

auctions, we believe that it will be critically important to the success of our auctions to leave the Commission some discretion to fine-tune auction procedures between auctions and, in some cases, on an ad hoc basis, during the course of an auction. Accordingly, we affirm our original decisions to adopt rules that afford the Commission some flexibility to modify its procedures during the course of an auction, within the scope of the options we have delineated and under the circumstances described above.

#### **D. Treatment of Upfront Payments**

27. In the Second Report and Order we required bidders to tender a substantial payment in advance of the auction in order to deter frivolous or insincere bidding.<sup>61</sup> Upfront payments were also intended to provide a source of funds for collection of penalties for bid withdrawal.<sup>62</sup> The amount of the upfront payment was related to the level of eligibility the bidder wished to establish, measured in terms of the population and amount of spectrum encompassed by the licenses on which the bidder was permitted to bid. In some cases the upfront payment could amount to millions of dollars.<sup>63</sup> We required that upfront payments be submitted prior to bidding, and we did not permit use of letters of credit or Treasury bills for upfront deposits due to administrative difficulties in accepting payment in such forms, at least until the Commission has more experience in conducting auctions.<sup>64</sup> We stated that upfront payments made by a winning bidder would be applied to satisfy its down payment obligations, and that losing bidders' upfront payments would be returned if they wished to withdraw from further bidding.<sup>65</sup>

28. Petitions. GTE asserts that the Commission should adopt an interest-bearing evergreen deposit procedure for upfront deposits.<sup>66</sup> GTE states that, since the Commission is not currently authorized to establish interest-bearing accounts, substantial sums of money could be tied up in upfront deposits without any accrual of interest for substantial periods of time. GTE asserts that maximum bidder flexibility can be achieved by allowing bidders to add or withdraw deposit funds during the course of the auction. GTE states that the Commission needs to ensure that it has the requisite authority to permit the accumulation and payment of interest.

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<sup>61</sup> Second Report and Order at ¶ 171.

<sup>62</sup> Id. at ¶ 176.

<sup>63</sup> Id. at ¶¶ 172, 173.

<sup>64</sup> Id. at ¶¶ 182, 184, 185.

<sup>65</sup> Id. at ¶ 187, n.140.

<sup>66</sup> GTE Petition at 11-13.

29. AIDE states that when a winning bidder's upfront payments, less bid withdrawal penalties, exceed the required deposit, the excess upfront payment should remain available for crediting to another auction or for refund to the winning bidder.<sup>67</sup> AIDE points out that, in the case of designated entities, the required deposit is only 10 percent. AIDE notes that the Commission has stated that it will apply this policy for losing bidders, and as a matter of equal protection the Commission should apply the same policy to winning bidders with excess upfront payments.<sup>68</sup>

30. AIDE requests clarification of footnote 133 in the Second Report and Order.<sup>69</sup> Footnote 133 reads:

For example, an entity that is interested in bidding on several 30 MHz PCS licenses with a goal of providing service to a population of at most 50 million should make an upfront payment of \$30 million ( $\$.02 \times 30 \text{ MHz} \times 50,000,000$ ). That bidder will not be permitted to bid (at any time) in the auction, or be permitted to win, 30 MHz licenses covering more than 50 million pops.

31. Discussion. Allowing bidders to add funds to upfront deposits in order to increase their eligibility level, or to withdraw funds from upfront deposits, as GTE recommends, would add greatly to the complexity of the Commission's administrative task. The Commission would have to keep track of changes in eligibility due to changes in upfront payments, as well as to changes in bidders' activity levels, and would have to ascertain that fund transfers had taken place before permitting bidders to bid at the levels to which the additional payments entitled them. Because of the short intervals between bidding rounds, delays in the transfer of funds would likely create problems for both bidders and the Commission. For these reasons, we believe it is prudent to require bidders to submit upfront payments that represent the maximum level of bidding that they anticipate before the beginning of the auction. Bidders can always ensure that they will be able to expand their bidding above their originally anticipated level by submitting a sufficiently large upfront payment and maintaining a high activity level.

32. We agree with AIDE that winners' upfront deposits, in excess of their required down payment deposits and any penalties they may owe, should be refunded expeditiously. We intend to refund excess upfront deposits of all bidders as soon as possible. We will not apply excess upfront deposit balances to subsequent auctions, however, due to the additional administrative difficulty of tracking the funds.

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<sup>67</sup> AIDE Petition at 15.

<sup>68</sup> Id. at 16.

<sup>69</sup> Id. at 13.

33. With respect to AIDE's request for clarification, we clarify that footnote 133 means that in any round of the auction, a bidder who has made an upfront payment of \$30 million may bid on, or hold the high bid from the previous round on, 30 MHz licenses in markets with a combined population totaling not more than 50 million. The specific licenses on which the bidder submits bids may vary from round to round, but the total MHz-pop ceiling cannot be exceeded in any single round.

#### **E. Default Penalty**

34. In the Second Report and Order the Commission imposed a default penalty for withdrawing a bid after a simultaneous multiple round auction has closed.<sup>70</sup> This default penalty was set at 3 percent of the amount of the winning bid the next time the license is offered by the Commission, or 3 percent of the amount of the defaulting bidder's bid, whichever is less. The default penalty would be imposed in addition to the bid withdrawal penalty, which was set at the difference between the amount bid and the amount of the subsequent winning bid. We stated that the default penalty was intended to provide an incentive for bidders who wished to withdraw their bids to do so before the close of the auction. We stated that such a penalty was appropriate because a withdrawal that occurs after an auction closes is likely to be more harmful than one that occurs before closing. We stated that if a withdrawal occurs after the auction closes, other bidders will have little opportunity to revise their strategies, and the likelihood will be lower that the licenses will be awarded to those who value them most. We also stated that default imposes on the government the extra costs of re-auctioning the license.

35. Petition. AIDE asserts that the default penalty will produce a windfall to the Treasury if the winning bid exceeds the defaulting bid by more than 3 percent.<sup>71</sup> AIDE states that the defaulting bidder should pay no penalty if the second bid exceeds the defaulting bid by 3 percent or more, and that if the second bid exceeds the defaulting bid by less than 3 percent, the defaulting bidder's penalty should be the difference between the second winning bid and 103 percent of the defaulting bid.

36. Discussion. We believe that it is appropriate to charge the full 3 percent default penalty in addition to the bid withdrawal penalty whether or not the winning bid in the second auction exceeds the defaulting bid. As we stated in the Second Report and Order, the function of the default penalty is to encourage bidders who plan to withdraw their bids to do so before the close of the auction.<sup>72</sup> The additional costs to the Commission and to other bidders of auctioning the license a second time, and the increased likelihood that the license will not be won by the bidder who values it most, are incurred as a consequence of default

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<sup>70</sup> Second Report and Order at ¶ 154.

<sup>71</sup> AIDE Petition at 14.

<sup>72</sup> Second Report and Order at ¶ 154.

regardless of the level of the bids. Even if the winning bid is higher than the defaulting bid, we have no reason to believe that it is higher than the winning bid would have been had the defaulting bidder withdrawn before the close of the auction, nor have we reason to believe that a high winning bid compensates for the undesirable effects of default. Consequently, we retain the default penalty as set forth in the Second Report and Order.

#### F. Disclosure of Bidding Information

37. In the Second Report and Order the Commission recognized the informational benefits to be gained from releasing bidder identities during an auction, but concluded that such information should not be released because "the risk of collusion and strategic manipulation outweighs the benefits of the additional information." Instead the Commission adopted an intermediate approach pursuant to which the bidder identification numbers and bid amounts for each bidder will be released at the end of each round of bidding. This approach provides bidders with useful information without incurring excessive risks of collusion and strategic manipulation.<sup>73</sup>

38. Petitions. GTE and Southwestern Bell request that the identities of bidders be released during the course of the auction. GTE requests that the identity of the bidder associated with each bidder identification number be disclosed during the bidding process.<sup>74</sup> SBC states that the Commission should announce both the identity of the highest bidder and the bid amount for each round of the auction.<sup>75</sup> GTE argues that a bidder must construct a strategy based on its own valuation of the spectrum as well as estimates of its competitors' valuations and past bids, and that a fundamental component of this exercise is knowledge of who the competitors are. GTE notes that the Commission's sole justification for not furnishing information about the identity of bidders is a concern for collusion, and states that the Second Report and Order includes other mechanisms for minimizing collusion. GTE states that increases in available information raise the level of competition and the efficiency of license assignments, and that access to bidder identification information may increase revenue from the auction process while ensuring award to the bidder who most highly values the license.<sup>76</sup> SBC argues that the decision to keep winning bidder identities secret creates an opportunity for collusive behavior because cartels could coordinate activities and punish violators without detection. SBC notes that if the identity of all bidders is known, the Commission and bidders need not be concerned with protecting bidders' identity. SBC states that knowing who the successful bidders are affects other bidders' ability to assess the accuracy of their valuation of the spectrum and allows them to ascertain that an aggregation

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<sup>73</sup> Id. at ¶ 158.

<sup>74</sup> GTE Petition at 4-6.

<sup>75</sup> SBC Petition at 8-10.

<sup>76</sup> GTE Petition at 5-6.

of licenses is underway which might pose a competitive threat. MCI states that because of the potential for bidder collusion and strategic manipulation, bidder identities should not be revealed.<sup>77</sup>

39. Discussion. Arguments in favor of disclosing bidder identities primarily turn on the value of the information in improving the quality of bids. Some auction experts argue that bidders' estimates of license values can be improved by comparing them to the valuations of their competitors.<sup>78</sup> Bidders' valuations of licenses may also be highly dependent on knowing the identity of neighboring carriers, especially regional leaders and competitors, and on knowing the manner in which complementary licenses are likely to be used and the compatibility of standards both inside and outside their desired service areas. Maximizing information available to bidders may increase bids by decreasing bidders' incentives to reduce their bids to avoid the "winner's curse," the tendency for the bidder who most overestimates the value of the item for sale to win an auction. Revealing bidder identities may facilitate awarding licenses to those who value them most highly by providing more information to bidders. More accurate valuation of licenses by bidders can thus improve the efficiency of license assignments. In addition, publicly disclosing the identity of other bidders may encourage vigorous bidding for licenses. Releasing bidder identities may increase interest in and media coverage of the auctions.

40. Our experience with the first narrowband PCS auction showed that preventing bidder identities from being revealed can be extremely difficult. In addition, if some but not all bidders know other bidders' identities, those bidders have an advantage in the quality of information available to them and in the potential ability to thwart others' bidding strategies. Concealing bidder identities may give an advantage to larger bidders that have the resources to devote to discovering other bidders' identities.

41. As we noted in the Second Report and Order, however, releasing the identities of high bidders may foster strategic manipulation, such as bidding up the prices of licenses needed by rivals, and may facilitate collusion.<sup>79</sup> Some auction experts argue that anonymity makes it harder to target a firm for strategic hold-up because the bidding and aggregation strategies of specific competitors cannot be easily detected.<sup>80</sup> Concealing bidder identities makes initiating collusive arrangements during the course of an auction more difficult because

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<sup>77</sup> MCI Comments at 3.

<sup>78</sup> See e.g. comments of PacBell on NPRM, Attachment by Paul R. Milgrom and Robert B. Wilson at 21.

<sup>79</sup> Second Report and Order at ¶ 158.

<sup>80</sup> Comments of NYNEX on NPRM, attachment by Robert G. Harris and Michael L. Katz, "A Public Interest Assessment of Spectrum Auctions for Wireless Telecommunications Services" at 9.

bidders will not easily be able to identify the parties against whom they are bidding, unless those parties voluntarily reveal their identities. On the other hand, concealing bidders' identities may not be critical to preventing collusion during an auction; existing antitrust laws and the FCC's collusion rules should be adequate to prevent collusive conduct. In any event, under an anonymous bidding scenario, if bidders want to collude they can simply disclose their bidder identification numbers to one another before the auction.

42. Because of the advantages of providing more information to bidders and the difficulties involved in ensuring that bidder identities remain confidential, we will generally release the identities of bidders before each auction. However, we recognize that experts disagree on the potential for knowledge of bidders' identities to facilitate collusion and other strategic behavior. Consequently we wish to have the flexibility to conceal bidder identities if further experience shows that it would be feasible and desirable to do so. We may also wish to test the effects of releasing identities of bidders. Consequently we are reserving the option to withhold bidder identities on an auction-by-auction basis. If we decide to withhold bidder identities for a particular auction, we will announce that decision by a service-specific auction Order. We will announce by Public Notice prior to each auction whether the identities of bidders will be made public in that auction.

