this *Second Further Notice* seeks further comment on those issues, including 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. The *Second Further Notice* also seeks comment on whether the Commission should adopt additional rule changes that would restrict the award of designated entity benefits under certain circumstances and in connection with relationships with certain types of entities and individuals with high personal net worth, including whether and how in-region relationships and personal net worth should be considered in determining eligibility for designated entity benefits. The *Second Further Notice* seeks guidance from the industry on how it should define the elements of any restrictions it might adopt regarding the award of designated entity benefits. Small entity comments are specifically requested.

F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rule

None.

²³⁹ This figure is as of March 29, 2006.

²⁴⁰ See 5 U.S.C. § 603.

STATEMENT OF CHAIRMAN KEVIN J. MARTIN

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

We initiated this proceeding to examine our rules governing designated entities to better achieve the purpose of ensuring that small businesses have an opportunity to participate in the provision of spectrum-based services. Today's order adopts several measures to help accomplish that goal. Specifically, we strengthen our unjust enrichment and spectrum leasing rules for designated entities in order to provide additional incentives for small businesses receiving bidding credits to offer facilities-based service. We also further the integrity of the designated entity program by implementing random audits, additional document and transaction reviews, and periodic reporting. Together, these measures significantly strengthen the designated entity program.

In the further notice portion of this item, we ask whether additional safeguards are necessary to reduce the opportunity for manipulation of our rules governing the provision of bidding credits to small businesses. I look forward to working with my colleagues as we continue to develop the record in this proceeding.

**STATEMENT OF
COMMISSIONER MICHAEL J. COPPS**

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

In this age when telecommunications companies seem only to grow larger and larger, it is important to have programs that encourage competition from smaller entrepreneurs. This is exactly what the Designated Entity (DE) program is all about and it is why we must do everything we can to make this program perform as intended. Small companies must have a fighting chance to compete with industry giants to obtain valuable spectrum. In an era of consolidation, the program is especially important to rural areas that might otherwise remain underserved. Quite frankly, rural America seems too often to have been pushed off the big companies' radar scopes. This is a central reason why I remain strongly committed to small carriers' participation in spectrum auctions. It is good policy; it also happens to be the law.

But let's be candid. Whenever government attempts to provide incentive programs for small business, there are those who try to twist the rules in order to gain unwarranted entry into these programs. We have seen this in many business sectors and we have unfortunately experienced such chicanery and cheating in telecom too. We must not allow the bad apple to spoil the bushel, however. Instead we need good rules to curb the chicanery. Recent experience teaches us that we must move quickly to curb abuses of the DE program. News reports indicate that, in prior auctions, entities with deep pockets helped themselves to discounts they were never meant to enjoy. This unacceptable behavior threatens the integrity of our auctions and, worse, it cheats consumers. It costs taxpayers millions of dollars in foregone revenue. It also means that spectrum goes to those most willing and able to manipulate the rules of the game, rather than to the entities Congress actually intended to benefit. And it denies consumers the benefits of new and all-too-rare competition. So, our job is to deny wealthy companies or individuals any opportunity to misuse the DE discount to outbid small carriers – the very carriers the DE program is meant to protect.

Today we take meaningful steps in the right direction. We do so in time to apply new rules to the large and important Advanced Wireless Services (AWS) auction scheduled for this summer. I am grateful to the Chairman for his role in moving this item along in time to have these rules apply to the AWS auction. And I am grateful to him and to my other colleagues for their support of strong measures to prevent fraud and unjust enrichment by those who would seek to abuse this valuable program. In particular, I am pleased that by strengthening our unjust enrichment rules we take away the incentive for speculators to try to masquerade as legitimate DEs. Under our new rules, bidders who benefit from the 25 percent discount must forfeit that discount if they then turn around and sell some or all of their license rights to someone else. By eliminating the payoff for this "flipping" of licenses, we discourage sham buyers from participating in the first place. And most importantly, we reserve the DE program for companies that actually intend to use their spectrum to serve customers.

I am also pleased that we commit to thoroughly review the application and all relevant documents for each and every winning bidder claiming DE status. Additionally, we pledge to audit every DE at least once during the initial license term. These are two important safeguards against sham bidders, and I am glad the Commission agreed to implement them as well.

There is more to do to ensure the ongoing integrity and credibility of the DE program. For instance, I have real questions about whether a company should be able to qualify for the DE discount if it is owned in large part by a multi-billion-dollar wireless company – or any multi-billion-dollar communications company, for that matter. I believe the unjust enrichment reforms we announce today

will go a long way towards eliminating the worst abuses of this kind. But we still need to consider whether additional partnership restrictions are warranted.

At the same time, we must also be cautious about overshooting the mark and harming the very small carriers and entrepreneurs that Congress meant to protect. Legitimate DEs must have access to capital to compete meaningfully against the large carriers. I would not support any measures that improperly compromised their ability to do so.

