

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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

EX PARTE SUBMISSION OF THE DEPARTMENT OF JUSTICE

The U.S. Department of Justice (“Department”) hereby submits the following ex parte submission in connection with the *Further Notice of Proposed Rule Making*¹ in the above-captioned proceeding. The Department supports the Federal Communications Commission’s (“FCC”) proposal to deny designated entity (“DE”) benefits to entities that have a material relationship with a large in-region incumbent wireless service provider or a large entity that has a significant interest in communications services. The Department believes this proposal will serve the public interest by ensuring that DEs are in fact small businesses. Based on its experience in evaluating the competitive significance of DEs during merger reviews, the Department offers suggestions on how to determine whether a material financial or operational relationship exists.

¹ FCC, Further Notice of Proposed Rule Making No. 06-8, *In re Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commissions Competitive Bidding Rules and Procedures*, WT Docket No. 05-211 (rel. Feb. 3, 2006) (“FNPRM”).

I. Introduction

The Department's responsibilities include enforcing the antitrust laws and promoting competition, and it has participated in prior Federal Communications Commission proceedings involving the role of competition in telecommunications. The Department has also conducted several wireless merger investigations, some resulting in consent decrees.² In these investigations, and its review of pre-merger notification filings, the Department has considered the competitive role and independence of DEs that have significant relationships with other wireless carriers.

Under the *Further Notice*, the FCC is reviewing whether entities with material financial or operational relationships with large companies should be disqualified from receiving DE benefits. The FCC's goal for the DE program is to facilitate the participation of small businesses in the competitive bidding process and encourage them to participate in auctions and the provision of wireless services. In considering these rule changes, the FCC should balance the need to ensure that only qualified small businesses reap the benefits of the program and that the rules are not circumvented, against the need to preserve financing options for DEs.³

The FCC is considering a proposal that would deny DE benefits to otherwise qualified DEs that have a "material relationship" with a "large in-region incumbent wireless services

² See, e.g., *United States v. SBC Communications Inc. and BellSouth Corp.*, Civ No. 00-2073 PLF (D.D.C. entered Dec. 29, 2000 modified Oct. 13, 2004); *United States v. Cingular Wireless Corp., SBC Communications Inc., BellSouth Corp. and AT&T Wireless Services, Inc.*, Civ No. 04-1850 RBW (D.D.C. entered Mar. 14, 2005); *United States v. ALLTEL Corp. and Western Wireless Corp.*, Civ. No. 05-1345 RLC (D.D.C entered Oct. 12, 2005).

³ FNPRM, *supra* note 1, ¶¶ 6-7.

provider.”⁴ The FCC is also considering whether this disqualification should apply to material relationships with large entities with a significant interest in communications services, “e.g., voice and data providers, content providers, equipment manufacturers, other media interests, and/or facilities or non-facilities based communications services providers.”⁵ Under the proposal, a “material relationship” would exist if another entity has provided a “material portion of the total capitalization of the applicant (i.e., equity plus debt), or has any material operational arrangement with the applicant (such as management, joint marketing, trademark, or other arrangements) or other material financial arrangement.”⁶ A “large in-region incumbent wireless services provider” would be defined as having over \$5 billion in gross revenues for the past three years and as an entity that has an interest in CMRS or AWS licenses that have a significant overlap in the area to be licensed to the DE.⁷ The FCC’s proposal would require reimbursement from DEs that later enter into disqualifying material relationships within five years of the auction.⁸

In the Department’s experience reviewing wireless transactions, it has often had to determine the competitive significance of DEs in wireless services markets. While some DEs are independent competitors, others are entities that exist principally for the benefit of their large

⁴ *Id.* ¶¶ 4-5.

⁵ *Id.* ¶¶ 5, 10-11.

⁶ *Id.* ¶ 13.

⁷ *Id.* ¶¶ 16-17.