#### G. Standby Queue

43. Petition. GTE states that for 10 MHz blocks in broadband PCS the Commission should adopt the "standby queue" bidding mechanism considered in experiments sponsored by the National Telecommunications and Information Administration and conducted at the California Institute of Technology.<sup>81</sup> The standby queue allows parties seeking individual licenses to coordinate their bids in order to beat a bid for a combination of licenses. GTE asserts that the standby queue would allow bidders seeking to combine smaller blocks into a larger set of frequencies, or to combine blocks on a geographic basis, to obtain information about the status of bidding that would permit them to bid rationally and efficiently.

44. Discussion. The standby queue is a mechanism to be used in conjunction with combinatorial auctions. In the Fifth Report and Order we concluded that the disadvantages of combinatorial bidding were likely to outweigh the advantages for auctions of broadband PCS licenses, and we adopted simultaneous multiple round bidding as our auction methodology for broadband PCS licenses. Nevertheless, we left open the option to use combinatorial auctions if simultaneous multiple round auctions do not result in efficient aggregation of licenses, and if there are significant advances in the development of combinatorial auctions.<sup>82</sup> Although we have no current plans to use combinatorial auctions, if in future we do adopt such an auction methodology we will consider the use of a standby queue mechanism.

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<sup>81</sup> GTE Petition at 13-14.

<sup>82</sup> Fifth Report and Order at ¶ 35.

## H. Filing Fees

45. Petition. William E. Zimsky (Zimsky) states that the rule imposing filing fees for the filing of short form applications for auctions should be deleted.<sup>43</sup> Zimsky asserts that because there is no provision in 47 U.S. C. § 158(g) for imposing the filing fee for the new short form application, the Commission lacks the statutory authority to impose such a fee. Zimsky also asserts that, even if the Commission has such statutory power, to impose a filing fee on all bidders is unreasonable because the filing fee was designed to recoup the costs of fully processing the application. Since only auction winners will submit long form applications and have their applications scrutinized, the losing bidders do not receive this service. Consequently, the Commission's proposed scheme is unconstitutional, he argues, because a user fee which is not reasonably related to, or a fair approximation of, the cost incurred by the government in providing the service for which the fee is assessed, effects a taking of applicants' property without just compensation, in violation of their fifth amendment rights. Zimsky cites Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 163 (1980); United States v. Sperry Corp., 493 U.S. 52, 60 (1989) in support of his argument.

46. Discussion. The Commission has requested express statutory authority to impose section 8 application fees for short form applications. In the absence of such express authority, we do not currently impose fees for short-form applications. However, long-form applications in most services are subject to fees under section 8. Consequently we find Zimsky's petition to be moot, and we dismiss it.

## I. Waiver Requests in Short-Form Applications

47. Cable & Wireless, Inc. (CWI) asks that the Commission reconsider its rules that appear to mandate dismissal of the short-form application, (Form 175) that do not certify compliance with the foreign ownership provision of Section 310 of the Communications Act, notwithstanding the filing of a request for waiver or other relief.<sup>44</sup> CWI asserts that the Commission should permit participation at auction where the applicant certifies to the pendency of such a waiver request. In considering the acceptance for filing of short form applications, the Commission will accept certifications that state that a request for waiver or declaratory ruling concerning the requirements of section 310 is pending.<sup>45</sup>

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<sup>43</sup> See William E. Zimsky Petition.

<sup>44</sup> See petition of CWI.

<sup>45</sup> On January 5, 1994, CWI also filed a petition seeking a declaratory ruling that the public interest warrants grant of common carrier radio license applications to U.K. citizens and/or corporations that possess ownership interests in excess of the foreign ownership benchmarks in Section 310(b)(4) of the Communications Act. We expect to address the merits of this petition in a separate Declaratory Ruling.

## J. Rules Prohibiting Collusion

48. In order to prevent collusion in bidding, the Commission in the Second Report and Order stated,

. . . bidders will be required to identify on their short-form applications any parties with whom they have entered into any consortium arrangements, joint ventures, partnerships or other agreements or understandings which relate in any way to the competitive bidding process. Bidders will also be required to certify on their short-form applications that they have not entered into any explicit or implicit agreements, arrangements or understandings of any kind with any parties, other than those identified, regarding the amount of their bid, bidding strategies or the particular properties on which they will or will not bid . . . . After such applications are filed and prior to the time that the winning bidder has made its required down payment, all bidders will be prohibited from cooperating, collaborating, discussing or disclosing in any manner the substance of their bids or bidding strategies with other bidders, unless such bidders are members of a bidding consortium or other joint bidding arrangement identified on the bidder's short form application.<sup>86</sup>

49. Petition. BET Holdings, Inc. (BET) states that the above requirements prevent bidders from entering into any new agreements, joint ventures or similar arrangements with other entities after filing a short-form application.<sup>87</sup> BET claims that as a consequence bidders may be locked into bidding arrangements significantly before the commencement of the auctions, and will be unable to modify their bidding strategies, consult with experts or others, or enter into additional alliances with new parties any time after the filing of the short-form application. BET states that the collusion rule is an unrealistic constraint on lawful business behavior. For example, according to BET, if a company does not identify affiliates or others with whom it must consult, the company would be forbidden from soliciting research, sharing resources, or discussing its bids until after the winning bidder tenders its down payment.<sup>88</sup> BET requests that the Commission rely on antitrust law as a safeguard against collusion.

50. Discussion. While we intend to rely primarily on the antitrust laws to prevent bidding collusion, we believe that the anticollusion rules in the Second Report and Order will provide an important additional tool that will enable the Commission to detect, prevent, and punish collusion. To prevent and detect collusion, we believe that it is important to have clearly stated rules concerning the entities with whom communication about bidding strategies is permissible. The requirement that an entity identify at the time of the short-form application those affiliates, subsidiaries, or others with whom it has agreements concerning

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<sup>86</sup> Second Report and Order at ¶ 225.

<sup>87</sup> BET Petition at 10.

<sup>88</sup> *Id.* at 11.

bidding, and the prohibition of communication concerning bidding with entities identified by other bidders, serve this purpose and are not particularly burdensome. Similarly, prohibiting additional agreements and alliances concerning bidding between applicants bidding for the same licenses, after applications have been filed and the identities of all applicants are known, seems a prudent deterrent to collusion that should have only a minimal and temporary effect on bidders' flexibility. We wish to make explicit our intention that the prohibition extend to post-application settlement agreements and discussions concerning settlement agreements.

51. We do believe, however, that our prohibition on communication among bidders and formation of agreements among bidders after applications have been filed may have been excessively broad in that it includes communications and agreements with bidders who are not bidding against each other, and so may prevent useful agreements that have no effect on the competitiveness of bidding. Consequently, we are modifying our collusion rules, which currently prohibit bidders from communicating with one another after short-form applications have been filed regarding the substance of their bids or bidding strategies and which also prohibit bidders from entering into consortium arrangements or joint bidding agreements of any kind after the deadline for short-form applications has passed. In order to permit certain bidders to respond to higher than expected license prices by combining their resources during an auction, we will now permit bidders who have not filed Form 175 applications for any of the same licenses to engage in discussions and enter into bidding consortia or joint bidding arrangements during the course of an auction. We conclude that where bidders have not applied for any of the same licenses there is little risk of anticompetitive conduct and therefore we believe that it is appropriate to relax our collusion rules to permit bidders in this context to have greater flexibility to increase their competitiveness in the auction by combining their resources, provided that no change of control of any applicant takes place.

52. In addition, we now believe that entering into consortium arrangements or adding equity partners during an auction may have a useful effect in enabling bidders to acquire the capital necessary to bid successfully for licenses. We have concluded that formation of consortia or changes in ownership after the filing of short-form applications will not necessarily have anticompetitive effects, provided they do not involve parties that might have bid against each other and do not result in a change in control of the applicant. Consequently, we wish to modify our rules regarding amendments to short-form applications. As a result of our experience in the nationwide narrowband PCS auction, we believe that it is necessary to allow applicants to amend their FCC Form 175 applications to make ownership changes after the filing deadline has passed, provided such changes do not result in a change in control of the applicant. Permitting such amendments will provide bidders with flexibility to seek additional capital after applications have been filed, while ensuring that the real party in interest does not change. Accordingly, we will modify Section 1.2105(c) to permit applicants to amend their FCC Form 175 applications to reflect ownership changes that do not result in a change in control of the applicant, provided the parties have not filed Form 175 applications for any of the same licenses. Such changes shall not be regarded as major amendments to an application, provided they do not result in a transfer of control of the license or the applicant and do not change control of the company.

53. Situations may arise in which an applicant has some common ownership interest with another bidder. We wish to clarify that, unless that other entity is expressly identified as an entity with whom the applicant has an agreement concerning bidding, we will prohibit communication concerning bidding with that bidder, as described in the Second Report and Order, even if the other bidder is identified on the applicant's short form application as having some common ownership interest with the applicant. We will retain the anticollusion rules as set forth in the Second Report and Order, with these clarifications.

#### **K. Information Disclosure by Applicants and Licensees**

54. Petitions. Two petitions deal with the amount of information auction participants are required to disclose. GTE requests that the Commission require applicants to provide full ownership disclosure in their short form applications.<sup>89</sup> GTE asserts that by enabling the Commission and competing applicants to assess the legitimacy of auction applicants, full disclosure facilitates the award of licenses to qualified and eligible service providers. According to GTE, full disclosure also promotes open and informed bidding decisions.

55. SBC asks that the Commission minimize requirements for disclosure of information upon transfer of licenses.<sup>90</sup> SBC states that the point of transfer disclosures is to "prevent unjust enrichment as a result of the methods employed to issue licenses and permits."<sup>91</sup> SBC asserts that rules designed to prevent unjust enrichment should be solely applicable, if at all, to designated entities that receive special accommodations, since the risk of unjust enrichment is high only in auctions where such special accommodations are provided. SBC asserts that the formation of reasonable and efficient alliances would be discouraged by the mandate to expose the details of the alliance to competitors. SBC particularly objects to the requirement that any management agreements or consulting contracts be filed. SBC seeks clarification that the disclosure requirements will apply only to the licensees which either have not begun to offer service or have only offered service for some minimal period of time.

56. Discussion. With respect to ownership disclosure in short-form applications, in the Second Report and Order we decided to require applicants to furnish only minimal information in short-form applications and bidder certifications prior to auctions in order to reduce administrative burdens and minimize the potential for delay.<sup>92</sup> Further ownership disclosure requirements, however, were adopted on a service specific basis in later Reports

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<sup>89</sup> GTE Petition at 2-4.

<sup>90</sup> SBC Petition at 6-8.

<sup>91</sup> Id. at 6 (citing 47 U.S.C. §309(j)(4)(E)).

<sup>92</sup> Second Report and Order at ¶ 165.

and Orders.<sup>93</sup> We believe that GTE's concerns are fully met by these requirements.

57. As for transfer disclosure requirements, Congress in the Budget Act required us to develop and test alternative auction designs.<sup>94</sup> We noted in the Second Report and Order that in addition to allowing detection of unjust enrichment, transfer disclosure requirements would provide data necessary for evaluation of our auction designs.<sup>95</sup> We noted that the reporting requirements would allow us to monitor our compliance with the Congressional directive in Section 309(j)(3)(B) to ensure that "new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants. . . ."<sup>96</sup> The information will be useful in meeting our statutory obligation to report to Congress on the outcome of the auctions.<sup>97</sup> The information we acquire from transfer disclosures, including purchase price and other aspects of the sale contracts and management agreements, will enable us to determine the ultimate distribution of licenses and the value of the spectrum for particular uses, and will permit comparisons between licenses awarded with and without designated entity provisions. Such analyses require collection of data from all licensees, not just from designated entities or those who have not begun to offer service or have only offered service for a short period of time. As we stated in the Second Report and Order, we do not expect the transfer disclosure requirements to be burdensome to licensees because the documents to be submitted will have been prepared for other purposes in any event. Moreover, parties may request confidential treatment of competitively sensitive information pursuant to Sections 0.457 and 0.459 of our Rules.<sup>98</sup> Consequently we will retain transfer disclosure requirements for all transfers of licenses obtained by competitive bidding.

