

June 2007

Zoning the Beachfront

As the telecom industry gears up for a multi-billion dollar auction, divergent views on how the rules are set are center stage in a raging public policy debate.

Soon, perhaps by mid-July, the Federal Communications Commission will adopt new rules for the auction of 60 MHz of spectrum in the 700 MHz band – long regarded as beachfront spectrum for its excellent propagation characteristics. As the telecommunications industry gears up for an auction that is predicted to fetch upwards of \$15 billion, divergent views on how the rules are set are center stage in a raging public policy debate. Who is saying what, and why, speaks volumes about the current landscape, and how the FCC resolves the important policy questions will go a long way to determining who gets the penthouse condo on the beach and who gets stuck in quicksand.

Background. The 700 MHz band includes the 698-806 MHz band previously allocated to television channels 52-69. Under the Digital Television Transition and Public Safety Act of 2005, Congress required all television stations to migrate from these channels to digital television spectrum in lower frequencies, clearing 108 MHz for other uses. The digital television transition must be completed by February 17, 2009.

Meanwhile, Congress took steps to put the cleared TV spectrum to use, requiring the FCC to start the auction for the “recovered” spectrum by January 28, 2008 and collect auction revenues by June 30, 2008. Potential bidders have expressed a strong desire to have as long as six months from the day final rules are announced to obtain funding, create business models and develop auction strategies – a deadline that may be hard to meet.

Congress is requiring the FCC to start the auction by January 28, 2008 and collect auction revenues by June 30, 2008.

Before Congress established a date for the digital television transition, the FCC auctioned the Lower 700 MHz C Block (paired frequencies in the 710-716/740-746 MHz bands). Licenses were assigned according to 734 Cellular Market Areas (CMAs), with Aloha Wireless being the most successful high bidder. In rural areas, small telephone companies successfully obtained licenses that overlaid their telephone service areas. The FCC also auctioned the Lower 700 MHz D Block (unpaired frequencies in the 716-722 MHz band), with Qualcomm being the successful high bidder nationwide. The FCC also auctioned guard band in the 700 MHz spectrum. These are two MHz of spectrum in the A Block (paired frequencies in the 746-747/776-777 MHz band) and four MHz of spectrum in the B Block (paired frequencies in the 762-764/792-794 MHz band). Auction winners included Pegasus, Access Spectrum and Sprint Nextel. All told, these early auctions raised about \$700 million.

New Rules. In April, the FCC promulgated a first set of rules for the upcoming auctions. First, on the heels of a financially successful Advanced Wireless Services auction last year, the FCC adopted a “geographic mix” of licenses, but solicited further comment on how the

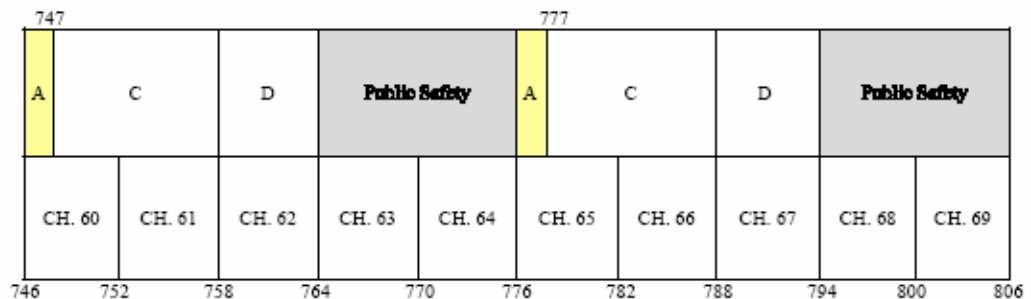
bands should be divided. Licenses will be awarded for a term that will not extend beyond February 17, 2019, the ten-year anniversary of the digital television transition. If a license is not renewed, the spectrum is returned to the FCC for reauction.

The FCC also adopted generous power limits. For both the Lower 700 MHz band (698-746 MHz) and the Upper 700 MHz band (746-806 MHz), licensees can operate base stations at an average power of 1 kW/MHz ERP. For example, a licensee transmitting a signal across a six MHz block could transmit at 6 kW ERP over the entire 6 MHz, with each 1 MHz segment limited to 1 kW ERP. In rural areas – counties with fewer than 100 persons per square mile, licensees can operate base stations at an average power of 2 kW/MHz ERP so long as they coordinate with all non-public safety licensees authorized to operate within 75 miles of the base station in question. Incumbent C- and D-Block licensees in the Lower 700 MHz band, as well as licensees using unpaired spectrum, may employ power levels up to 50 kW if they do not produce signals exceeding a power flux density of 3 mW/m² on the ground within 1 km of the base station.

