UNITED STATES DEPARTMENT OF COMMERCE
National Telecommunications and
Information Administration
Washington, DC 20230

Memorandum for: Lawrence E. Strickling
Assistant Secretary for Communications and Information

From: Anthony G. Wilhelm, Ph.D.
Director, Broadband Technology Opportunities Program (BTOP)

Subject: Programmatic Waiver of the Restriction on the Sale of BTOP Project Assets for Indefeasible Right-of-Use Arrangements for Fiber Optic Networks

ISSUE FOR DECISION: Whether you should grant a programmatic waiver of the prohibition in the BTOP Notices of Funds Availability (NOFAs) on the sale or lease of award-funded broadband facilities during their life and the conditions for approving such a sale or lease, to the extent that that prohibition applies to the recipient's provision of indefeasible right-of-use (IRU) arrangements to other broadband service providers for fiber optic networks for the provision of broadband service.

BACKGROUND: The National Telecommunications and Information Administration (NTIA) published two NOFAs to govern the implementation of BTOP.[1] Both the First and Second NOFAs impose a general prohibition on the sale or lease of BTOP project assets during the life of the award-funded broadband facilities or equipment. NTIA, however, may waive this prohibition when certain conditions are met. There are slight variations between the First and Second NOFAs in how this restriction against the sale or lease of BTOP-funded facilities is treated. Specifically, the First NOFA provides that NTIA may approve a sale or lease if it is: (a) for adequate consideration; (b) the purchaser or lessee agrees to fulfill the terms and conditions relating to the project after such sale or lease; and (c) either: (i) the sale or lease is set forth in the original application and is part of the BTOP applicant's proposal for funds; or (ii) the agencies waive this provision for any sale or lease occurring after the tenth year from the date of issuance of the grant.[2] The Second NOFA provides that NTIA will consider a petition for waiver of the above restriction if: (a) the transaction is for adequate consideration; (b) the purchaser or lessee agrees to fulfill the terms and conditions relating to the project after such sale or lease (*e.g.*, the network non-discrimination and interconnection obligations); and (c) the transaction would be in

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[1] *See* Notice of Funds Availability and Solicitation of Applications, 74 Fed. Reg. 33104 (July 9, 2009) (First NOFA), available at http://www.ntia.doc.gov/frnotices/2009/FR_BBNOFA_090709.pdf; Notice of Funds Availability and Solicitation of Applications, 75 Fed. Reg. 3792 (Jan. 22, 2010) (Second NOFA), available at http://www.ntia.doc.gov/frnotices/2010/FR_BTOPNOFA_100115.pdf.

[2] First NOFA, 74 Fed. Reg. at 33123.

the best interests of those served by the project. The petition for waiver may be submitted at any time during the life of the grant-funded facilities and equipment, and it must include supporting documentation justifying why the petition should be granted.[3]

This restriction on the sale or lease of BTOP-funded broadband facilities, however, does not prohibit a BTOP recipient from leasing its facilities to another service provider for the provision of broadband services.[4]

An IRU arrangement is the contractual grant of usage rights in particular pieces of facilities or equipment that are used in the provision of communications services. It may combine aspects of a sale, a lease, and a service contract.[5] The proposed programmatic waiver would apply to IRU arrangements that, like the lease of a building, conveys to the buyer the exclusive, irrevocable right to use a fiber optic facility for any legal purpose, generally for all or almost all of its useful life, but does not convey to the buyer legal title to any real or personal property, such as fiber or other equipment.[6] IRUs typically convey usage rights for conduit, dark fiber,[7] or carrying capacity or bandwidth (*e.g.*, lit fiber,[8] capacity, or wave IRUs[9]).

Many BTOP recipients have indicated that, when their networks are built, they have plans to enter into IRUs to convey interests in their BTOP-funded fiber to other entities for the provision of broadband service. Such arrangements would allow the BTOP recipients to earn revenue from their BTOP facilities that will help to sustain the projects once the period of grant funding ends and ensure their long-term viability.

The prohibitions contained in the First and Second NOFAs on the sale or lease of project assets do not define either of the terms "sale" or "lease," creating ambiguity with respect to the proper treatment of some IRU transactions. Within the telecommunications industry, IRUs may be

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[3] Second NOFA, 75 Fed. Reg. at 3809-3810.

[4] First NOFA, 74 Fed. Reg. at 33123; Second NOFA, 75 Fed. Reg. at 3810. Moreover, this provision is not meant to restrict a transfer of control of the recipient. Second NOFA, 75 Fed. Reg. at 3810.