#### L. Application-Processing Rules

58. In the NPRM in this proceeding the Commission stated:

In order to avoid needless duplication, we propose that the following general filing and processing rules apply to all PCS: Sections 22.3-22.45 and 22.917(f), and 22.918-22.945, 47 C.F.R. §§ 22.3-22.45, 22.917(f), and 22.918-22.945. For those PCS applicants who file on Form 574, we believe that Sections 90.113-90.159 of our rules,

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<sup>93</sup> See Third Report and Order, Appendix at 13; Fifth Report and Order at ¶ 62 .

<sup>94</sup> 47 U.S.C. 309(j)(3).

<sup>95</sup> Second Report and Order at ¶ 214.

<sup>96</sup> Id. at ¶ 215.

<sup>97</sup> See Budget Act, 47 U.S.C. § 309(j)(2).

<sup>98</sup> Second Report and Order at ¶ 215, citing 47 CFR §§ 0.457, 0.459.

47 CFR §§ 90.113-90.159, could be used to process those applications with appropriate modifications.<sup>99</sup>

59. Petition. AIDE asserts that the Commission acted improperly in proposing substantive PCS application-processing rules in the NPRM because, it argues, such rules are outside the scope of this rulemaking, which is limited to implementation of the competitive bidding requirements of §309(j) of the Communications Act.<sup>100</sup> AIDE argues that the Commission's proposal of application-processing rules is legally insufficient to constitute a valid notice of proposed rules, and that some of the rules cited have no immediate applicability to PCS service. AIDE asserts that in the Second Report and Order the Commission failed to respond to the merits of the arguments concerning filing and processing rules in AIDE's comments on the NPRM. AIDE concludes that the Commission needs to issue a supplemental Notice of Proposed Rulemaking to adopt license-processing rules for PCS.

60. Discussion. The competitive bidding process is a means of assigning licenses, and rules and procedures for processing of license applications are an integral and necessary part of that process. The Commission adopted few filing or processing rules in the Second Report and Order. Those rules that the Commission did adopt pertaining to the filing and processing of applications and certifications were clearly proposed in the NPRM.<sup>101</sup> The rules to which AIDE refers were adopted not in the Second Report and Order but in subsequent Orders establishing auction rules for specific services.<sup>102</sup> We address AIDE's petition relating to those rules either in the Orders in which they were adopted or in reconsiderations of those Orders.<sup>103</sup>

#### M. Financial Qualifications

61. In the Second Report and Order, the Commission stated that applicants filing short form applications would be required to certify that they are financially qualified pursuant to Section 308(b) of the Communications Act. The applicants would also be required to certify that they satisfy any financial qualification requirements for the service in question.<sup>104</sup>

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<sup>99</sup> NPRM at ¶ 128.

<sup>100</sup> AIDE Petition at 20-21.

<sup>101</sup> See Second Report and Order at ¶¶ 164-168, NPRM at ¶¶ 96-101.

<sup>102</sup> See Third Report and Order at ¶ 41, n. 18; Fifth Report and Order at ¶ 83.

<sup>103</sup> See Fifth Report and Order at ¶ 83.

<sup>104</sup> Second Report and Order at ¶ 166.

62. Petition. AIDE states that applying competitive bidding and payment requirements in addition to existing financial qualification requirements disadvantages designated entities, who have historically been constrained by difficulties in capital formation and financing. AIDE recommends that short-form applications not require any certification of financial qualification. If an application became mutually exclusive, according to AIDE, the applicant's payment of its winning bid would demonstrate that it was financially qualified. If the application did not become mutually exclusive, then the applicant should have a short period in which to file any required demonstration of financial qualifications by amendment.<sup>105</sup>

63. Discussion. We believe that, in order to prevent the delay in bringing service to the public that might be occasioned by bankruptcies or by prolonged financial negotiations, it is important to require licensees to have the financial ability to construct and operate a system in addition to being able to purchase the license. Consequently we will continue to require applicants to certify on their short-form applications that they meet any existing financial qualification requirements of the services in which licenses are auctioned. We will not, however, impose additional showings of financial qualification as a part of the auction process.

#### IV. DESIGNATED ENTITIES

##### A. Introduction

64. Several provisions of the Budget Act address participation by small businesses, rural telephone companies, and businesses owned by women and minorities (referred to collectively as "designated entities") in the competitive bidding process and in the provision of spectrum-based services. Specifically, Section 309(j)(4)(D) of the Act, provides that, in prescribing competitive bidding regulations, the Commission shall, inter alia,

ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures . . .<sup>106</sup>

In addition, section 309(j)(3)(B), provides that in establishing eligibility criteria and bidding methodologies the Commission shall seek to promote the objectives of "economic opportunity and competition and ensur[e] that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone

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<sup>105</sup> AIDE Petition at 19-20.

<sup>106</sup> 47 U.S.C. § 309(j)(4)(D).

companies, and businesses owned by members of minority groups and women." To promote these objectives, section 309(j)(4)(A) expressly states that the Commission is required "to consider . . . alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments, with or without royalty payments, or other schedules or methods."<sup>107</sup>

65. In the Second Report and Order we adopted a broad menu of provisions that the Commission might employ to implement these statutory provisions. We adopted general provisions and eligibility rules designed to ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and/or women were afforded the opportunity to participate in both the competitive bidding process and in the provision of spectrum-based services. Specifically, we provided that small businesses (including those owned by women and/or minorities and rural telephone companies) that are winning bidders for certain blocks of spectrum could pay in installments over the term of their licenses. We also indicated that rural telephone companies may be eligible for bidding credits for licenses obtained in their service areas if they make an additional infrastructure build-out commitment beyond any existing performance requirements. We indicated that bidding credits may be available to designated entities on certain frequency blocks. In addition, we retained the option of establishing set-aside spectrum in certain services, in which eligibility to bid may be limited to some or all designated entities. Finally, we stated that we would consider the use of tax certificates as a means of creating incentives both for designated entities to attract capital from non-controlling investors and to encourage licensees to assign licenses to designated entities in post-auction transactions.

66. In the Second Report and Order we recognized that the provisions applicable to particular designated entities would vary depending on the nature of each individual service. For example, we retained the discretion to modify our general designated entity provisions for capital intensive services such as broadband PCS. In this regard, we stated that we would evaluate on a service-specific basis the capital requirements and other characteristics of the service to determine the appropriate provisions. We continue to believe that it is essential for the Commission to retain flexibility to select, and if necessary to modify, the general

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<sup>107</sup> See also 47 U.S.C. § 309(j)(4)(C)(ii), requiring the Commission, when prescribing area designations and bandwidth assignments, to promote "economic opportunity for a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women"; section 309(j)(3)(A), establishing the objective to promote "the development and rapid deployment of new technologies, products, and services for the benefit of the public, including those residing in rural areas, without administrative or judicial delays"; section 309(j)(12)(D)(iv), requiring that the Commission's 1997 report to Congress evaluate, inter alia, whether and to what extent "small businesses, rural telephone companies, and businesses owned by members of minority groups and women were able to participate successfully in the competitive bidding process."

designated entity provisions and eligibility requirements on a service-specific basis depending on the capital requirements and construction costs of the particular service.

## B. Rural Telephone Company Definition

67. Background. In the Second Report and Order, we adopted a definition of "rural telephone company" that includes independently owned and operated local exchange carriers that (1) do not serve communities with more than 10,000 inhabitants in the licensed area, and (2) do not have more than 50,000 access lines, including all affiliates.<sup>108</sup> We stated our belief that a limitation on the size of eligible rural telephone companies was appropriate because Congress did not intend for us to provide special treatment to large LECs that happen to serve small rural communities.<sup>109</sup>

68. Petitions. Several parties filed petitions for reconsideration of the Second Report and Order requesting that we modify our standard definition for rural telephone companies. Petitioners' proposals include requests that the Commission amend its definition of "rural telephone company" (1) to expressly include municipal- and government-owned telephone companies within the "rural telephone company" definition in accordance with the earlier Senate version of the Budget Act;<sup>110</sup> (2) to define "rural telephone company" as a local exchange carrier with annual revenues of less than \$100 million or serving no more than 100,000 access lines;<sup>111</sup> and (3) to include within the definition of "independently owned and operated" LECs that either operate 50,000 access lines or less or serve communities of 10,000 or fewer inhabitants.<sup>112</sup>

69. In addition, Blooston, Mordkofsky, Jackson & Dickens (Blooston) and South Dakota Networks, Inc. (SDN) request that the Commission eliminate the term "independently owned and operated" from the definition of "rural telephone company." According to Blooston, this restriction is unnecessary to prevent the largest telephone companies from taking advantage of provisions provided for rural telephone companies, since this same purpose is already served by the 50,000 access line limit, Blooston argues the Commission should amend its eligibility rules to indicate that they include the access lines of affiliates. Similarly, SDN indicates that the Commission should include "and affiliates" after "50,000 or fewer access lines" in the

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<sup>108</sup> 47 CFR § 1.2110(b)(3).

<sup>109</sup> See Second Report and Order at ¶282.

<sup>110</sup> See Anchorage Telephone Utility (ATU) Petition.

<sup>111</sup> See Petitions of The National Telephone Cooperative Association (NTCA), South Dakota Network, Inc. (SDN) and U.S. Intelco Networks, Inc. (USIN).

<sup>112</sup> See Petitions of the Rural Cellular Association (RCA) and SDN.

current definition. SDN maintains that the current language penalizes holding companies structured to permit telephone companies to offer paging and other nonregulated services.

70. The National Telephone Cooperative Association (NTCA) requests that the Commission amend the definition of rural telephone company to include any local exchange carrier with annual revenues of less than \$100 million or serving no more than 100,000 access lines. NTCA also indicates that the term "independently owned" should not exclude small rural telephone companies that are affiliated with each other and that rural telephone company consortia should be permitted. USIN similarly advocates a "rural telephone company" definition based annual revenues of less than \$100,000,000 or less than 100,000 access lines. According to USIN a revenue-based test is more accurate than net worth/net profit test.

71. The Rural Cellular Association (RCA), South Dakota Network, Inc. (SDN) and NTCA ask that the Commission amend the definition of rural telephone companies to include any independently owned and operated local exchange carriers ("LECs") that either operate 50,000 access lines or less or serve communities of 10,000 or fewer inhabitants. According to NCTA and RCA, the existing definition needlessly excludes many small independent telephone companies that serve rural areas. SDN alternatively requests that we revise the definition to include carriers with 100,000 or fewer access lines or up to \$100 million in annual revenues.

72. Finally, Anchorage Telephone Utility (ATU) requests that the Commission modify the definition of rural telephone companies to include government-owned telephone companies. According to ATU, such a modification is necessary to achieve congressional intent. ATU notes that the Senate bill included municipally-owned telephone companies in its definition of rural telephone companies. ATU's argues that the Senate Bill mandates special consideration for rural telephone companies and directed the FCC to grant "rural program licenses" to "qualified" common carriers and explicitly said that the category of "qualified" carriers included all state-owned and municipally-owned telephone companies.<sup>113</sup> As evidence Congress' intent to include these provisions in the enacted version of Budget Act, ATU asserts that the Conference Report declares that the Senate's "findings" are incorporated by reference.

73. Oppositions and Replies. In its Comment on Petitions for Reconsideration, BET supports retention of the Commission's existing generic rural telephone company definition.<sup>114</sup> BET maintains that adoption of RCA's proposal to define rural telephone companies as LECs that have 50,000 access or fewer or serve communities with no more than 10,000 inhabitants will allow large LECs that "happen to serve rural areas" to qualify for designated entity provisions. In response to BET's Comments, RCA asserts that the "independently owned and

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<sup>113</sup> See ATU Petition at 2-3.