The band plan for the Upper 700 MHz is much more contentious than the lower 700 MHz.

Licenses also will be subject to hearing aid compatibility and E911 requirements.

Proposed Band Plans. In April, the FCC invited comment on various band plans for the 700 MHz band. For the Lower 700 MHz, the FCC proposed to retain its earlier band plan, noting that the B Block would be attractive to an incumbent C Block licensee because the paired spectrum could be combined to create a larger pipe. The B Block also would be attractive to rural operators given the relatively small size of the CMAs, while at the same time creating a block of larger Economic Areas (EAs) that could be combined to create a national footprint. This band plan is depicted below.



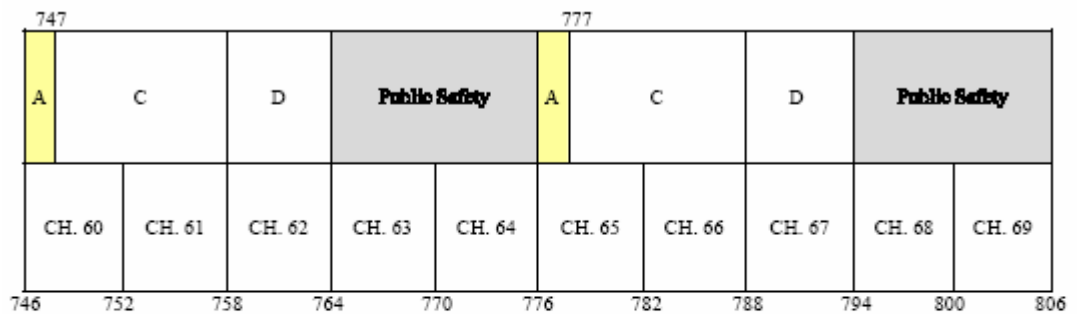
Block	Frequencies	Bandwidth	Pairing	Area Type	Licenses
A	746-747, 776-777	2 MHz	2 x 1 MHz	MEA	52*
B	762-764, 792-794	4 MHz	2 x 2 MHz	MEA	52*†
C	747-758, 777-788	22 MHz	2 x 11 MHz	REAG	12
D	758-764, 788-794	12 MHz	2 x 6 MHz	REAG	12

*Blocks have been auctioned

†42 of 52 licenses nationwide held by the Commission, remaining licenses potentially grandfathered

The band plan for the Upper 700 MHz is much more contentious. The FCC has asked for comment on several different band plans, with incumbents seeking larger geographic areas, smaller entities asking for smaller geographic areas, the guard band licensees asking to relocate and Frontline asking for 12 MHz of spectrum to be allocated for public safety and wholesale obligations.

Proposal 1 would auction spectrum only according to Regional Economic Area Groupings (REAGs). A bidder could create a nationwide license by acquiring all 12 of the REAG licenses. This plan is disfavored with new entrants and by other carriers looking for additional spectrum.

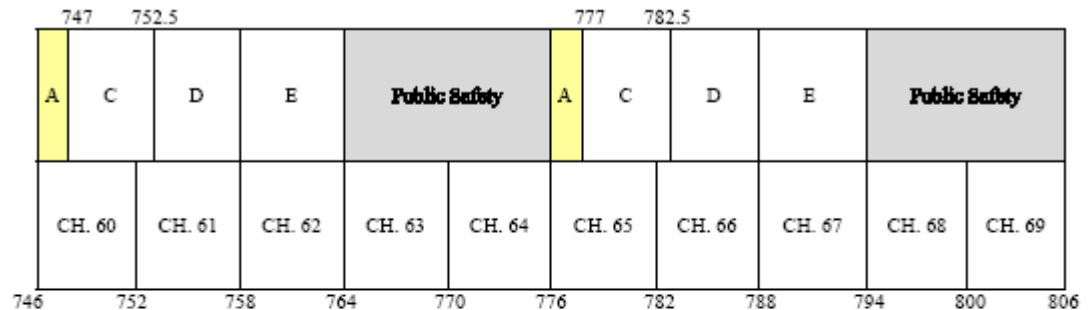


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Proposal 2 is favored among new entrants because it would create an 11 MHz block of licenses auctioned according to CMAs or EAs, while also allowing a national carrier to acquire REAGs for nationwide coverage.