[5] Charles A. Rohe & Richard H. Agins, *Indefeasible Rights of Use in a Revived Telecommunications Industry: Revisiting the Treatment of IRUs in Bankruptcy Proceedings,* Norton Annual Survey of Bankruptcy Law at 334-335 (2008).

[6] *See id.* at 335; Harry Newton, *Newton's Telecom Dictionary* 622 (25th ed. 2009).

[7] A dark fiber IRU conveys rights to fiber pairs and the grantee must provide the electronics necessary to activate the fiber for the transmission of voice and data services. Arun S. Subramian, *Assessing the Rights of IRU Holders in Uncertain Times,* 103 Colum. L. Rev. 2094, 2099 (2003).

[8] A lit fiber IRU conveys rights to a fully functional number of fiber pairs to the grantee. *Id.*

[9] A capacity or wavelength IRU conveys to the grantee the use of a percentage of fiber bandwidth. *Id.* Advances in technology now permit fiber pairs to be divided into multiple wavelengths (often referred to as lambdas) using Dense Wavelength Division Multiplexing (DWDM), with each wavelength capable of carrying hundreds of data and voice circuits. Capacity in lit fiber is frequently sold by reference to the demarcation points at which it is accessible rather than specifying the actual route over which the capacity will be carried. Rohe & Agins, 2008 Norton Annual Survey of Bankruptcy Law at 336-337.

structured in a variety of ways, and there is no generally accepted set of essential requirements. An IRU may be structured as a capital lease (which is treated under Generally Accepted Accounting Principles (GAAP) as akin to a purchase of capital assets), an operating lease (which is not), or, particularly in the case of a lit capacity IRU, as a long term service agreement. As a result of this ambiguity, some recipients may conclude that the provision of certain IRUs on their BTOP-funded networks would require the recipient to first seek a waiver from NTIA of the sale/lease restrictions in the First and Second NOFAs before it could consummate the transaction.[10]

It would be consistent with the purposes of the BTOP program to allow recipients to provide all types of fiber IRU arrangements to other broadband service providers for the provision of broadband service over BTOP-funded facilities. Further, it would place an undue administrative burden on both the BTOP program staff and on the BTOP recipients to require each BTOP recipient to submit an individual request for a waiver of the restriction of the sale of BTOP-funded assets each time it seeks to provide a fiber IRU arrangement.[11] Accordingly, we seek a programmatic waiver of the NOFAs' prohibition on sale or lease of BTOP-funded facilities during their life, to the extent it applies to IRUs that a BTOP recipient provides to another broadband service provider to be used for the provision of broadband service. The proposed programmatic waiver would cover the NOFAs' conditions for approval of such sales, including the requirement that a Round One recipient must have documented its intent to sell BTOP-funded assets in its application or request a waiver at least ten years after award.[12] This programmatic waiver would not cover the outright sale of BTOP-funded property through the transfer of legal title in such property.

STANDARD OF REVIEW: In section X.N. of both the First and Second NOFAs, NTIA reserved the right to grant waivers of discretionary program requirements. Specifically, the NOFAs provide that NTIA may waive such discretionary requirements "*upon its own initiative* or when requested."[13] The NOFAs also set forth the standard for determining whether such a waiver may be warranted: NTIA may waive the provisions of the NOFAs "under extraordinary circumstances and when it is in the best interest of the Federal government."[14]

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[10] An IRU for fiber that is structured as an operating lease would fall within the exception set forth in the First and Second NOFAs that permits a recipient to lease BTOP-funded facilities to another service provider for the provision of broadband service without first seeking prior NTIA approval. An IRU for fiber capacity that is structured as a service agreement would not invoke the sale or lease prohibition; therefore, prior NTIA approval of these arrangements would be unnecessary.

[11] A Round One recipient would also have to submit additional waiver requests requesting waiver of the requirement to document its intent to sell the facilities in its initial application as well as of the ten-year prohibition against seeking such waivers. *See* First NOFA, 74 Fed. Reg. at 33123.

[12] *See id.*

[13] *Id.* at 3813.

