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# TELECOMMUNICATIONS

## THE FCC ISSUES A GROUNDBREAKING DECISION TO ALLOW SPECTRUM LEASING

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In October 2003 the Federal Communications Commission (FCC) released a landmark decision that will allow radio spectrum to be leased by companies that hold FCC spectrum licenses.<sup>1</sup> This decision offers wireless communication providers new ways to unlock the market value of their licensed spectrum and will free up new sources of spectrum for companies wishing to offer innovative new communications services.

The new FCC spectrum leasing rules authorize most wireless carriers, including cellular, PCS and microwave radio licensees, to lease their spectrum to other qualified service providers or investment groups that may, in turn, sublease the spectrum to other qualified parties. This marks a historic change in the FCC's thinking about spectrum. Until now, the agency generally considered spectrum leasing to be inconsistent with the managerial responsibilities of a licensee under the Communications Act of 1934. Moreover, the Commission has traditionally taken a "command and control" approach to spectrum management — licensing specific spectrum blocks to specific licensees for specific types of services. The new rules should therefore have a wide-ranging impact. They will provide eligible wireless licensees with a much needed means of trading spectrum among themselves so as to improve their service footprints or restructure their businesses. Additionally, spectrum leasing is likely to offer carriers and investment groups a new method for financing the cost of spectrum.

This paper discusses the FCC's spectrum leasing decision and summarizes the types of spectrum leases that the new rules will permit.

### I. Permissible Spectrum Leases Under the New FCC Rules

The FCC's *Spectrum Leasing Order* permits eligible wireless service providers to enter into two different types of leases for all or part of their spectrum (e.g., for a certain area or at certain times). The first type of lease is called a "spectrum manager" lease. It requires the licensee to retain ultimate control over the spectrum and be responsible for compliance with all FCC regulations, but permits the lessee to operate facilities on a day-to-day basis for providing a communications service to customers.<sup>2</sup> The second type of lease is called a "*de facto* transfer" lease. It permits the licensee to grant complete authority over its spectrum, and FCC rule compliance, to the lessee.<sup>3</sup>

Prior FCC authority is required for a *de facto* transfer lease, whereas notice to the FCC is all that is needed for a spectrum manager lease. Under both types of leases, however, a lessee (or sub-lessee) can only use the leased

spectrum for the type of radio communication services that are covered by the FCC license of the lessor. For example, a cellular mobile licensee may not lease out its spectrum for broadcasting services; nor may a microwave network operator lease its spectrum for mobile communications.

Despite these limitations, the new rules represent a significant departure from past practice. Until now, FCC precedent — specifically, the agency's 1963 *Intermountain Microwave* decision<sup>4</sup> — generally prevented a licensee from leasing or sharing its spectrum rights with another party. Allowing a non-licensee to have control over licensed facilities was viewed as inconsistent with Section 310(d) of the Communications Act,<sup>5</sup> which bars the direct or indirect transfer of a radio licensee without prior FCC approval. The *Spectrum Leasing Order*, however, reinterprets Section 310(d) to allow lessees to control licensed radio facilities so long as the licensee retains ultimate responsibility for the underlying spectrum (as in spectrum manager leasing) or obtains prior FCC approval for the lease (as in *de facto* transfer leasing).<sup>6</sup>

The requirements for each type of lease are described more fully below.

#### A. Spectrum Manager Leasing

Under a spectrum manager lease, a licensee may lease spectrum without prior FCC approval — only notice to the FCC is required — as long as the licensee retains *de facto* control over the leased spectrum. To retain *de facto* control, the licensee must: (1) ensure the lessee complies with the Communications Act and FCC regulations on an ongoing basis; (2) continue to be responsible for all interactions with the FCC required under the license; and (3) remain directly accountable, along with the lessee, to the FCC for any rule violations by the lessee.

To qualify as a spectrum lessee, a party also must meet the same ownership requirements that apply to licensees under the Communications Act and prior FCC policies. Accordingly, if a lessee will provide a common carrier service, it may not be more than 20% owned by non-U.S. parties or, absent prior FCC consent, have greater than 25% indirect ownership by non-U.S. parties.<sup>7</sup> Spectrum obtained by parties that were granted special preferences in past spectrum auctions (e.g., by being classified as a small business or a minority-owned "designated entity") cannot be leased to entities which themselves do not also meet those qualifications (except for short-term *de facto* transfer leases described below). Additionally, as noted above, lessees must comply with all of the ser-

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vice rules that apply to the licensee and may not use leased spectrum for a service that would be inconsistent with the license.

No FCC approval is required for spectrum manager leases. The licensee need only provide notice to the FCC within 14 days after entering into a spectrum manager lease, and at least 21 days before the lessee commences operations (or 10 days in the case of a lease that lasts for less than one year). The FCC retains the right to investigate and terminate any spectrum manager lease arrangements that it deems to violate the public interest.

