

## Transactions Involving Rural LEC Properties

### FCBA Transactional Practice Committee

#### I. Practical Considerations for Transaction Parties

##### A. Does the selling party have a domestic 214 authorization?

1. Although all telecommunications carriers have a blanket Section 214 authorization to operate lines that are used to provide domestic telecommunications services, both interexchange or interstate access, a corporate change of control or transfer of substantially all the assets requires FCC approval for the transaction
2. 47 C.F.R. § 63.04 contains the requirements for contents of domestic 214 applications.
3. Domestic 214 applications must be filed on paper.
4. Domestic 214 applications are presumed to be eligible for streamlined processing under 47 C.F.R. § 63.03 if:
  - a. Both applications are non-facilities based carriers;
  - b. The transferee is not a telecommunications provider; or
  - c. the proposed transaction involves only the transfer of ILEC assets and does not involve a corporate change of control.
5. Streamlined processing will be presumed to apply if the transferee would have a market share of less than 10 percent in the interstate, interexchange market and would provide service as a competitor in a market served by a dominant carrier who is not party to the application(if applicable) where:
  - a. Neither applicant is a dominant carrier;
  - b. The applicants are a dominant carrier and non-dominant carrier that provides services exclusively outside the geographic area where the dominant carrier is dominant; or
  - c. The applicants are ILECs with less than 2 percent of nationwide lines when combined and with no overlapping or adjacent service areas.
6. Streamlined processing means that applications are deemed granted so that a transferee may operate the transferred authorization on the 31st day after public notice unless the staff directs otherwise.

##### B. Does the selling party have an international 214 authorization?

1. 47 C.F.R. § 63.18 contains the requirements for contents of international 214 applications.
2. Streamlined processing is accorded the applicants unless:
  - a. The applicants is affiliated with a foreign carrier in the destination market absent specific showings included in the rule;
  - b. The applicant is affiliated with a dominant U.S. carrier whose international switch or private line services the applicant is seeking to resell, unless it agrees to be treated as dominant in the destination market; or
  - c. If the Commission otherwise informs applicant that the application may not be treated as streamlined.
3. The application must be provided electronically in the FCC's IBFS electronic filing system.
4. RLECs are almost always resellers and are thus afforded streamlined processing.
5. Streamlined processing means that applications are deemed granted so that a transferee may operate the transferred authorization on the 14th day after public notice.
6. The international authorization need not be transferred if the acquiring parent has an international 214 authorization.

C. Does the transferor have any radio licenses?

1. Radio licenses, such as point to point microwave or CMRS licenses have their own application requirements.
2. Applicant is entitled to streamlined processing, meaning that the application is granted within thirty days after public notice.
3. Applications must be filed electronically in the FCC's ULS system.
4. Some radio licenses, such as industrial radio, have no streamlined processing, but they are almost always granted in 30 to 45 days of filing.
5. Licensee may also have obligations to file tower registration notices to FAA concerning the transfer, if applicable.
6. An applicant may file one consolidated application for transfer.

7. A consolidated application may slow down the processing of a small transaction so it is often not used in those circumstances.
  - a. A consolidated application must be filed on paper.
  - b. A consolidated application does not obviate the need to file individual license transfers electronically.
  - c. Consummation notices need to be filed after closing.

D. Does the transferee need a study area waiver?

1. A study area is the geographic area in which a wireline ILEC operates, and is an established boundary for regulatory purposes at the state and federal level.
2. The FCC froze study area boundaries on November 15, 1984, and codified the freeze in the Appendix-Glossary to Part 36 of the rules.
3. Because the study area boundaries were frozen, a specific waiver petition must be filed in order to be allow an acquiring company to change the boundary, such as when less than an entire study area is transferred or study areas are merged.
4. Waivers are routinely granted if the effect on the universal service fund is less than 1 percent.
5. Waivers are processed in six to twelve months, sometimes longer.