<sup>114</sup> BET Comments at 2.

operated" requirement for rural telephone company eligibility will prevent large LECs from qualifying for rural telephone company provisions. RCA also restates its request for an amendment to the general rural telephone company definition to include LECs that serve 100,000 access lines or fewer.<sup>115</sup>

74. In light of the Commission's decision in Fifth Report and Order in this proceeding, which adopted an alternative rural telephone company definition, NTCA argues that the Commission should abandon its generic rural telephone company definition and instead establish rural telephone company eligibility criteria on a service-specific basis. Alternatively NTCA proposes that we define rural telephone companies to include LECs that have annual revenues not in excess of \$125 million or that serve no more than 100,000 access lines.<sup>116</sup> Tri-County Telephone Company, Inc. (Tri-County) supports SDN's proposed rural telephone company definition (50,000 access lines or serves no community with more than 10,000 inhabitants or alternatively 100,000 access lines or less).<sup>117</sup>

75. Discussion. We are persuaded by petitioner's arguments that the current generic "rural telephone company" definition is overly restrictive and effectively excludes many independently owned telephone companies that serve rural areas.<sup>118</sup> In the Fifth Report and Order we departed from our generic definition of rural telephone companies in the context of broadband PCS by adopting a definition that includes any local exchange carrier having 100,000 or fewer access lines, including all affiliates.<sup>119</sup> In adopting this definition of a "rural telephone company," we sought to achieve the congressional goal of promoting the rapid deployment of service in rural areas by targeting only those telephone companies whose service territories are predominantly rural in nature, and who are thus likely to use their wireline telephone networks to build infrastructures to serve rural America.<sup>120</sup> For purposes of our rules governing broadband PCS licenses, we indicated our belief that this goal could best be achieved if we defined "rural telephone companies" as those local exchange carriers having 100,000 or fewer access lines, including all affiliates. We concluded that this definition included virtually all telephone companies whose service areas are predominantly rural.

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<sup>115</sup> RCA Reply at 2.

<sup>116</sup> NTCA Reply Comments at 4.

<sup>117</sup> Tri-County Reply at 3.

<sup>118</sup> See RCA Petition at 4-5; USIN Petition at 10; NTCA Petition at 2.

<sup>119</sup> See Fifth Report and Order at ¶ 198.

<sup>120</sup> We also note that the unique technological requirements and the capital intensive nature of broadband PCS dictated that we adopt this definition of "rural telephone company."

76. For the foregoing reasons, we also believe that using the 100,000 access line definition as our standard rural telephone company definition will better serve our goals of encouraging the provision of service to rural areas than the definition previously adopted in the Second Report and Order. Accordingly, we will amend our standard definition of "rural telephone company" to include all local exchange carriers with 100,000 access lines or fewer, including affiliates. In general, we believe that this definition will more precisely capture those carriers that are truly rural in nature, while excluding the largest telephone carriers that do not face similar capital formation problems. We believe that this definition will also better achieve Congress' goal of fostering the development and rapid deployment of new technologies and services to rural areas by making special measures available to legitimate rural telephone companies that require such provisions in order to meaningfully participate in the provision of service to rural areas without giving such benefits to large companies that do not require such assistance. Rural telephone companies that satisfy this definition thus will be eligible for rural telephone company provisions in each service where such provisions are established.<sup>121</sup>

77. As indicated above, Blooston, SDN and NTCA request that we eliminate the phrase "independently owned and operated" from the definition of "rural telephone company." These petitioners assert that the "independently owned and operated" restriction in the rural telephone company definition was intended to prevent large telephone companies from taking advantage of rural telephone company benefits, but that this purpose is served by the access line limit. In this regard, SDN argues that such language unduly penalizes holding companies of nonregulated services and entities created by groups of telephone companies to provide equal access, SS7, and other services.

78. We agree. The new 100,000 access line rural telephone company definition adopted above, includes the access lines of affiliates. Under the affiliation rules established in the context of broadband PCS, and adopted below as our generic affiliation rules, the access lines of holding companies, parent companies or affiliates of rural telephone companies that are not independently owned will be attributed for purposes of determining eligibility. This definition will capture most of the independently owned rural telephone companies, while excluding carriers affiliated with the largest LECs. In addition, we are concerned that the requirement that a rural telephone company must be independently owned would unnecessarily exclude rural telephone companies that are part of a holding company structure. Therefore we will delete the "independently owned and operated" requirement from our standard rural telephone company definition.

79. With respect to ATU's request that we amend our definition of rural telephone company to include municipal and government owned telephone companies that are owned by governmental authorities, we do not believe that such a change is warranted. ATU contends that Congress meant to mandate special consideration not only for telephone carriers serving

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<sup>121</sup> Such companies also will be eligible for special treatment under our cellular attribution rules for broadband PCS. See 47 CFR § 24.204(d)(2)(ii).

rural areas but also for all municipally-owned telephone companies, even those with wholly or predominantly urban service areas.<sup>122</sup> This argument is based on ATU's interpretation of the Senate bill which preceded the enacted Budget Act. ATU argues that the Senate bill containing the prototype of a mandate for special consideration for rural telephone companies directed the FCC to grant "rural program licenses" to "qualified" common carriers and explicitly said that the category of "qualified" carriers included all state-owned and municipally-owned telephone companies. ATU further states that the report of the conference committee that drafted the Budget Act declares that the Senate's "findings" are incorporated by reference.<sup>123</sup> ATU also asserts that without the aid of special assistance it and most other state-owned and municipal telephone companies will not be able to purchase spectrum licenses at auction because it is politically infeasible for them to generate and retain enough surplus revenue to fund such investments, due to popular aversion to increases in taxes or telephone rates.<sup>124</sup>

80. As we indicated in the Fifth Report and Order, we are not persuaded by ATU's arguments.<sup>125</sup> We can find no specific evidence that Congress intended the term "rural telephone companies" to include all state or municipally-owned telephone companies. In fact, the preceding bill contained an explicit mandate for preferential treatment of government-owned telephone companies that was deleted from the enacted bill. To the contrary, the fact that an antecedent bill contained an explicit mandate for preferential treatment of government-owned telephone companies that was deleted from the enacted bill could just as easily be interpreted as an indication that Congress rejected such a rule. We also disagree that state and municipal governments are without the means to participate successfully in auctions. As we noted in Fifth Report and Order such governments have substantial capabilities to raise funds through private financing, bond offerings and taxation.<sup>126</sup>

### C. Rural Telephone Company Consortia

81. Petitions. Telephone and Data Systems, Inc. (TDS) requests that the Commission relax the eligibility requirements for rural telephone company bidding consortia by (1) eliminating the 50,000 access line limit for rural telephone company consortium applicants; (2) allowing companies with more than 50,000 access lines, directly or through affiliates, to

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<sup>122</sup> ATU Petition at 2-3.

<sup>123</sup> Id.

<sup>124</sup> Id. at 4-5.

<sup>125</sup> See Fifth Report and Order at ¶203.

<sup>126</sup> See Fifth Report and Order at ¶ 200. In any event, most state and municipally owned telephone systems (although not ATU) will be captured by our new 100,000 access line rural telephone company definition.

participate in rural telephone company consortia by demonstrating that more than 50 percent of their access lines company-wide (including affiliates) and over 50 percent of those in the proposed service area serve only communities with 10,000 or fewer inhabitants and (3) providing that all rural telephone companies in consortia with 50,000 access lines or less have the right to hold up to 60 percent of the equity in the consortium. SDN and NTCA also argue that the Commission should allow rural telephone companies to form consortia, since combining telephone companies would not alter their rural nature, so long as the rural telephone company retains at least 50.1 percent equity and control.

82. USIN similarly requests that small businesses, including rural telephone companies, be allowed to qualify for special provisions if they pool their resources into consortia, provided such consortia are controlled by designated entities. According to USIN, if such consortia are not permitted, rural telephone companies and other small businesses may be foreclosed from participation in the auction process and in the provision of auctionable services. USIN also indicates that efficiencies and economies of scale are created by aggregation and thus special measures should be provided to these entities who may be able to provide service most efficiently.

83. Discussion. We deny the requests of TDS, SDN,<sup>127</sup> and NTCA that we modify the standard definition of rural telephone company to eliminate or relax the access line limit for rural telephone company consortia. In the Second Report and Order as a general matter, we declined to provide exceptions to our designated entity eligibility criteria for applicants that are consortia of various individual entities, which in combination fail to qualify as designated entities.<sup>128</sup> We found that such combinations, if they deviate from our standard definitions of designated entities, should not be eligible for provisions expressly designed for designated entities. This conclusion was based on our desire to provide economic opportunity to those entities designated in the statute and to ensure such entities the opportunity to provide spectrum-based services. We concluded that establishing exceptions to our definitions for consortia (even those wholly comprised of otherwise qualified designated entities) would undermine this objective by diluting the economic opportunity for individual qualified designated entities. We also found that allowing applicants to be formed from a combination of eligible and ineligible entities would invite attempts to abuse the designated entity provisions by those not entitled to them.

84. However, in the Second Report and Order we noted that we may determine on a service-specific basis to allow a designated entity consortium to receive other benefits based

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<sup>127</sup> SDN argues that the Commission should allow rural telephone companies to form consortia among themselves, since combining telephone companies does not alter their rural nature. SDN also argues that consortia with investors should be permitted so long as the rural telephone company retains at least 50.1 percent equity and control. SDN Petition at ¶¶ 20-23.

<sup>128</sup> See Second Report and Order at ¶ 286.

on equity and operational participation in the consortium by one or more designated entities. We retained the flexibility to enable designated entity consortia to qualify for special provisions particularly where the capital costs of a particular service are high and the formation of consortia is thus essential to foster investment in designated entity ventures and to enable such entities to compete in the provision of such service. In this regard, in the Fifth Report and Order we allowed consortia comprised of small businesses to qualify for all of the measures applicable to individual small businesses provided each member of the consortium individually satisfies the definition of a small business. We found that given the "exceptionally large capital requirements" associated with broadband PCS, allowing small businesses to pool their resources in this manner was necessary to help them overcome capital formation problems and thereby ensure their opportunity to participate in auctions and to become strong broadband PCS competitors.

85. As a general matter, we will continue to determine whether to permit designated entities to receive benefits based on their participation in consortia on a service-specific basis, depending on the capital requirements and other characteristics of the particular service. We modify the Second Report and Order, however, to provide that consortia may be permitted to qualify for any designated entity provisions (where each member individually meets the eligibility requirements) on a service-specific basis, where the capital requirements of the service are high. Where, as in broadband PCS, we find that the capital requirements necessitate allowing designated entities to pool their resources to help them overcome capital formation problems and thereby ensure their opportunity to participate in auctions and in the provision of service, we may adopt rules allowing such consortia to qualify for designated entity provisions.

#### D. Affiliation Rules

86. Petitions. Blooston and NTCA request that the Commission clarify the meaning of "affiliate" for purposes of access line aggregation. According to Blooston, passive investments by a rural telephone holding company in other telephone companies should not preclude eligibility for rural telephone company status, so long as there is no common control between the rural telephone company and the other carrier. Blooston reasons that the common control definition is used in the auction rules for small businesses' affiliates, has been used by the Commission when defining connecting carriers, and is generally used by the financial community and the Securities and Exchange Commission. Finally, Blooston requests that the Commission amend its designated entity provisions to allow rural telephone companies to combine into consortia and partner with investors without losing designated entity status so long as the majority equity control resides with members who are rural telephone companies. NTCA similarly requests that the term "affiliates" be clarified to indicate what organizational structures are permitted.

87. Discussion. In response to the requests of NTCA and Blooston that we clarify the meaning of the term affiliate to indicate the types of organizational structures that will be included, we amend the Second Report and Order to establish as our standard affiliation rules

the same affiliation rules adopted by the Commission in the Fifth Report and Order.<sup>129</sup> Blooston specifically requests that we clarify the meaning of "affiliate" so that passive investments by a rural telephone company in other rural telephone companies do not preclude designated entity status if there is no common control. As described more fully below, under our affiliation rules a passive interest in another telephone company, which does not constitute control of that company would not be considered an affiliation for purposes of access line aggregation.

88. In the Second Report and Order, we referenced the SBA's affiliation rules for purposes of defining generally whether an entity qualifies as a small business and gave examples of how the affiliation rules would be applied. In the Fifth Report and Order we expanded on the SBA's affiliation rules in establishing detailed affiliation standards for broadband PCS to be used in the context of determining designated entity eligibility where our criteria are based on the size of the entity seeking special treatment and require applicants to include "affiliates" when calculating their eligibility. These affiliation requirements are intended to prevent entities that do not meet these size standards from receiving benefits targeted to smaller entities.<sup>130</sup> We believe that these rules are appropriate for determining affiliations generally, and therefore we will incorporate these standards into our generic auction rules for purposes of determining all size-based eligibility requirements. We summarize these standards below.

89. Where we adopt sized-based eligibility rules and provide that such eligibility determinations shall include the applicant and all its "affiliates," the following rules shall govern determinations regarding affiliation. Apart from determining affiliation between the applicant itself and outside entities, the need to determine affiliation arises where an investor has an attributable interest in a designated entity.<sup>131</sup> In this context it is necessary for the Commission to examine whether such investor has a relationship with other persons or outside entities that rise to the level of an affiliation with the applicant, and if so, whether the affiliate's assets, revenues, net worth, number of access lines, or other applicable financial thresholds, when aggregated with the applicant's, exceed the Commission's size eligibility thresholds.