⁸ *Id.* ¶ 20.

wireless carrier affiliate. In the latter case, the Department has treated these DEs in our competitive analysis as one and the same as the large wireless carriers.⁹

II. Discussion

To ensure that DEs are independent small businesses, the FCC should adopt rules that allow for the consideration of a broad range of factors in determining whether a disqualifying material relationship exists. As is more fully discussed below, these factors include equity investments, debt instruments that provide for managerial, financial or operational control, management agreements and operational agreements that provide the large affiliate significant input into technology and equipment selection as well as other buildout decisions. In some instances a combination of financial and operational relationships maybe disqualifying, while in others a single material financial or operational relationship would be enough to deny DE benefits. These rules should be flexible enough to evolve as the DEs, their affiliates, and investors redefine their relationships. Accordingly, the FCC should look carefully at written agreements and further inquire into who has, or will have, actual control over the licenses and their use.

The Department has found contractual or other arrangements between DEs and large wireless carriers that created such close ties between the two that the DEs could not be considered to be truly independent competitive actors; in some of these instances, the DE

⁹ See, e.g., *United States v. SBC Communications, Inc.*, Civ. No. 1:00CV02073(PLF), Mem. Op. and Order (D.D.C. entered Oct. 13, 2004) (modifying the consent judgment); *id.*, Mem. of United States in Supp. of Joint Mots. to Modify Final J. and Estab. Procs. to Modify Final J. (filed Aug. 11, 2004) (the Department requiring AT&T Wireless to sever its relationship with DE Von Donop Inlet PCS, LLC in relation to certain licenses in order to agree to modify consent decree which would have been violated by Cingular Wireless's acquisition of AT&T Wireless). Both are available at <<http://www.usdoj.gov/atr/cases/indx257.htm>>.

affiliated with a large wireless carrier had not launched commercial services to end-user customers or other wireless carriers but only provided roaming services to its large affiliate. The Department also found that some DEs have ceded to the large wireless carrier approval rights over financial, spending, network design, or operational decisions or had the large wireless carrier actually construct its network; in these situations, the DE usually has such limited control over its own operations that it cannot be considered an independent entity. We also have observed that when the large wireless carrier leases, provides, or maintains a large portion of the DE's necessary network equipment, it often has effective control over the DE's day-to-day operations. Finally, when a large wireless carrier controls who can lease or purchase the DE's licenses or who can roam or receive other services using the DE's spectrum, it substitutes its business judgment for that of the DE in the most basic business decisions.

In addition to finding arrangements such as those described above disqualifying, the FCC should disqualify a DE that has any other agreement with a large wireless carrier that suggests that the licenses will be used principally for the benefit of the large wireless carrier or that suggests the DE's owners or managers play no meaningful role in managing and operating the licenses. In one investigation, the Department encountered a situation where the DE leased all its network equipment from the large wireless carrier. The amount the DE owed to the large carrier for equipment rental was effectively equal to the amount the large carrier owed to the DE for roaming charges. Both the equipment rental fee and the roaming charges were based upon the minutes of use generated over the DE's spectrum by customers of the large carrier, rising and falling in unison each month.¹⁰ As a result, no money changed hands. In other affiliations, the

¹⁰Additionally, this roaming revenue was the DE's only source of income.

managers and other owners of a DE were effectively guaranteed a profit, or protected from the risk of any loss, on the sale or lease of the DE's licenses. In a third type of such arrangement, the DE had no revenues and its only real costs were salary for the "controlling" manager and accounting fees, which were annually added to the promissory note held by the large wireless carrier; the promissory note was not due until the licenses were sold. The Department, however, does believe that there are appropriate, likely pro-competitive, agreements that may exist between a DE and a large wireless carrier. For example, arm's-length negotiated agreements for roaming or brand licensing and support do not necessarily raise similar concerns.

While the loss of a DE's competitive independence may be more likely when the affiliate is a large wireless carrier, these factors should apply equally to any affiliate to a DE in determining the DE's independence – whether the affiliate is a large in-region wireless provider, an out-of-region wireless provider (which includes carriers seeking to expand their coverage footprint), or entities with significant interests in other communications services. A relationship where the large enterprise dominates the DE is troubling as it suggests that the DE is not within the class of entities (i.e., small businesses) that the FCC's rules are designed to benefit.

III. Conclusion

In the Department's extensive experience reviewing DE's relationships with large wireless carriers in its numerous wireless merger investigations, it has often encountered DEs that are not independent of large enterprises. Therefore, it believes that action by the FCC to deny DE benefits to entities that are not truly independent small businesses is warranted.

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Respectfully submitted,

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