E. Are there pricing considerations to the acquisition?

1. 47 C.F.R. § 61.41(c), the price cap “all or nothing” rule, requires that a price cap company convert a rate of return property, except an average schedule company, to price caps within twelve months of the closing date of the transaction.
2. Rate of return companies, however, have an automatic exemption from the “all or nothing” rule if they purchase a price cap property and leave it under price cap regulation and they may also convert the property to rate of return.
3. 47 C.F.R. §69.3(e)(11) requires that an acquiring company may not include acquired lines in the NECA pools until the next annual access filing period and 47 C.F.R. § 69.3(e)(6) requires notification to NECA by March 1 of an annual access year.
  - a. Applicants often request and are granted a waiver of these rules to permit inclusion of the lines in NECA pools outside of these rule dates.
  - b. It is helpful to obtain NECA’s agreement to the expedited timetable, which it often grants.

4. 47 C.F.R. § 605(c)(3) designates average schedule companies as those with that status as of December 1, 1982.
  - a. Changing acquired lines to average schedule status or to remain an average schedule company after purchase of rate of return lines requires a waiver.
  - b. Waivers are granted to small companies, and those who acquire only a small number of lines in a transaction. Many waivers are denied.
  - c. FCC has a strong preference for cost-based companies, and will examine the specifics of a transaction before deciding whether to grant the waiver.

F. Are there universal service consequences?

1. Section 54.605, the “parent trap” rule, limits the acquiring rural company to the same per line universal service payments as the seller received prior to the transaction.
  - a. Waivers of the “parent trap” rule are always limited and hard to come by.
  - b. Safety valve support outlined in (d) is intended to provide partial relief from the parent trap rule.
  - c. FCC will grant a waiver of the filing deadline for USF self-certification or state certification.
2. Can RLEC-acquired lines from a CLEC be incorporated into the RLEC’s ILEC study area?
  - a. *Mid-Rivers* case holds that the answer is yes, sometimes, but only if the number of lines is small and there is minimal impact on the universal service fund.

G. Does the RLEC need to provide notice to subscribers under the bulk transfer rule, 47 C.F.R. § 64.1120(e)?

1. Bulk transfer of customers usually triggers need to notify customers and the FCC of the transfer in order to avoid slamming charges.
  - a. An exception exists for certain non-substantial ownership transfers when the customer service contact points are not changed
  - b. States typically have similar customer notification requirements, or simply require compliance with the FCC rule
2. There are ambiguities in the bulk transfer rule for transfers of entire companies without change post transaction.

H. The RLEC also has the obligation to ensure that its tariffs accurately reflect the ownership of the property.

1. Every state in which the company provides service will have its own tariffing requirements.
2. NECA will handle name changes, if necessary, for the company.
3. Other federal tariff changes may be necessary because of the transfer.

## II. Regulatory Issues Arising In Recent Acquisitions of Rural Exchanges

### A. Federal approvals

1. Timing of FCC action
  - a. Time to appear on Public Notice may be a month or more, for larger or more complex transactions
  - b. Streamlined treatment granted in many smaller transactions, but not granted in several recent transactions (including FairPoint-VzNE, a midsize transaction) – corporate stock acquisition will disqualify a transaction for streamlined treatment (CenturyTel-Madison River)
  - c. Some Commissioners have questioned whether the FCC should wait for DOJ and state approvals before acting on FCC applications
    - (1) No formal FCC policy to wait
    - (2) In LEC mergers and acquisitions, Commission has routinely taken action after DOJ but before the states complete their review of the transaction (and where the Commission did act after all states had completed their review, the FCC was addressing significant issues uniquely within its area of expertise, such as wireless market concentration or interLATA services in a BOC merger)
  - d. FCC’s 180-day “shot clock” was exceeded in a number of recent deals (TELPRI: 285 days, FairPoint: 301 days)
2. Legal qualifications of buyer – foreign ownership may be an issue
  - a. Issue arises under Section 310(b) for any carrier holding a common carrier radio license (e.g., fixed point-to-point microwave, commercial mobile radio service (CMRS), or other common carrier “Title III” license)
  - b. Buyer may seek a public interest ruling to allow indirect foreign ownership in excess of 25%, pursuant to Section