#### *B. De Facto Transfer Leasing*

Licenses may also enter into leases where *de facto* control over the spectrum is transferred to the lessee. A *de facto* transfer lease frees the lessor from the obligation to oversee the lessee's FCC compliance. The lessee is thus responsible for interacting with the FCC, complying with the rules and making all required regulatory filings. As with spectrum manager leasing, a *de facto* transfer lessee must be compliant with applicable foreign ownership restrictions and must qualify as a small business or designated entity if the license was originally granted based on special preferences for those types of entities.

Prior FCC approval is needed for *de facto* transfer leases, but the agency has established streamlined procedures for such approvals. For *de facto* transfer leases with a duration of more than 360 days ("long-term" leases), the application will be placed on public notice "promptly," and interested parties will have 14 days to file petitions to deny. Within 21 days of the public notice date, the FCC will consent to the application or "offline" it for further examination, in which case a decision still must ordinarily be made within 90 days.

For *de facto* transfer leases with a duration of 360 days or less ("short-term" leases), the FCC will approve applications within 10 days. Short-term *de facto* transfer leases may only be approved for an initial period of up to 180 days, and then renewed for additional periods so that the entire lease does not exceed a total of 360 days. Any leases of a duration beyond 360 days must be approved under the long-term *de facto* transfer lease procedures.

## **II. FCC Proposals for Future Spectrum-Related Rule Changes**

As part of its *Spectrum Leasing Order*, the FCC also proposed some additional rule changes that may further widen the scope for spectrum leasing in 2005 and beyond.<sup>8</sup> For example, the FCC may become involved in creating a clearinghouse for spectrum or otherwise help to facilitate lease arrangements. It also asked interested parties whether it should further change its rules to expand the scope of wireless services eligible to take advantage of the new leasing rules (e.g., by including satellite services) and to permit all types of leasing arrangements (not just spectrum manager arrangements) to be entered into without prior agency approval.

In making these proposals, the FCC pointed out that new technologies are now being developed and, in some cases, deployed — including software-defined radio, frequency-agile radio and spread spectrum technologies — to allow devices to search out and operate in spectrum not being used by others. The rulemaking notice therefore asks interested parties (who were asked to file comments with the agency in December 2003 and January 2004 on these matters) whether additional changes are needed to the new leasing rules to encourage the development and use of these technologies across broad portions of the radio spectrum which may now be occupied by multiple licensees.<sup>9</sup>

## **III. New Services and Financing That May Result from Spectrum Leasing**

The FCC's decision to allow spectrum leasing is significant for many reasons. As noted above, it will give existing licensees access to new spectrum to augment their existing services and allow carriers that are not fully using their spectrum in the near term to lease it out to other carriers. Likewise, the new rules should provide new market entrants wishing to offer wireless services a way to gain access to spectrum not previously available.

Some of the most significant long-term impacts of the FCC's new leasing rules may result from new financing options that the rules appear to create. For example, wireless carriers may be able to reduce the cost of spectrum access (e.g., in connection with the auction of new third generation spectrum licenses to be offered in 2004 and 2005) by using properly structured leasing arrangements that are underwritten by independent investors or financial institutions. A wireless carrier might also choose to use the new rules to refinance its existing network by leasing out spectrum to a new network operator in return for lease payments that are backed by customer revenues.

The specific types of spectrum lease and financing arrangements that will emerge will of course depend on the way the new rules are interpreted and enforced. But it is clear that new opportunities are going to be available for existing wireless carriers, new service providers and the providers of financing for wireless services as a result of the FCC's spectrum leasing decision.

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### **Footnotes**

<sup>1</sup> See *In re Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, WT Docket No. 00-230, *Report and Order and Further Notice of Proposed Rulemaking*, FCC 03-113 (released Oct. 6, 2003) (*Spectrum Leasing Order*).

<sup>2</sup> *Id.* ¶¶ 94-125.

<sup>3</sup> *Id.* ¶¶ 126-181.

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<sup>4</sup> 12 FCC 2d 559 (1963).

<sup>5</sup> 47 U.S.C. § 310(d).

<sup>6</sup> See *Spectrum Leasing Order* ¶¶ 51-81.

<sup>7</sup> See 47 U.S.C. § 310(b).

<sup>8</sup> See *Spectrum Leasing Order*, ¶¶ 213-323.

<sup>9</sup> In addition to the further rule changes the FCC is considering, five petitions for reconsideration have been filed with the FCC concerning the *Spectrum Leasing Order*. The petitioners all support spectrum leasing, but ask the Commission to change or clarify certain aspects of the order.