Block	Frequencies	Bandwidth	Pairing	Area Type	Licenses
A	762-763, 792-793	2 MHz	2 x 1 MHz	MEA	52*
B	762-764, 792-794	4 MHz	2 x 2 MHz	MEA	52*‡
C	747-752.5, 777-782.5	11 MHz	2 x 5.5 MHz	CMA or EA	734 or 176
D	752.5-758, 782.5-788	11 MHz	2 x 5.5 MHz	EA	176
E	758-764, 788-794	12 MHz	2 x 6 MHz	REAG	12

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The combined effect of the set-aside and wholesale-only model would likely reduce the number of bidders to a handful of new entrants.

Proposals 3 and 4 involve relocation of the 700 MHz A Block and B Block guard band to contiguous spectrum in the upper portion of the band. The remaining blocks would be auctioned by REAG (two 11 MHz blocks) and EA (one 10 MHz block). The guard band licensees favor these proposals.

Another option involves a proposal by Frontline, which requests that the FCC alter the upper portion of the band plan to auction a single nationwide 10 MHz license (a new E Block) consisting of the paired 757-762 MHz and 787-792 MHz frequencies. Frontline also proposes that the licensee would be required to construct a common, interoperable network infrastructure for use by both the public safety broadband network and the "E Block" licensee's commercial network. The E Block licensee would be required to cover 75 percent of the United States population within four years of the 700 MHz "auction clearing date," 95 percent within seven years, and 98 percent within 10 years. The E Block licensee also would manage and operate the public safety broadband network, and could collect a reasonable network management fee. Public safety broadband operations would be entitled to priority access during times of emergency. The license would have a 15-year term.

Two Frontline proposals have faced a tidal wave of criticism. First, incumbent wireless carriers and cable operators would be ineligible to obtain E Block licenses. Second, the licensee would be required to make its spectrum available on a wholesale basis. At least one economist has opined that the combined effect of the set-aside and wholesale-only model would likely reduce the number of bidders to a handful of new entrants.

Eligibility. Small businesses will be entitled to bidding credits of 15 percent (if attributable gross revenues for the previous three years do not exceed \$40 million) and 25 percent (if attributable gross revenues for the previous three years do not exceed \$15 million). The FCC declined to adopt spectrum set-asides or eligibility restrictions but sought comment on whether it should require incumbents to establish separate subsidiaries or spectrum caps or to restrict in-region incumbents. A trade association representing wireless ISPs asked the FCC to adopt an additional 20 percent bidding credit for just the rural CMAs where the bidder does not have a "material relationship" with a large wireless or cable carrier. Similarly, Alltel asked the FCC to impose a 25 percent "bidding premium" on ILEC-affiliated wireless carriers.

Public interest groups have asked the FCC to adopt an "open access" obligation for 30 MHz of the auctioned band.

In a very controversial proposal, public interest groups have asked the FCC to adopt an "open access" obligation for 30 MHz of the auctioned band. Under this model, a licensee would be required to interconnect any provider that wanted to use its network. Some 250,000 persons



SPECIALISTS IN SATELLITE, MEDIA AND TELECOM INVESTMENT BANKING

submitted letters to the FCC supporting this view, and lobbying activity is continuing.

Build-Out. The Rural Cellular Association proposed to modify the FCC's "substantial service" rules, which are largely based on population coverage, in favor of a geographic-based performance requirement. Under this proposal, which the FCC has embraced, licensees would be required to cover 25 percent of their license areas within three years, 50 percent within five years and 75 percent within eight years (with government land excluded). The FCC also sought comment on a "keep what you use" component that would reduce the size of the licensed area if a licensee failed to meet a benchmark.

This proposal has been criticized by large carriers and rural interests alike. Large carriers argue that requiring geographic build-out is not market-based and will force them to either sit out the auction or cover areas with little or no economic value. Small carriers complain about the additional hardship associated with extending coverage to sparsely populated areas, though a few have asked the FCC to create an exemption for the rural CMA markets.

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Fierce lobbying on these issues will continue until the last minute. Then, the industry will hold its breath to see how the FCC will zone the last remaining lots of beachfront spectrum that we expect to see for a long time.

By Stephen E. Coran
Attorney, Rini Coran, PC

Mr. Coran has practiced telecommunications law for nearly 20 years, focusing on wireless, satellite and emerging technology transactions, public advocacy and regulation. Rini Coran, PC provides strategic, transactional, regulatory and governmental relations counsel to help clients succeed in a dynamic telecommunications, media and technology marketplace. Mr. Coran can be reached at 202.463-4310 and scoran@rinicoran.com.