The limited time available to us for consideration of this item did not allow us to resolve these questions. I would have preferred launching this proceeding last summer so as to facilitate a more thorough review in time for comprehensive action today. But given the importance of both the upcoming AWS auction and the DE program, I think that the item we announce today is the most prudent course to protect the core values of the DE program. Certainly, we must be careful not to rush into further changes without full consideration of all their consequences, unintended as well as intended. I hope we will keep working on this program because another huge auction in the 700 MHz spectrum is not far off and we should have the program working as flawlessly as possible by then. In the meantime, I applaud the changes we make today to curb fraud and unjust enrichment and I thank my colleagues for their cooperative work to achieve these results.

**STATEMENT OF
COMMISSIONER JONATHAN S. ADELSTEIN
APPROVING IN PART, DISSENTING IN PART**

Re: Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures, WT Docket No. 05-211, Second Report and Order and Second Further Notice of Proposed Rule Making.

I must dissent from a large portion of this decision because it fails to accomplish the very specific goals the Commission outlined in the Further Notice and Proposed Rule Making (FNPRM) in this proceeding. While I endorse the narrow adjustments to the Designated Entity (DE) program that we adopt today, the majority falls far short of making the meaningful modifications to the DE program that were almost universally supported by commenters in this proceeding. I am disappointed that we were unable to follow through on our tentative conclusion from earlier this year, and believe that the Second FNPRM we adopt today is unnecessarily broad and complicated, and significantly ignores the full and complete record before us.

On January 27, 2006, my colleagues and I adopted an FNPRM in which we tentatively concluded that we should modify our Part 1 rules to restrict the award of designated entity benefits to an otherwise qualified designated entity where it has a "material relationship" with a "large in-region incumbent wireless service provider." This position was supported by a large and diverse group of commenters ranging from DEs²⁴¹ to Tier II carriers,²⁴² the minority community²⁴³ to rural telephone companies,²⁴⁴ and even members of Congress²⁴⁵ and the Department of Justice.²⁴⁶

²⁴¹ "It is extremely positive and encouraging that the Commission has decided to take this opportunity to change its Designated Entity program rules so as to make available more fair and reasonable opportunities for bona fide designated entities to secure the critical spectrum necessary to compete in the face of ever-increasing industry consolidation dominated by large incumbent wireless service providers." Comments of STX Wireless, LLC.

²⁴² "It is not unreasonable or unfair for the Commission to update its designated entity program to take into account the greatly increased concentration of spectrum resources in the hands of the national wireless carriers. By limiting access of the national carriers to bid credit benefits, the Commission can effectively refocus its designated entity policies to expand opportunities for successful small business participation in the wireless industry." Reply Comments of United States Cellular Corporation at 2-3.

²⁴³ "As carriers whose collective share of the wireless market is 89-90 percent, the five largest incumbents have the most to lose from the entry of facilities-based competitors into the wireless market, and therefore have the strongest incentives to manipulate the DE program in a manner that forestalls the competition that the DE program was meant to engender." Reply Comments of the Minority Media and Telecommunications Council (MMTC) at 3.

²⁴⁴ "The Commission's tentative conclusion that it should modify its Part 1 rules to restrict the award of DE benefits such as bidding credits to an otherwise qualified DE where it has a 'material relationship' with a large, in-region incumbent wireless service provider is consistent with Section 309(j) of the Communications Act of 1934, as amended." Comments of The Rural Telecommunications Group, Inc. and The Organization for the Promotion and Advancement of Small Telecommunications Companies.

²⁴⁵ "It is important that DEs have sources of capital and industry experience on which to rely, but allowing national wireless carriers to perform these functions is no longer good policy in light of their overwhelming dominance in the industry." Letter from 10 Members of the Congressional Black Caucus to Chairman Kevin Martin (March 3, 2006).

²⁴⁶ "The Department supports the Federal Communications Commission's proposal to deny designated entity benefits to entities that have a material relationship with a large in-region incumbent wireless service provider or a large entity that has a significant interest in communications services." *Ex Parte* Letter of the Department of Justice (March 17, 2006).

Yet, in a troubling and curious reversal, less than three months later, I stand alone in dissenting from our decision today to not to close this obvious loophole. It is stunning that we have failed to take any meaningful action to specifically address the single biggest issue facing the DE program given the overwhelming support in the record to do so. We missed a real opportunity to shut down what almost everyone recognizes has the potential for the largest abuse of our DE program: giant wireless companies using false fronts to get spectrum on the cheap.