90. General Principles of Affiliation. An affiliation under the SBA rules would arise, first, from "control" of an entity or the "power to control it." Thus, under the SBA rules, entities are affiliates of each other when either directly or indirectly (i) one concern controls

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<sup>129</sup> See Fifth Report and Order at ¶¶ 201-217.

<sup>130</sup> See, e.g., Second Report and Order at ¶ 272.

<sup>131</sup> In the context of broadband PCS, we stated that, generally, investors owning more than 25 percent of the applicant's passive equity would be considered to have "attributable" interests. See Fifth Report and Order at ¶ 158. With regard to IVDS, we used the SBA standard to determine attributable interests, i.e., control.

or has the power to control the other, or (ii) a third party or parties controls or has the power to control both.<sup>132</sup> In determining control, the SBA's rules provide generally that every business concern is considered to have one or more parties who directly or indirectly control or have the power to control it. The rules, in addition, provide specific examples of where control resides under various scenarios, such as through stock ownership or occupancy of director, officer or management positions. The rules also articulate general principles of control, and note, for example, that control may be affirmative or negative and that it is immaterial whether control is exercised so long as the power to control exists.<sup>133</sup> Second, an affiliation, under SBA rules, may also arise out of an "identity of interest" between or among parties.<sup>134</sup> We adopted these same general provisions as our affiliation rules for broadband PCS and will also incorporate them into our general affiliation rules.

91. In adopting these affiliation rules, we emphasize that these rules will not be applied in a manner that defeats the objectives of our service specific attribution rules. For example, in the context of broadband PCS, our attribution rules expressly permit applicants to disregard the gross revenues, total assets and net worth of certain passive investors, provided that an eligible control group has de facto and de jure control of the applicant.<sup>135</sup> Our attribution rules are designed to preserve control of the applicant by eligible entities, yet allow investment in the applicant by entities that do not meet the size restrictions in our rules. Therefore, so long as the requirements of our attribution rules are met, the affiliation rules will not be used to defeat the underlying policy objectives of allowing such passive investors. More specifically, if a control group has de facto and de jure control of the applicant, we shall not construe the affiliation rules in a manner that causes the interests of passive investors to be attributed to the applicant.

92. Applying these SBA affiliation rules, an affiliation would arise, for example, where an entity with an attributable interest in an applicant is under the control of another entity. An affiliation would also arise where an entity with an attributable interest in an applicant controls, or has the power to control, another entity. For example, if an attributable investor in an applicant is also a shareholder in a large Corporation X, when should Corporation X be deemed an affiliate of the applicant as a result of the shareholder's ownership interest in both entities? Under the SBA rules and the rules we adopt here, Corporation X would be deemed an affiliate of the applicant if the shareholder controlled or had the power to control

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<sup>132</sup> 13 CFR § 121.401(a)(2)(i), (ii).

<sup>133</sup> Id. § 121.401(c)(1).

<sup>134</sup> Id. § 121.401(a)(2)(iii), (d).

<sup>135</sup> See Fifth Report and Order at ¶ 205.

Corporation X, in which case, Corporation X's gross revenues must be included in determining the applicant's gross revenues.<sup>136</sup>

93. For purposes of determining control, ownership interests will be calculated on a fully-diluted basis. Thus, for example, stock options, convertible debentures, and agreements to merge (including agreements in principle) will generally be considered to have a present effect on the power to control or own an interest in either an outside entity or the PCS applicant or licensee. We will treat such options, debentures, and agreements generally as though the rights held thereunder had been exercised.<sup>137</sup> However, an affiliate cannot use such options and debentures to appear to terminate its control over or relationship with another concern before it actually does so.<sup>138</sup>

94. Voting and Other Trusts. In a similar vein, we also borrow from the SBA's rules and our own rules in other services to find affiliation under certain voting trusts in order to prevent a circumvention of eligibility rules. The SBA's rules provide that a voting trust, or similar agreement, cannot be used to separate voting power from beneficial ownership of voting stock for the purpose of shifting control of or the power to control an outside concern, if the primary purpose of the trust is to meet size eligibility rules.<sup>139</sup> Similarly, under the Commission's broadcast multiple ownership rules, stock interests held in trust may be attributed to any person who holds or shares the power to vote such stock, has the sole power

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<sup>136</sup> See Fifth Report and Order at ¶ 206.

<sup>137</sup> See 13 C.F.R § 121.401(f). SBA's rules provide the following examples to guide the application of this provision:

Example 1. If company "A" holds an option to purchase a controlling interest in company "B," the situation is treated as though company "A" had exercised its rights and had become owner of a controlling interest in company "B." The [annual revenues] of both concerns must be taken into account in determining size.

Example 2. If company "A" has entered into an agreement to merge with company "B" in the future, the situation is treated as though the merger has taken place. [A and B are affiliates of each other].

<sup>138</sup> Id. SBA's rules provide this example:

If large company "A" holds 70 percent (70 of 100 outstanding shares) of the voting stock of company "B" and gives a third party an option to purchase 66 of the 70 shares owned by A, company "B" will be deemed to be an affiliate of company "A" until the third party actually exercises its option to purchase such shares. In order to prevent large company "A" from circumventing the intent of the regulation which [gives] present effect to stock options, the option is not considered to have present effect in this case.

<sup>139</sup> 13 CFR § 121.401(g).

to sell such stock, has the right to revoke the trust at will or to replace the trustee at will.<sup>140</sup> Also, under the broadcast rules, if a trustee has a familial, personal or extra-trust business relationship to the grantor or the beneficiary of a trust, the stock interests held in trust will be considered assets of the grantor or beneficiary, as appropriate.<sup>141</sup> Because we believe the broadcast rules provide more definitive guidance in this particular area, we shall use them as a model for the general affiliation rules adopted here. Thus, for example, if an investor with an attributable interest in an applicant holds a beneficial interest in stock of another firm that amounts to a controlling interest in that other firm, depending on the identity of the trustee, the other firm may be considered an affiliate and its assets and gross revenues may be attributed to the applicant.

95. Officers, Directors and Key Employees. Under the SBA's affiliation rules, which we adopt as our generic approach, affiliations also generally arise where persons serve as the officers, directors or key employees of another concern and they represent a majority or controlling element of that other concern's board of directors and/or management of the outside entity.<sup>142</sup> Thus, if a person with an attributable interest in an applicant, through his or her other key employment positions or positions on the board of another firm, controls that other firm, then the other firm will be considered an affiliate of the applicant. Such affiliations may or may not result in the applicant's exceeding our size limitations. As this rule reflects, for purposes of attributing the financial position of an outside entity in this context, officers and directors of an outside concern are not foreclosed entirely from holding attributable or non-attributable interests in an applicant. Whether or not such persons control the outside entity, we also do not want to prohibit these persons, who may be experienced in the telecommunications, finance, or communications and equipment industries, from assisting start-up companies by serving as officers or directors of the applicant. Thus, if such persons serving as officers or directors of the applicant do not control the applicant or otherwise have an attributable interest in the applicant, their outside affiliations (even if controlling) will not be considered at all for purposes of determining the applicant's eligibility under our rules.<sup>143</sup>

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<sup>140</sup> See 47 CFR § 73.3555 note 2(e).

<sup>141</sup> Id.

<sup>142</sup> See 13 CFR § 121.401(h). A key employee is an employee who, because of his/her position in the concern, has a critical influence in or substantive control over the operations or management of the concern. 13 CFR § 121.405.

<sup>143</sup> SBA's size standard affiliation rules also provide that affiliations can arise in a variety of other scenarios, such as where one concern is dependent upon another for contracts and business, where firms share joint facilities, or have joint venture or franchise license agreements. To the extent we believe these rules may have general applicability we shall codify them in our affiliate rules. We caution parties that issues relating to de facto control of the applicant (or parties with attributable interests in the applicant) could also arise under arrangements not expressly codified in the rules.

96. Affiliation Through Identity of Interest: Family and Spousal Relationships. Consistent with the SBA's rules, an affiliation may arise not only through control, but out of an "identity of interest" between or among parties.<sup>144</sup> For example, affiliation can arise between or among members of the same family or persons with common investments in more than one concern. In determining who controls or has the power to control an entity, persons with an identity of interest may be treated as though they were one person.<sup>145</sup> For example, if two shareholders in Corporation X are both attributable shareholders in an applicant, to the extent that together they have the power to control Corporation X, Corporation X may be deemed an affiliate of the applicant.

97. Similarly, as under the SBA rules, we will consider spousal and other family relationships in determining whether an affiliation exists. Under the SBA rules for determining small business status, for example, members of the same family may be treated as though they were one person because they have an "identity of interest."<sup>146</sup> Likewise, in order to determine whether individuals are economically disadvantaged, the SBA rules governing eligibility for participation in the government's "section 8(a)" program for socially and economically disadvantaged small businesses have special provisions for attributing spousal interests. The latter rules provide generally that half of the jointly-owned interests of an applicant and his or her spouse must be attributed to the applicant for purposes of determining the applicant's net worth.<sup>147</sup>

98. In the context of auction size-based eligibility standards at issue here, we begin by clarifying that our reason for considering spousal and kinship relationships is not to determine whether the spouse or other kin of a women-owned applicant actually is controlling the applicant, thereby violating our eligibility rules for woman-owned businesses. Our rules do not embody any presumptions concerning spousal control in that context. Rather, our objective here is to ensure both that entities are actually in need of the assistance provided by our rules and that entities otherwise ineligible under applicable size criteria do not circumvent the rules by funding family members that purport to be eligible applicants.

99. In formulating these rules, we need to consider also that, as a practical matter, it will not be possible for us prior to the auctions to resolve all questions that pertain to the individual circumstances of particular applicants. Furthermore, if we determine subsequent to an auction that a winning bidder in fact was ineligible to bid or to benefit from special provisions, such as bidding credits, because of spousal or kinship relationships, not only will authorization of service be delayed but, as discussed above, disqualified applicants may be

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<sup>144</sup> See 13 CFR § 121.401(a)(2)(iii).

<sup>145</sup> *Id.* at § 121.401(d).

<sup>146</sup> 13 CFR § 121.401(d).

<sup>147</sup> See 13 CFR § 124.106(a)(2)(i)(A)(1).

subject to substantial penalties. In these circumstances, we think that the public interest requires that we endeavor, insofar as possible, to establish bright-line tests for determining when the financial interests of spouses and other kin should be attributed to the applicant.

100. We have decided that, for purposes of determining whether the financial limitations in our eligibility rules have been met, we will in every instance attribute the financial interests of an applicant's spouse to the applicant. This will resolve any concern that an applicant might transfer his or her assets to a spouse in order to satisfy the financial restrictions that apply to eligible entities. For example, an applicant could not transfer stock or other assets to his or her spouse and thereby dispose of interests that, if held by the applicant, would render the applicant ineligible. Just as importantly, this approach will resolve any concern that an applicant might participate in bidding by using the personal assets of an ineligible spouse, which would defeat entirely the objective of providing special financial measures for designated entities.

101. In adopting this rule, we fully recognize that instances could arise in which, if all factors were considered, attributing a spouse's financial interests to the applicant could lead to harsh results. As a general matter, however, we think it provides a workable bright-line standard that resolves fully our policy concerns and avoids undesirable ambiguity concerning the nature of our requirements. As in the SBA rules, however, one exception is clearly warranted; this affiliation standard would not apply if the applicant and his or her spouse are subject to a legal separation recognized by a court of competent jurisdiction. In calculating their personal net worth, for example, investors in the applicant who are legally separated must, of course, still include their share of interests in community property held with a spouse.

102. As indicated above, circumstances could also arise in which other kinship relationships are used as a means to evade our eligibility requirements. Because we believe kinship relationships in many cases do not present the same potential for abuse that exists with spousal relationships, particularly in terms of the "identity of interests" that are likely to exist between the persons involved, we shall adopt a more relaxed standard for determining when kinship interests must be attributed to applicants. In this area, we shall follow the same standard that is applied by the SBA when interpreting its "identity of interest" rule described above. Specifically, an identity of interests between family members and applicants will be presumed to exist, but the presumption can be rebutted by showing that the family members are estranged, or that their family ties are remote, or that the family members are not closely related in business matters.<sup>148</sup> For purposes of determining who is a family member under this rule, we shall use a definition that is identical to the definition of "immediate family member" in the SBA's rules, 13 CFR § 124.100.