310(b)(4) of the Act, in a separate petition (e.g., Hawaiian Telcom)

B. State approvals

1. Qualifications of buyer – financial structure and operating experience will be examined – focus will be on the availability and quality of services to consumers
  - a. Debt-equity ratio and other financial details of the buyer will be scrutinized; confidential information will be required to be produced
    - (1) In Hawaii and Northern New England, conditions included restrictions on dividends tied to debt-equity ratio
    - (2) In contrast, the FCC historically has not delved into such details in this type of transaction
  - b. Private equity firms may receive greater scrutiny than experienced operators (e.g., Hawaiian Telcom), even though private equity firms previously have taken substantial positions in a number of rural operators, including ACS, FairPoint, Madison River, and others
  - c. Buyer's history of operations, even in other states, will be scrutinized – especially service quality and reliability, and investment in infrastructure – with a view to ensuring that customers will not be harmed by the transaction
  - d. Under state statutes, approval may require not merely a finding that the public will not be harmed, but a finding that the public will be better off if the transaction is approved
    - (1) Buyer's promises to improve service quality and reliability, offer new services, and invest in infrastructure will be critical in such states
    - (2) Conditions to closing may include: broadband build-out (particularly in rural areas), elimination of double poles, other specific financial commitments for infrastructure expansion and upgrades (TELPRI, FairPoint and Hawaiian Telcom deals all included such conditions)

- (3) These conditions may be imposed on Buyer or on Seller
- (4) Seller also may be required to resolve pending disputes, or place cash in escrow in case of a finding of liability post-closing
- (5) In a multi-state transaction, bidding wars can ensue, and a dynamic may be created favoring the state that makes the latest possible decision

2. State procedures can be very different from FCC practice

a. Discovery

- (1) States often have detailed rules governing submission of evidence and interaction between parties
- (2) The record can include:
  - (a) lengthy “prefiled” (i.e., pre-hearing) testimony, in addition to formal written briefs
  - (b) responses to voluminous written data requests, interrogatories, and requests for production of documents
  - (c) live witness testimony at public hearings and technical conferences, often scheduled simultaneously in different states
- (3) With few, if any, restrictions on who may intervene in the docket, numerous parties may serve discovery requests upon the applicants and ask to examine the applicants’ witnesses at hearing
- (4) Complex rules also may govern type of confidentiality afforded to different types of evidence

b. Pleading rules can be quite different from the FCC’s, and may include additional pleading cycles or additional hearings when a state believes new material information has been put on the record

c. *Ex parte* rules can prohibit any contact with decision makers, or even with advisory staff, who may be a party to the proceeding; the parties may only be permitted to talk to a surrogate such as the consumer advocate or public advocate; deliberations may be required to take place in public

- d. State order may not be final until opportunity for appeal has elapsed (e.g., Vermont)
    - e. State may hire outside consultants to sift through the record and advise the staff or decision-makers; applicants may be required to pay the consultants' fees; same *ex parte* restrictions may apply to these experts as to the staff
  - 3. "Settling" the merger review cases
    - a. Settlements with individual intervenors in the dockets, while desirable in order to narrow the issues and hasten a decision, may trigger a requirement to give all other parties notice and an opportunity to join in the stipulated settlement terms
    - b. States may incorporate stipulated terms or reject them, at the discretion of the state regulatory authority; states may wait until case is completed before deciding whether to accept or reject stipulated terms
  - 4. Conditions of approval
    - a. States typically have imposed specific conditions related to the promises buyer has made, but sometimes may impose conditions to achieve independent state policy objectives (e.g., in Maine, state required FairPoint to advocate FCC changes in universal service policy)
    - b. Conflicts among the various conditions can develop, making it difficult for buyer to fulfill all of the conditions of closing; for example, buyer may be challenged to comply both with commitments to invest in broadband deployment, and with requirements to pay off debt
- C. Additional issues related to wholesale services (carrier-to-carrier issues arising in both federal and state proceedings)
  - 1. Status of buyer for purposes of determining its interconnection, wholesale service and unbundling obligations under Sections 251(b) and (c) of the Communications Act
    - a. Qualifying for the rural exemption from Section 251(c) requirements under Section 251(f)(1) of the Act
    - b. Qualifying as a two percent carrier for purposes of seeking suspension or modification of Section 251(b) or (c) requirements under Section 251(f)(2)