During the past month, there has been considerable discussion about an alternative proposal to our original tentative conclusion – a limitation on investment in DEs by all providers of communications services over a given revenue threshold. While we do not vote on that proposal here, many commenters argued that this approach would not have tightened the DE program, but rather that the approach would have killed it. I certainly had concerns that the proposal, as structured, would have cast a wide net over the DE program – limiting funding to the DE community from almost all FCC-regulated companies, manufacturers, and service providers, whether circuit or IP-based. Not surprisingly, the proposal to adopt a low revenue threshold was loudly opposed by a number of significant voices including members of Congress,²⁴⁷ two subcommittees of the FCC's own Advisory Committee on Diversity for Communications in the Digital Age,²⁴⁸ current and former DEs,²⁴⁹ and a quintet of Native Alaskan Corporation CEOs.²⁵⁰ Some argue that so-called DE reform was really a disguise to eliminate an avenue of competition to incumbent wireless companies.²⁵¹

Notwithstanding the flaws in this proposal, I have been willing to consider a variety of alternatives to our tentative conclusion that would have responded to complaints by large wireless carriers that they were being unfairly singled out or that we were ignoring our precedent of conducting market by market analyses in looking at spectrum issues. Moreover, if the wireless loophole was adequately addressed in a final decision, I was willing to consider a revenue-based restriction that affected all FCC regulatees provided that a revenue threshold was based on the record, not one that could indiscriminately shut down the DE program. But inexplicably, no deal could be struck. Ultimately, it was easier for the majority to make a few minor changes to the DE program than close the loophole that is recognized by almost everyone but this Commission.

²⁴⁷ "It would be wholly inconsistent with the promotion of these objectives for the Commission to limit the sources of capital and expertise available to new entrants in the complex wireless industry beyond the largest national carriers identified in the rulemaking who dominate the industry." Letter from Congressman Edolphus Towns and Congresswoman Diane Watson to Commissioners Michael Copps and Jonathan Adelstein (April 7, 2006).

²⁴⁸ "The [Subcommittees] believe the Commission should receive the input of the full Committee before taking steps in response to the FNPRM released February 3, 2006 in WT Docket No. 05-211, recent reports regarding which suggest that the Commission may substantially undermine opportunities for diversity of ownership and other goals mandated by Section 309(j) of the Communications Act. Accordingly, the Subcommittee asks the Commission to convene the full Committee as soon as possible with respect to this matter." Statement of The Transactional Transparency and Related Outreach Subcommittee and the Career Advancement Subcommittee of the Advisory Committee on Diversity for Communications in the Digital Age (April 6, 2006).

²⁴⁹ "Imposing severe new limitations on DEs sourcing investments from a broad category of companies defined as having revenues of \$125 million or more will have the effect of killing the DE program." Ex Parte of Carroll Wireless, LP, CSM Wireless, LLC, Leap Wireless Int'l, Inc. United States Cellular Corp., TA Associates, 3G PCS, LLC, Royal Street Commc'ns, LLC, MetroPCS Commc'ns, Inc., Catalyst Investors and Council Tree Commc'ns, Inc. (April 5, 2006) ("Carroll Wireless et al").

²⁵⁰ "Such ruling would effectively dismantle the DE Program as mandated by Congress. We urge the Commission to maintain the most important diversity tool at its disposal, stay with the clear record in this case and proceed with finalizing its Tentative Conclusion in this proceeding." Ex Parte of Doyon, Ltd., Koniag Development Corp., St. George Tanaq Corp. Chugach Alaska Corp., and Bethel Native Corp. (April 7, 2006).

²⁵¹ Ex Parte of Carroll Wireless et al.

Of course, I support the changes made in this item as DE reform has been an important issue to me for some period of time. In my separate statement to the FNPRM, I talked about a tighter review of DE applications involving large wireless carriers and am pleased that we have extended a thorough Wireless Telecommunications Bureau review to all DE applications. And I applaud the efforts of MMTC in highlighting the need for a more rigorous audit program and advancing proposals that form the basis for those we adopt today. MMTC, like many others in this proceeding, provided thoughtful comments and discussion on the DE program, and has helped create the record that allows us to make at least some changes to the DE program prior to the upcoming AWS auction.

Finally, I must add that I am troubled by the tone and approach of the Second FNPRM. I believe it disproportionately relies on the perceived status of the communications marketplace in assessing changes to the DE program. While I recognize the dual statutory goals highlighted in the item of ensuring opportunities for DEs and preventing unjust enrichment, we also have an obligation to promote competition and innovation in the wireless industry pursuant to Section 309(j)(3)(B), and the DE program is an appropriate vehicle to further that objective. I worry that the Second FNPRM, instead of suggesting proposals that could promote the effectiveness and integrity of DEs, could ultimately lead to determinations that do more harm to potential competition in the communications marketplace than truly protect the program. The item seems to ignore the well-developed record in proposing an unnecessarily complicated and expansive review of perceived problems of the DE program when the solutions already are right in front of us.