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<sup>148</sup> See generally Texas-Capital Contractors, Inc. v. Abdnor, 933 F.2d 261 (5th Cir. 1990).

103. In appropriate cases, an applicant should be able to rebut the presumption regarding kinship affiliations with relative ease, simply by demonstrating that the applicant has no close relationship in business matters with the relevant family members. Of course, should such business relationships arise with a winning applicant after the auction, we might need to consider whether the applicant intended to circumvent the requirements of our eligibility rules.

104. The affiliation requirement is intended to prevent entities that, for all practical purposes, do not meet the size standard required for eligibility from receiving benefits targeted to smaller entities.<sup>149</sup> We believe that the affiliation rules described above will accomplish this objective.

#### **E. Rural Telephone Company Bidding Credits.**

105. Petitions. NCTA, USIN and SDN argue that the FCC should retain the rural telephone company bidding credit provision adopted in the Second Report and Order but delete the accelerated build-out requirement as a condition for receipt of bidding credits. USIN asserts that bidding credits will not help attract capital when tied to such an expanded build-out requirement. According to USIN, making bidding credits contingent on an accelerated build-out effectively nullifies the provision because the commitment of additional capital for network build-out will reduce the amount available to finance the license price by enough to offset any benefit conferred by the availability of the credit.<sup>150</sup> SDN agrees that additional build-out should not be required as a prerequisite for rural telephone company bidding credits, but states that a rural telephone company should receive additional bidding credits if it substantially covers its certified rural service area during its license term.<sup>151</sup> NTCA argues that the accelerated build-out requirement for bidding credits should be eliminated since this requirement is unrelated to the statutory purpose of promoting investment in and rapid deployment of new technologies and services in rural areas.<sup>152</sup>

106. SDN also contends that the risk of forfeiting the bidding credit (plus interest) for failure to meet the expanded build-out commitment will have a chilling effect because of the difficulty of anticipating potential problems that may be encountered in attempting to extend service rapidly to remote areas. Further, SDN maintains that an accelerated build-out requirement could engender a perverse incentive for a rural telephone company that would otherwise concentrate primarily on providing PCS service in the rural portions of a BTA or MTA (which, according to SDN might be a commercially-attractive strategy because of

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<sup>149</sup> See, e.g., Second Report and Order at ¶ 272.

<sup>150</sup> USIN Petition at 12.

<sup>151</sup> SDN Petition at 14.

<sup>152</sup> See 47 U.S.C. § 309(j)(3)(A).

steeper competition in urban areas), forcing it to concentrate instead on extending its network in densely-populated areas.<sup>153</sup>

107. Finally, SDN and USIN contend that it is inequitable to provide rural telephone companies with a less favorable bidding credit provision than other designated entities. In this regard, USIN argues that the Second Report and Order fails to explain why rural telephone company bidding credits should contain more restrictive terms than other designated entity bidding credits. On the contrary, SDN contends that rural telephone companies should receive a greater bidding credit than other entities, because they face higher service and construction costs. Accordingly, SDN maintains that if accelerated build-out is to be included in the rural telephone company provision, an incentive should be provided in the form of bonus credit over and above the standard bidding credit available to other designated entities.

108. Discussion. In the Second Report and Order we adopted a system of bidding credits for rural telephone companies designed to further promote the investment in and rapid deployment of new technologies and services in rural areas.<sup>154</sup> We generally concluded that any special measures adopted for rural telephone companies, including bidding credits, should be limited to bidding for licenses in their rural service areas. We found that this limitation satisfied Congress's objectives without unduly favoring rural telephone companies in markets where there was no compelling reason to do so. Specifically, we concluded that Congress was primarily concerned with assuring rural consumers the benefits of new technologies and providing opportunities for participation by rural telephone companies in the provision of wireless services that supplement or replace their landline facilities.<sup>155</sup> Accordingly, we provided that rural telephone companies would be eligible for bidding credits for specified licenses only in their service areas.

109. However, unlike bidding credits available to women and minority-owned firms, we linked the amount of the bidding credit for rural telephone companies to their commitment to achieve certain expanded infrastructure build-out requirements in their rural service areas. We provided that the amount of the bidding credit would be proportionately linked to the amount by which the rural telephone company agreed to expand its build-out commitment. In this regard, we indicated that failure to meet the expanded build-out commitment would result in liability for a penalty in the amount of the bidding credit, plus interest at the rate applicable to installment payments. We further provided that grant of the licenses to rural telephone companies utilizing bidding credits would be conditioned upon payment of this penalty, if and when it becomes applicable. We concluded that this added construction requirement would

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<sup>153</sup> SDN Petition at 14-15.

<sup>154</sup> See 47 U.S.C. § 309(j)(3)(A).

<sup>155</sup> Second Report and Order at ¶ 243.

fulfill the congressional objective of developing and rapidly deploying new services to those residing in rural areas.

110. On reconsideration of this issue, we no longer believe the provision in the Second Report and Order, which links the availability of bidding credits for rural telephone companies to their agreement to satisfy an expanded construction requirement, is necessary or appropriate to promote the statutory objectives. We agree with petitioners' assertions that the expanded build-out requirement may have adverse consequences contrary to the purpose of bidding credit provision. We are also concerned that the expanded construction requirement may be unduly burdensome both to rural telephone company licensees and the Commission. In this regard, we are concerned that the accelerated build-out requirement may not be economically feasible in some rural areas and thus may result in frequent forfeitures of the bidding credit amount by rural telephone companies. As discussed more fully below, we now believe that Congress' objectives of promoting investment in and rapid deployment of new technologies and services to rural areas will best be achieved through the use of other provisions such as installment payments, bidding credits (without an expanded build out requirement), and service area partitioning. Thus, we amend our rules to retain flexibility to adopt any of these or other provisions for rural telephone companies on a service-specific basis after considering the characteristics and capital requirements of the particular service.

#### **F. Rural Telephone Company Eligibility for Installment Payments**

111. Petitions. SDN, USIN, and NCTA all request that installment payments be extended to rural telephone companies regardless of their status as small businesses. AIDE and Cook Inlet argue that all designated entities should be permitted to pay for their licenses in installment payments irrespective of their size. These parties all object to the decision to limit eligibility for installment payments to small businesses as defined in §1.2110(b)(1), (i.e., companies with net worth including that of affiliates of \$6 million or less and no more than \$2 million of annual after-federal-tax profit for the last two years). USIN argues that there is no statutory support in the provisions cited by the Commission as authority for adopting different provisions for one designated entity group as opposed to another.

112. Citing the legislative history to the Budget Act and H.R. Report No. 103-111 in particular, USIN also maintains that the statutory purpose of requiring special provisions for designated entities was to promote entry by firms with difficulty in obtaining access to capital. Petitioners maintain that the \$6 million net worth/\$2 million net revenue standard for installment payment eligibility is too strict and will prevent rural telephone companies from qualifying for the installment payment option although they face significant difficulty in obtaining access to capital. USIN asserts that as a practical matter rural telephone companies may have high levels of non-amortized assets and yet have less capital available for investment than many businesses that meet the small business definition. SDN maintains that rural telephone companies should be eligible for installment payments regardless of whether they qualify as small businesses because they will generally incur higher build out costs with lower revenue streams than other designated entities. According to USIN, a rural telephone

company bidding for a license in a capital-intensive service should be eligible for installment payments if its annual revenue are under \$100 million USIN asserts that without installment payments such telephone companies will be unable to bid for broad-coverage licenses as traditional rural telephone company lenders have indicated unwillingness to finance auction bids.

113. AIDE objects to the determination in the Second Report and Order that limits the installment payment option to small businesses bidding on licenses for "those smaller spectrum blocks that are most likely to match the business objectives of bona fide small businesses."<sup>156</sup> According to AIDE, such the installment payment option should be available to all designated entities bidding on all licenses. AIDE maintains that Congress did not intend to give the FCC discretion to offer special provisions to some designated entities in some auctions but not in others. AIDE argues, moreover, that these limitations on the availability of installment payments are not justified by the Commission's desire to prevent abuse of its designated entity provisions since there are other safeguards designed specifically for that purpose, such as the rules for disclosure of real parties in interest, the definitional requirements including the assets of affiliates and the financial qualification rules.

114. Discussion. For the reasons set forth below, we deny petitioners' requests to expand the installment payment option to other designated entities irrespective of their economic status. However, we will retain the flexibility to expand or modify the installment payment option on a service-specific basis for other appropriately-sized entities where the spectrum costs and capital infrastructure requirements necessitate their application to other entities. For example, in the Fifth Report and Order we recognized that the substantial expected capital required to acquire and construct broadband PCS licenses warranted expansion of the installment payment option to most entities acquiring licenses in the entrepreneurs' blocks.<sup>157</sup> Under the broadband PCS rules, installment payments are available to smaller entities that do not technically qualify as small businesses and an enhanced installment payment option is available to eligible small businesses and businesses owned by women and/or minorities.

115. In the Second Report and Order, we concluded that for some auctions, small businesses would be eligible for installment payments. We noted that by allowing payment in installments, the government would be extending credit to an eligible winning bidder, thus reducing the amount of private financing needed in advance of the auction by a prospective licensee. We noted that this will assist small entities who are likely to have difficulty obtaining adequate private financing. As a result, we concluded that installment payments would be an effective way to promote efficiently the participation of small businesses in the provision of spectrum-based telecommunications service and an effective tool for efficiently

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<sup>156</sup> See Second Report and Order at ¶ 237.

<sup>157</sup> See Fifth Report and Order at ¶¶ 136-140.

distributing licenses and services among geographic areas.<sup>158</sup> Thus, we limited application of installment payments to small entities, including such entities that are owned by minorities and/or women. We found that this approach best served the intent of Congress in enacting section 309(j)(4)(A), to avoid a competitive bidding program that has the effect of favoring incumbents, with established revenue streams, over new companies or start-ups.<sup>159</sup>

116. Consistent with Congress's concern that auctions not operate to exclude small businesses, the provisions relating to installment payments for minorities and/or women also were intended to assist only minorities and women who are small businesses. The House Report states that these related provisions were drafted to "ensure that all small businesses will be covered by the Commission's regulations, including those owned by members of minority groups and women."<sup>160</sup> (emphasis added). It also states that the provisions in section 309(j)(4)(A) relating to installment payments were intended to promote economic opportunity by ensuring that competitive bidding does not inadvertently favor incumbents with "deep pockets" "over new companies or start-ups."<sup>161</sup> Because the Congressional objective here was to assist "new companies or start-ups," we therefore concluded that the Commission should use installment payments only for smaller sized entities. As indicated by the legislative history, large entities with established revenue streams were not intended to be beneficiaries of this particular means of financial assistance. We concluded that the statutory language, when read in conjunction with the legislative history, does not indicate that Congress's purpose was to accord special financial assistance measures under section 309(j)(4)(A) to entities other than those with small economic status.<sup>162</sup> In this regard, we reject petitioner's proposals to allow installment payments for rural telephone companies or other designated entities irrespective of their size. We will continue to determine on a service-specific basis the appropriate economic eligibility criteria for installment payments. And we may, as we did in the context of broadband PCS, establish different installment payment options for entities who face different economic barriers.

117. In addition, and consistent with our decision to limit installment payments to small entities, we decline to make installment payments available for all licenses in all auctions. Rather, in order to match the provisions with eligible recipients, we will continue to make

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<sup>158</sup> See Second Report and Order at ¶¶ 233-240.

<sup>159</sup> See H.R. Rep. No. 103-111 at 255.

<sup>160</sup> Id.

<sup>161</sup> Id.

<sup>162</sup> Under authority of Section 309(j)(4)(D), we have, however, afforded other types of financial assistance measures, such as bidding credits, to other designated entities. See e.g., Third Report and Order, in PP Docket No. 92-253, 59 FR 26741 (May 24, 1994), at ¶¶ 72-81 (which provides bidding credits to businesses owned by minorities and/or women).

installment payments available only for certain licenses that do not involve the largest spectrum blocks and service areas. In this regard, in the context of narrowband PCS, we adopted installment payments only for the regional, MTA and BTA licenses. Similarly, for broadband PCS, we limited eligibility for installment payments to the BTA licenses contained in the entrepreneurs' blocks. We continue to believe that where large, valuable blocks of spectrum are being auctioned we should not give ineligible entities the incentive to create small business "fronts," thereby enabling large businesses to become eligible for low-cost government financing. Nor do we desire to delay service to the public by encouraging under-capitalized firms to receive licenses for facilities which they may lack the resources adequately to finance.<sup>163</sup> Accordingly, we will continue to allow installment payments only for licenses in those smaller spectrum blocks and service areas that are most likely to match the business objectives of bona fide small entities in the context of a particular service. The particular spectrum block sizes that will be eligible for installment payments will be decided in the context of each particular service taking into account the cost of acquiring the spectrum and constructing the system.