2. Status of seller as a BOC – whether buyer will be deemed a “successor or assign” of a Bell Operating Company (BOC) under Section 3(4) of the Act
  - a. FairPoint’s acquisition of VNE lines the first to be treated as creating a “successor or assign” of a BOC
    - (1) Other acquisitions of BOC lines had been for less than 100% of lines in the state
    - (2) Not clear from the FCC’s decision what the precise gating factors will be in future transactions
  - b. Consequences of BOC classification remain to be sorted out
  - c. FairPoint also granted the same regulatory relief that the seller enjoyed (e.g., forbearance pursuant to Section 10 of the Act, findings of “non-impairment” in particular wire centers, etc.)
3. Buyer’s assumption of interconnection agreements, other inter-carrier agreements for “wholesale” services and facilities
  - a. Assumption of agreements – consents
  - b. Splitting geographically blended agreements, creating “mirror” agreements
  - c. Extending terms of existing or expired (but evergreen) agreements
  - d. Filing agreements with states
4. Buyer’s adoption of seller’s wholesale tariffs, SGATs (statements of generally available terms), other wholesale regulatory obligations
5. Modifications to tariffs to reflect contract arrangements, volume discounts to reflect division of geographic territory, pro-ration of credits, discounts and similar financial terms

D. Transition & operational issues

1. In asset purchases, buyer may convert any of the acquired systems (especially back-office operations such as ordering & provisioning, billing & collection) to conform to buyer’s existing systems, or to entirely new systems

2. Concerns about transition can delay approval, lead to additional regulatory conditions, and add to cost of acquiring exchanges

E. Settlement of pending disputes outside the acquisition approval process

1. Buyer may be stepping into seller's shoes in a number of disputes over rates, interconnection, pole attachments, etc.
2. While the parties should strive to clarify at the outset what litigation buyer will assume, and where seller will remain "on the hook," the state may have its own views about where this line should be drawn (e.g., federal warrantless wiretap litigation)

III. Participation of Competitors and other Stakeholders

A. Concerns of CLECs and Other Wholesale Customers

1. Legal obligations of Buyer

- a. Will sale by Bell Operating Company (BOC) to rural carrier include § 271 obligations?
  - (1) These include compliance with the 14-point checklist and performance standards and remedies imposed to satisfy the § 271 public interest standard
  - (2) CLECs are concerned that loss of BOC status by a transfer of exchanges may deprive CLECs of these market-opening protections
- b. Will buyer be a entitled to the rural carrier exemption under § 251(f)(1)?
  - (1) Rural telephone companies are not required to comply with § 251(c) obligations (negotiation, interconnection, unbundling, resale) obligations until the state commission determines to lift the exemption. See § 251(f)(1).
  - (2) Can this be used to eliminate preexisting § 251(c) obligations in the transferred areas?
- c. Will buyer be a two percent carrier entitled to suspension or modification of Section 251(b) and (c) obligations under § 251(f)(2)?
  - (1) Carriers with less than 2% of access lines nationwide may petition the state commission to suspend the requirements of § 251(b) (resale, number portability, dialing parity, access to rights of way, reciprocal compensation).
  - (2) Similarly, can this be used to eliminate preexisting obligations?
- d. Will buyer continue historic arrangements that may not be governed by rule or contract (e.g., RLEC-BOC traffic

exchange and service arrangements)?

2. Service delivery and disruption

- a. CLECs and other carrier-customers depend on ILECs for services (interconnection, UNEs, reciprocal exchange of traffic, collocation, etc.)
- b. Does the buyer have experience providing wholesale services?
- c. What personnel, systems, expertise are being brought over to the purchaser?

3. Financial incentive to shortchange wholesale operations

- a. Purchasers often more thinly capitalized than sellers
  - (1) E.g., Verizon 2007 financials: \$93 billion revenues, \$5.5 billion net income, \$31 billion debt
  - (2) FairPoint 2007 pro forma (including Northern New England): \$1.5 billion revenues, \$12 million net income, \$2.3 billion debt
- b. If expenses must be reduced, incentives exist to cut back on services needed by competitors

4. Systems

- a. ILEC operations support systems (OSS) are immensely complex; typically they were developed over decades by adding to proprietary, mainframe-based systems
- b. Extensively tested during 271 process to ensure they are accessible by and useful to CLECs; this was a necessary part of ensuring that local markets were open to competition
- c. Purchasers may not be able to use those systems, may intend to develop their own
- d. Hawaiian Telcom example has “spooked” the industry
- e. Agreements between purchasers and Verizon have included escalating fees for use of Verizon systems during transition period, creating a possible incentive for premature cutover
  - (1) E.g., the Verizon/FairPoint agreement provided for fees of \$14.2 million per month for the first 8 months; \$500,000 per month decrease in months 9-12; in month 13, increase to \$14.7 million; then increases \$500,000 each month thereafter
  - (2) FairPoint recently told financial analysts that it will not achieve cash flow accretion until after terminating the agreement to use Verizon’s systems (Bloomberg Transcript of analyst call, 4/17/08)

5. Increased costs

- a. Purchasers may try to increase wholesale rates to help pay for the transaction
- b. CLECs may lose volume discounts
  - (1) Seller and purchaser both now provide the services in different territories
  - (2) Can a CLEC obligated to purchase a minimum quantity of services to qualify for a volume discount meet the minimum quantity for either seller or purchaser in their respective territories?
- c. Will CLECs incur costs on account of the purchaser's new systems?
  - (1) Training costs
  - (2) Costs of developing new interfaces, etc.
  - (3) Will purchaser seek recovery of systems development costs through wholesale rates?

B. Additional Concerns of Other Stakeholders

- 1. Entry by buyer into new lines of business, increased deployment of network services, and improvements in infrastructure
  - a. Positive: consumer advocates, labor want to commitment from buyer to increase investment
  - b. Negative: Niche players fear new competition
- 2. Management of telephone & utility poles
  - a. Complex agreements among the pole owners governing maintenance and cost recovery
  - b. Users want uninterrupted access to poles, ducts, conduit and rights-of-way
- 3. Economic development
  - a. Investment in services and facilities that promote economic growth
  - b. Involvement in community economic development plans
  - c. Protection of jobs in the state
- 4. Continuation and/or renegotiation of collective bargaining agreements

C. Conditions That Have Been Proposed to Protect Interests of Stakeholders

- 1. Maintain existing legal obligations
  - a. Where BOC is selling, impose BOC status on buyer (as "successor or assign" of BOC)
  - b. No new or expanded rural exemption