### G. Rural Telephone Company Partitioning

118. Petitions. SDN requests that rural telephone companies be allowed to partition their rural service areas either pursuant to an agreement with the BTA or MTA licensee, or by licensing a separate PCS service area using a system similar to the cellular unserved area application process.<sup>164</sup>

119. Several commenters responding to the NPRM in this proceeding suggested that the Commission allow partitioning of PCS licenses so as to permit rural telephone companies to hold licenses to provide service only in their service areas.<sup>165</sup> In the Second Report and Order we recognized that partitioning may be an effective means to achieve Congress's goal of ensuring that advanced services are provided in rural areas.<sup>166</sup> In the context of broadband PCS, we adopted a system of geographic partitioning, for rural telephone companies which allows rural telephone companies to acquire partitioned broadband PCS licenses in one of two ways: (1) they may form bidding consortia to participate in auctions, and then partition the licenses won among consortia participants, or (2) they may acquire partitioned broadband PCS licenses from other licensees through private negotiation and agreement either before or after the auction (provided the partitioned area is reasonably related to the size of the rural

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<sup>163</sup> See 47 U.S.C. § 309(j)(3)(A).

<sup>164</sup> See SDN Petition at 7.

<sup>165</sup> See, e.g., comments of GVNW at 2-4, and NTCA at 13.

<sup>166</sup> See Second Report and Order at ¶ 243 n. 186.

telephone company's rural service area).<sup>167</sup> We require that partitioned areas conform to established geopolitical boundaries and that each area include the wireline service area of the rural telephone company applicant. We believe that this system of partitioning of rural service areas will provide a significant opportunity for many of these designated entities who desire to offer PCS to their customers as a complement to their local telephone services. Therefore, we will retain the flexibility in the generic auction rules to adopt a system of partitioning on a service-specific basis where the capital requirements and construction costs are such that a system is necessary to assist rural telephone companies who cannot afford or do not desire to bid for or construct systems for an entire service area.<sup>168</sup>

#### H. Unjust Enrichment Provisions

120. Petitions. AIDE requests that when the Commission recaptures the benefits accruing to a designated entity pursuant to the unjust enrichment provisions, the unjust enrichment penalty should credit the licensee's pre-sale investments in the license and should be based on the portion of the licensee's taxable gain on the sale allocated to the license, with appropriate adjustments. BET similarly requests that the Commission revise the unjust enrichment provisions to credit the designated entity for its pre-transfer expenditures on the license including construction costs.

121. Discussion. We deny the requests of AIDE and BET. In the Second Report and Order the Commission crafted unjust enrichment provisions designed to prevent designated entities from profiting by the rapid sale of licenses acquired through the benefit of provisions and policies meant to encourage their participation in the provision of spectrum-based services. These rules were intended to deter designated entities from prematurely transferring licenses obtained through the benefit of provisions designed to create opportunities for such designated entities in the provision of spectrum-based services. We sought through our unjust enrichment provisions to discourage designated entities who do not intend to provide service to the public from abusing our provisions by obtaining a license at a lower cost than other licensees and then selling the license after a short time to a non-designated entity at a profit. In addition, the unjust enrichment rules were intended to recapture for the government a portion of the value of the bidding credit or other special provision if such a designated entity prematurely transfers its licenses to an ineligible entity, thereby frustrating the government's efforts to encourage the inclusion of designated entities in the provision of new spectrum-based services.

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<sup>167</sup> See Fifth Report and Order at ¶152.

<sup>168</sup> In a Further Notice of Proposed Rulemaking in this docket, the Commission will also explore the merits of allowing businesses owned by minorities and/or women to acquire partitioned PCS licenses, as well as partitioned licenses in other services.

122. We recognize that over time, a designated licensee may have made substantial investments in a license prior to transfer. In order to reward efficiency and encourage such investments in infrastructure development, we provided that we will generally reduce the amount of the recapture penalty as time passes or construction benchmarks are met.<sup>169</sup> We further provided that our recapture provisions would not apply to the transfer or assignment of a license that has been held for more than five years.<sup>170</sup> In addition, where a recapture penalty is assessed, we stated that the penalty will not prevent the transferring designated entity from recovering the depreciated value of its capital investment. Moreover, we indicated that in appropriate circumstances, we might waive recapture "if the licensee has incurred substantial start-up costs or made significant capital investments with the intention of starting service, but due to circumstances beyond its control, was unable to provide service."<sup>171</sup>

123. We believe that these measures adequately account for a designated entity's pre-transfer investments in a license, including construction expenses. Therefore, we decline to adopt AIDE's proposal that we credit the licensee's pre-sale investments in the license and base the recapture amount on the portion of the licensee's taxable gain on the sale allocated to the license, because such provisions would require the government to undertake lengthy and complex accounting and allocation proceedings to determine the amount of the penalty. Similarly, we deny BET's request that we credit designated entities for their pre-transfer expenditures on a license because we believe that our recapture provisions adequately account for these expenditures by reducing the amount of the penalty over time. Moreover, the unjust enrichment provisions were designed to act as a penalty to deter premature license transfers by designated entities. Therefore we decline to modify the recapture provisions adopted in the Second Report and Order. We note, however, that because license terms and construction requirements vary by service, and because we may adopt different designated entity provisions for different services, we will set forth the specific recapture provisions in the service-specific competitive bidding rules of each auctionable service. Moreover, we modify our general recapture provisions to provide flexibility on a service-specific basis to extend the duration of the recapture provisions beyond five years.

#### **I. Upfront Payment Amount**

124. Petitions. AIDE requests that the Commission reduce the amount of the upfront payment for designated entities. AIDE asserts that a reduced upfront payment would help ensure that capital constrained designated entities have the opportunity to participate in the competitive bidding process. According to AIDE, a reduced upfront payment is necessary to create opportunities for designated entities to participate in competitive bidding and will allow such entities to preserve their limited resources for post-auction infrastructure development.

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<sup>169</sup> See Second Report and Order at ¶ 262.

<sup>170</sup> Id.

<sup>171</sup> Id. at n.205.

125. Discussion. The Commission adopted an upfront payment requirement in order to ensure that only serious, qualified bidders participate in our auctions. We reasoned that an upfront payment requirement would ensure the validity of the information generated during auctions and increase the likelihood that licenses will be awarded to the qualified bidders who value them the most, thus promoting the rapid deployment of new technology. Upfront payments will also provide the Commission with a source of available funds in the event a bid withdrawal penalty must be assessed. By requiring a substantial upfront payment amount, the Commission seeks to deter speculative and frivolous bidding by all bidders, including designated entities. Moreover, the standard upfront payment formula (\$.02 per MHz per pop for the maximum MHz-pops a bidder intends to bid on in any single round of bidding), is based on the amount of spectrum and population coverage on which a bidder seeks to bid and therefore is directly linked to the expected value of the license and anticipated construction costs a licensee will incur.

126. Nevertheless, in the Second Report and Order we retained the flexibility to cap, reduce or modify the upfront payment amount for designated entities.<sup>172</sup> We indicated that such decisions would be made in the service-specific competitive bidding rules for individual services. In the Fifth Report and Order, recognizing that the standard upfront payment formula may create a barrier for smaller entities wishing to participate in auctions, we reduced by 25 percent the upfront payment amount required for designated entities bidding in the entrepreneur's blocks.<sup>173</sup> Given the varied spectrum costs of different services, we will continue to consider such reduced upfront payments for designated entities on a service-specific basis. Generally, we will only reduce the upfront payment amounts for designated entities in capital intensive services, such as broadband PCS, where the spectrum bandwidth will result in upfront payment amounts that may be prohibitive for some smaller entities.

#### **J. Installment Payments**

127. In the Second Report and Order, we stated that, for some auctions, winning bidders that are small businesses would be eligible to use installment payments in paying for licenses.<sup>174</sup> We provided that for these winning bidders, a down payment of 10 percent would be due within five business days of the close of the auction, and that an additional 10 percent would be due within five days of grant of the license.<sup>175</sup> We stated that we would impose interest on installment payments at a rate equal to the rate for U.S. Treasury obligations of maturity equal to the license term. We stated that the schedule of installment payments would

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<sup>172</sup> See Second Report and Order at ¶ 178 n.37.

<sup>173</sup> See Fifth Report and Order at ¶ 156.

<sup>174</sup> Id. at ¶ 233.

<sup>175</sup> Id. at ¶ 238.

begin with interest-only payments for the first two years, and that thereafter principal and interest would be amortized over the remaining term of the license.<sup>176</sup>

128. Upon reconsideration, we have decided that we may need to tailor installment payment provisions more precisely to needs of various groups of designated entities and the characteristics of particular services. In the Fifth Report and Order we provided installment payments for minorities and women in some blocks, and provided different installment provisions for small businesses of different sizes.<sup>177</sup> We will continue to establish different installment payment provisions on a service-specific basis. We may offer installment payments to minorities and women, in some circumstances, and may offer installment payments having differing terms to different classes of designated entities. We may vary the interest rate and the payment schedule for installment payments, including the amount and timing of the down payment and the schedule for amortization of principal and interest. Installment payment provisions for each service will be specified in Orders establishing auction rules for that service. We believe that this additional flexibility will allow us to take account of differences in capital requirements across services and license blocks, and to provide access to capital in ways that will give various groups of designated entities a realistic chance to participate in offering service.

#### K. Eligibility Issues

129. Petitions. Black Entertainment Television Holdings, Inc. (BET) requests that the FCC reconsider the public company restriction on the availability of provisions for minority and women-owned companies in broadband PCS. BET argues that given the costs of acquiring spectrum and the construction expense, such a limitation would defeat realistic opportunities for a wide range of minority-owned firms. BET also requests that we clarify that provisions for minority and women-owned firms are separate and distinct from provisions for small businesses. Finally, BET argues that rights, privileges, options or other forms of ownership that do not affect the ability of a designated entity to control a company, or diminish a designated entity financial stake in a venture, should not be considered in the definitional analysis for purposes of determining eligibility.

130. Discussion. In the Second Report and Order, we stated that publicly traded minority and women-owned companies would not be eligible for provisions applicable to these designated entities. In the Fifth Report and Order, however, we deviated from this restriction to allow publicly traded minority and women-owned companies to qualify to bid in the entrepreneurs' block, and under certain circumstances to qualify for bidding credits.<sup>178</sup> We will continue to consider exceptions to our restriction on publicly traded company eligibility

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<sup>176</sup> Id. at ¶ 239.

<sup>177</sup> Fifth Report and Order at ¶¶ 137-139.

<sup>178</sup> See Fifth Report and Order at ¶¶ 163-164.

for minority and women-owned businesses on a service-specific basis, in each case considering the capital requirements and the expected build-out cost of the service. We agree with BET that in services with high entry costs, precluding publicly traded companies from receiving measures intended for minority and women-owned businesses may undermine our objective of ensuring the opportunity for these designated entities to participate in the provision of spectrum-based services.

131. As requested by BET, we clarify that the provisions for businesses owned by women and minorities are separate and distinct from the provisions for small businesses. Thus, women and minority-owned businesses may qualify for measures adopted for these entities irrespective of their size, and small businesses may qualify for small business provisions regardless of their ownership by minorities and women. And small businesses that are owned by members of minorities and/or women may qualify for provisions applicable to both groups.

132. Finally, in the general auction rules, we indicated that in determining designated entity eligibility we would consider all rights, warrants and options on a fully diluted basis, *i.e.*, they will be treated as if already exercised.<sup>179</sup> We intend to maintain the existing rule of calculating these ownership interests on a fully diluted basis, since we expect that such ownership interests will almost always have the potential either to impact the ability of a designated entity to control a company or to diminish a designated entity's financial stake in the venture. However, in the rare circumstance where such ownership interests have no effect on a designated entity's ability to control a firm or to diminish the designated entity's financial stake, we will consider requests for waivers.<sup>180</sup> We note, however, that we expect such instances to be rare, and petitioners will be required to make an affirmative showing sufficient to overcome the presumption that such ownership interests should be calculated as if exercised for purposes of determining eligibility issues.

133. Petitions. AIDE and Cook Inlet propose stricter eligibility and anti-sham measures to avoid designated entity shams. Specifically, Cook Inlet proposes requiring that a designated entity maintain clear structural control of an entity in order to be eligible for designated entity provisions. In this regard, Cook Inlet argues that in limited partnerships, the general partner should be required to be a designated entity and restrictions should be imposed on the ability of other general partners to exercise management control. Cook Inlet also proposes that the Commission require designated entities to document their eligibility by attaching documentation to their long form application.

134. We agree with AIDE that in some instances stricter eligibility requirements are appropriate to ensure that only legitimate designated entities are the beneficiaries of the

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<sup>179</sup> 47 CFR Sec. 1.2110 (b)(2).

<sup>180</sup> See 47 CFR Sec. 1.2110.

special provisions established under our rules. In particular, we clarify that, when an applicant or a licensee is a partnership, because each general partner generally has the ability to act on behalf of the partnership, all general partners in the license applicant must be designated entities in order to qualify for designated entity status. We believe that this clarification is consistent with the Commission's long-standing practice of attributing control in the context of partnerships to the general partners. This clarification will ensure that designated entities in partnerships retain de facto as well as de jure control.

135. In addition, we agree with AIDE that documentation of designated entity status should be submitted along with the applicants' long-form applications in order to enable the Commission to verify designated entity eligibility. Accordingly, we will require designated entities to substantiate their eligibility by describing on their long-form application how they satisfy the requirements for eligibility. We will also require designated entity applicants to list on their long-form application all agreements that effect designated entity status, such as all partnership agreements, shareholder agreements, management agreements and other agreements, including oral agreements, which establish that the designated entity will have both de facto and de jure control of the entity. In addition, we will require that such information be maintained at the licensee's facilities, or by its designated agent, for the term of the license, and that the information be made available to Commission staff upon request in order to enable the Commission to audit designated entity eligibility on an ongoing basis.

136. In addition, if an applicant for designated entity status proves unqualified, and the Commission determines that the application for designated entity status involved willful misrepresentation or other serious misconduct, the Commission will impose severe penalties. These may include monetary forfeitures, revocation of licenses, and prohibition of participation in future auctions.

137. With respect to AIDE's proposal that clear structural control should be required to establish designated entity eligibility, we believe that as a general rule, our strict requirement that women and minority principals control the applicant and maintain a 50.1 percent voting interest (in a corporate applicant) and a 50.1 percent equity stake in the entity is sufficient to prevent "fronts" and to ensure that our provisions are only made available to legitimate qualified designated entities. However, we reserve the flexibility on a service-specific basis, taking into account the nature of the specific provisions applicable in that service, to adopt additional or different requirements for designated entity eligibility.<sup>181</sup>

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<sup>181</sup> For example, in the Fifth Report and Order we allowed minority or women-owned broadband PCS applicants to sell up to 75 percent of the company's equity to passive investors so long as the control groups retained control and 25 percent of the equity and each other investor owned less than 25 percent of the passive equity. We also established control group tests for small businesses and entities that wished to bid in certain blocks.

138. While we conclude that our requirement that control and substantial equity rest with minorities and/or women will generally be adequate to ensure that parties do not attempt to evade the statutory requirement to provide economic opportunities and ensure participation by businesses owned by these groups, we also reaffirm our commitment to investigate all allegations of fronts, shams or other methods used to try to evade our eligibility rules. In this regard, we remind parties that we will conduct random pre and post-auction audits to ensure that applicants receiving designated entity benefits are bona fide designated entities.

#### L. Small Businesses

139. Petitions. NTCA and USIN request that we amend the small business definition so that it can be flexibly modified in the context of a particular service. NTCA and USIN advocate that such flexibility is appropriate because the existing \$6 million net worth/\$2 million net income test is too low to reflect the capital-intensive nature of the broadband PCS business. NTCA asserts that most rural telephone companies are unable to meet this test even though they have few subscribers and very few employees. USIN states that the current definition discriminates against small rural telephone companies, and that the proper measure for small businesses in capital-intensive services is those with annual revenues of less than \$100 million.

140. Discussion. We agree with NTCA. In the Second Report and Order we relied on the Small Business Administration's (SBA) standard definition. The SBA definition permits an applicant to qualify for financial assistance based on a net worth not in excess of \$6 million with average net income after Federal income taxes for the two preceding years not in excess of \$2 million.<sup>182</sup> The record in this proceeding reflected broad disagreement about the appropriate definition of small businesses. Many commenters, including the Chief Counsel for Advocacy of the SBA, argued that the SBA net worth/revenue definition was too restrictive and would exclude businesses of sufficient size to survive, much less succeed, in the competitive wireless communications marketplace. The SBA's Chief Counsel for Advocacy and Suite 12 Group advocated adoption of a revenue test, arguing that a net worth test could be misleading as some very large companies have low net worth. The SBA's Chief Counsel recommended that the revenue standard be raised to include firms that (together with affiliates) have less than \$40 million in revenue. The SBA Chief Counsel suggested that the Commission consider a higher revenue ceiling or adopt different size standards for different telecommunications markets.<sup>183</sup>

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<sup>182</sup> 13 CFR 121.802.

<sup>183</sup> Some parties recommend using the SBA's 1500 employee standard. See, e.g., comments of SBA Associate Administrator for Procurement Assistance at 2, CFW Communications at 2, and Iowa Network at 17. A number of other commenters argue, however, that adoption of this alternative SBA definition would open up a huge loophole in the designated entity eligibility criteria. Specifically, they contend that telecommunications is

141. Other parties indicated that the definition used by the Commission might impede the ability of small businesses to raise capital in anticipation of auctions. They noted that many small firms are soliciting investors to enable these firms to compete better in auctions, and argued that their designated entity status should not be jeopardized as a result. Thus, these commenters suggested, if the FCC adopts the SBA's net worth standard, the net worth valuation should relate back to the date of the PCS Final Report and Order (September 23, 1993).

142. In contrast, several commenters argue that the small business definition must be made more restrictive in order to prevent large firms from spinning off companies to compete as designated entities. In this regard, some parties recommend limiting provisions to those small businesses that were in existence for the previous two years.

143. In the Second Report and Order, we adopted the existing SBA net worth/net income size standard as the generic threshold for small businesses to qualify as designated entities because at that time we were unable to conclude that the other proposals suggested by commenters were superior to this established standard. However we acknowledged that for certain telecommunications industry sectors this standard may not be high enough to encompass those entities that require the benefits, but also have the financial wherewithal to construct and operate the systems. Accordingly, we indicated that this "threshold could be adjusted upward on a service-by-service basis to accommodate such situations." We also noted that we may modify the small business definition if the SBA changed its definition or the Commission determined that an alternative definition was more appropriate for capital intensive services.

144. In this regard, in the Fifth Report and Order we revised the definition of a small business set forth in the Second Report and Order to include entities with up to \$40 million in gross revenues, and we provided that these small businesses would be permitted to pool their resources and form consortia to bid in the entrepreneurs' blocks or to receive other small business benefits. We also adopted rules that allow small businesses and businesses owned by women and/or minorities to raise capital by selling passive ownership interests in their companies. Thus, for example, under certain conditions, businesses owned by women and minorities have the option of taking on one large passive partner (holding up to 49.9 percent of the enterprise) or selling a greater portion of their companies' equity (up to 75 percent of the equity) to passive investors in smaller increments. Either of these structures should

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a capital, rather than labor, intensive industry, and that an entity with 1,500 employees is likely to be extremely well capitalized and have no need for the special treatment outlined by Congress in the Budget Act. See, e.g., comments of LuxCel Group, Inc. at 4, Suite 12 Group at 10-11.

enhance the ability of these entities to obtain the necessary funding to meet long-term construction, operation and expansion goals.<sup>184</sup>

145. Given the diversity of services that may be subject to competitive bidding and the varied spectrum costs and build-out requirements associated with each, we conclude that it is more appropriate to define the eligibility requirements for small businesses on a service-specific basis, taking into account the capital requirements of each particular service in establishing the appropriate threshold. Therefore we will amend our generic auction rules to replace the small business definition with a provision enabling the Commission to establish a small businesses definition in the context of each particular service.

## V. FINAL REGULATORY FLEXIBILITY ANALYSIS

146. Pursuant to the Regulatory Flexibility Act of 1980, 5 U.S.C. § 604, the Commission's final analysis is as follows:

### A. Need for, and Purpose of, this Action

147. As a result of new statutory authority, the Commission may utilize competitive bidding mechanisms in the granting of certain initial licenses. The Commission published an Initial Regulatory Flexibility Analysis, see generally 5 U.S.C. § 603, within the Notice of Proposed Rule Making in this proceeding, and published a Final Regulatory Flexibility Analysis within the Second Report and Order (at ¶¶ 299-302). As noted in these previous final analyses, this proceeding will establish a system of competitive bidding for choosing among certain applications for initial licenses, and will carry out statutory mandates that certain designated entities, including small entities, be afforded an opportunity to participate in the competitive bidding process and in the provision of spectrum-based services.

### B. Summary of the Issues Raised by the Public Comments in Response to the Initial Regulatory Flexibility Analysis

148. No comments were submitted in response to our Initial Regulatory Flexibility Analysis.

### C. Significant Alternatives Considered

149. Although, as described in (B) above, no comments were received pertaining to our Initial Regulatory Flexibility Analysis, the Second Report and Order addressed at length the general policy considerations raised as a result of the Commission's new auction authority.

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<sup>184</sup> See Fifth Report and Order at ¶185.

## **VI. PROCEDURAL MATTERS AND ORDERING CLAUSES**

150. Accordingly, IT IS ORDERED, that the petitions for reconsideration ARE GRANTED to the extent described above and DENIED in all other respects, and that the petition of William E. Zimsky IS DISMISSED as moot.

151. IT IS FURTHER ORDERED, that Part 1 of the Commission's Rules IS AMENDED as set forth in Appendix B, attached. IT IS ORDERED that the rule changes made herein WILL BECOME EFFECTIVE 30 days after their publication in the Federal Register. This action is taken pursuant to Sections 4(i), 303(r) and 309(j) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 303(r) and 309(j).

**FEDERAL COMMUNICATIONS COMMISSION**

**William F. Caton**  
**Acting Secretary**

## APPENDIX A

### FILINGS IN RESPONSE TO THE SECOND REPORT AND ORDER

#### Petitions

Anchorage Telephone Utility (ATU, Anchorage)  
John G. Andrikopoulos, et al. (Andrikopoulos)  
The Association of Independent Designated Entities (AIDE)  
Black Entertainment Television Holdings, Inc. (BET)  
Dennis C. Brown and Robert H. Schwaninger, Jr. (Brown & Schwaninger)  
Blooston, Mordkofsky, Jackson & Dickens (Blooston)  
Cable and Wireless, Inc. (CWI)  
Cook Inlet Region, Inc. (CIRI, Cook Inlet)  
GTE Service Corporation and Affiliates (GTE)  
Houston, Dallas, Oxnard and Huntington Cellular Settlement Groups (Cellular Settlement Groups)  
MCI Telecom. Corp. (MCI)  
Millin Publications, Inc. (Millin)  
The National Assoc. of Business and Educational Radio (NABER)  
The National Telephone Cooperative Association (NTCA)  
The Rural Cellular Association (RCA)  
South Dakota Network, Inc. (SDN)  
Southwestern Bell Corporation (SBC)  
Telephone and Data Systems, Inc. (TDS)  
Thumb Cellular Limited Partnership (Thumb Cellular)  
U.S. Intelco Networks, Inc. (USIN)  
William E. Zimsky (Zimsky)

#### Oppositions and Comments

Black Entertainment Television Holdings, Inc. (BET)  
Quentin L. Breen (Breen)  
GTE Service Corp. and Affiliates (GTE)  
MCI Telecom. Corp. (MCI)  
Pacific Bell and Nevada Bell (Pacific Bell)  
Telephone and Data Systems, Inc. (TDS)  
Tri-County Telephone Company, Inc. (Tri-County)  
The United States Telephone Association (USTA)

Replies

Anchorage Telephone Utility (ATU, Anchorage)

The Association of Independent Designated Entities (AIDE)

Houston, Dallas, Oxnard and Huntington Cellular Settlement Groups (Cellular Settlement Groups)

The National Telephone Cooperative Association (NTCA)

The Rural Cellular Association (RCA)