- c. Require buyer to assume all of seller's wholesale agreements, tariffs
- 2. Require buyer to continue providing wholesale services seller was providing, on same terms as seller, for some period
  - a. E911
  - b. Operator Services/Directory Assistance
  - c. Pole and conduit attachments
  - d. CLEC user forums
  - e. CLEC handbook
  - f. Trunk ordering intervals
  - g. Tandem transit service
- 3. Maintain wholesale service quality standards and incentives to maintain and upgrade facilities and services
  - a. Impose performance metrics, and remedies in case metrics are not met, that were imposed on BOCs as part of § 271 process
    - (1) Will performance metrics and remedies be applicable if purchaser does not retain seller's BOC status?
  - b. Require establishment of management team and appropriate contacts within the company (e.g., for CLECs, pole attachment requests, consumers, etc.)
  - c. Require specific infrastructure investment, either in terms of \$\$ invested, or in terms of # or % of lines/customers upgraded
- 4. Systems
  - a. A neutral third-party should test systems (or, at a minimum, monitor systems development) before cutover
  - b. FCC or state commissions should retain jurisdiction over cutover process
  - c. The purchaser should not be able to unilaterally decide to cut over
- 5. Wholesale customers should incur no additional costs as the result of the transaction
  - a. The purchaser should adopt seller's wholesale tariffs and SGATs governing services such as:
    - (1) Access charges
    - (2) UNEs
    - (3) Collocation
  - b. Wholesale rates should be frozen for some period (UNEs, resale discount, wholesale tariff, etc.)
  - c. Seller and purchaser both should pro-rate minimum commitments for volume discounts to reflect volumes purchased in their respective territories
  - d. Purchaser should extend ICAs and commercial agreements

- (1) At least, assume existing agreements
- e. No recovery of capitalized system development expense
  - (1) Or, if recovery of capitalized expenses is allowed, must carefully allocate among services (wholesale/retail) and jurisdictions (regulated/unregulated, interstate/intrastate)
- f. No expenses should be imposed on wholesale customers for adaptation to new systems (interfaces, training, etc.)

D. How a Purchaser Should Approach CLECs and Other Stakeholders

- 1. Treat them like customers — which is what they are
- 2. Reach out early and often – Don't let the first meeting be at the commission
- 3. Adopt useful suggestions – and let them know you're doing so at their suggestion

IV. Bibliography

A. Verizon/FairPoint Orders

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- 2. *In re Verizon New England Inc., Northern New England Telephone Operations Inc., Enhanced Communications of Northern New England Inc., Northland Telephone Company of Maine, Inc., Sidney Telephone Company, Standish Telephone Company, China Telephone Company, Maine Telephone Company, and Community Service Telephone Co., Re: Joint Application for Approvals Related to Verizon's Transfer of Property and Customer Relations to Company to be Merged with and into FairPoint Communications, Inc.*, Docket No. 2007-67, Order (Me. Pub. Utils. Comm. Feb. 1, 2008) (available at [http://mpuc.informe.org/easyfile/cache/easyfile\\_doc202917.DOC](http://mpuc.informe.org/easyfile/cache/easyfile_doc202917.DOC))
- 3. *In re Verizon New England Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Co., Verizon Select Services Inc. and Fairpoint Communications, Inc. — Petition for Authority to Transfer Assets and Franchise*, Dkt No. DT 07-011, Order Approving

Settlement Agreement with Conditions, Order No. 24,823 (N.H. Pub. Utils. Comm. Feb. 25, 2008) (available at <http://www.puc.state.nh.us/Regulatory/Orders/2008orders/24823t.pdf>)

4. *Joint Petition of Verizon New England Inc., d/b/a Verizon Vermont, Certain Affiliates Thereof, and FairPoint Communications, Inc. for Approval of an Asset Transfer, Acquisition of Control by Merger and Associated Transactions*, Dkt. No. 7270, Order re: Modified Proposal (Vt. Pub. Svc. Bd. Feb. 15, 2008) (available at [http://www.state.vt.us/psb/document/7270finalremodifiedplan\\_APR.pdf](http://www.state.vt.us/psb/document/7270finalremodifiedplan_APR.pdf)).
5. *Joint Petition of Verizon New England Inc., d/b/a Verizon Vermont, Certain Affiliates Thereof, and FairPoint Communications, Inc. for Approval of an Asset Transfer, Acquisition of Control by Merger and Associated Transactions*, Dkt. No. 7270 (Vt. Pub. Svc. Bd. Dec. 21, 2007) (denying transaction) (available at <http://www.state.vt.us/psb/document/7270finalorder.pdf>).