[14] *Id.*

ANALYSIS: To the extent that the First and Second NOFAs' restrictions on a recipient's ability to sell BTOP-funded project assets without first obtaining a waiver from NTIA encroach on the recipient's ability to provide IRUs in BTOP-funded fiber optic facilities to other broadband service providers for the provision of broadband service, these restrictions are discretionary requirements that NTIA may waive upon its own initiative. Telecommunications industry participants commonly use IRUs to provide access to and use of their fiber optic facilities. Although these arrangements may take many forms, they are often structured as capital leases, which, pursuant to GAAP, buyers may treat as akin to a purchase of capital assets.[15]

This situation presents the requisite "extraordinary circumstances" to justify a programmatic waiver of the First and Second NOFA sale restrictions, to the extent they apply to BTOP recipients' provision of fiber IRUs to other broadband service providers for the provision of broadband service. Imposing a requirement that a recipient first seek a waiver from NTIA before it may provide such IRUs adds a burdensome and unnecessary administrative layer to a common telecommunications industry practice. Eliminating this requirement will minimize the administrative burden on BTOP recipients who would be required to prepare and submit such waiver requests, as well as on NTIA and the National Oceanic and Atmospheric Administration (NOAA) Grants Office who would need to review and take action on each request. Eliminating this process will permit scarce agency and recipient resources to be directed to more productive uses during the implementation of BTOP projects, which are already subject to very aggressive timelines for completion. Because BTOP policy favors these types of transactions, it is appropriate for NTIA to streamline the waiver process for recipients entering into fiber IRUs with other broadband service providers for the provision of broadband service.

Allowing recipients to enter into such IRUs also promotes BTOP's purposes, and advances the interests of the Federal government, by expanding the reach of broadband service to additional end users, community anchor institutions, and business enterprises and increasing competition by bringing additional broadband service providers to the market. Further, it allows for harmonization of the disparate requirements for seeking waivers of the sale or lease restriction between the First and Second NOFAs in the particular case of such IRUs, preventing Round One and Round Two recipients from being held to different standards when they seek to provide such IRUs.

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[15] In its Round Two Frequently Asked Questions (FAQ), BTOP enumerated several criteria that may indicate whether an IRU is structured as a capital asset purchase, such that the full cost of the purchase would be treated as an eligible cost under the various cost principles applicable to BTOP grant awards. These criteria require that: (i) the grantee receives an exclusive, irrevocable right to use specific facilities for a determinate price and definite duration; (ii) the term of the IRU covers the useful life of the facility; (iii) the full purchase price of the IRU is paid in advance; and (iv) the IRU transfers ownership of the facility, or conveys "beneficial ownership" to the grantee, even if legal title remains with the grantor. The full acquisition cost of an IRU that qualifies as a purchase is eligible for funding under BTOP provided that the obligation to pay that cost is incurred during the BTOP period of performance.

As part of this programmatic waiver request and consistent with the NOFA conditions needed for approval of individual waiver requests of the sale or lease prohibition, in case-specific situations meriting such action and where technically feasible, NTIA will direct BTOP recipients: (i) to include provisions in the terms of their fiber IRUs that require compliance with certain BTOP requirements, including that the purchaser will provide broadband service and adhere to BTOP's nondiscrimination and interconnection obligations; and (ii) to advise their IRU purchasers that failure to meet these conditions will result in revocation of the IRU. The terms of the IRU should also include an acknowledgement that the property is subject to NTIA's undivided equitable reversionary interest, known as the Federal Interest, for its useful life.[16]

Additionally, NTIA will advise BTOP recipients that intend to provide fiber IRUs that they must retain sufficient capacity so that they can still fulfill their broadband service obligations under the award. In this regard, the sale of fiber may not represent such a dominant share of the available capacity that no other service provider, including the recipient, may use the fiber to provision broadband service. Therefore, this programmatic waiver shall apply only in cases where: (i) no entity or group of affiliated entities obtains IRUs in a majority share of the capacity available for purchase at the time of the transaction on any fiber route constructed with BTOP funds; and (ii) no entity or group of affiliated entities cumulatively obtains a majority of the initial total capacity on any such fiber route.

Moreover, NTIA will advise recipients that the revenue they or their subrecipients receive from their provision of fiber IRUs will be considered program income that must be treated in accordance with BTOP's requirements governing the use of program income if it is earned during the BTOP period of performance.

In addition to the sale restrictions contained in the First and Second NOFAs, the Uniform Administrative Requirements governing BTOP grant awards contain provisions governing the use and disposition of grant funded property that is no longer needed or being used for the originally authorized purpose. In the case of IRUs within the scope of this programmatic waiver, there will be no transfer of legal title. In addition, NTIA has determined that, as long as the IRU purchaser uses its IRU to accomplish the public purpose for which the BTOP grant was funded (*i.e.*, for the provision of broadband service to community anchor institutions or to end users in unserved or underserved areas, subject to the BTOP terms identified above), these property disposition requirements will not apply.[17]

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[16] These requirements are more thoroughly described in the Federal Interest Requirements Fact Sheet available at http://www2.ntia.doc.gov/files/fact_sheet_federal_interest_082510_v2.pdf. NTIA's useful life schedule is available at http://www2.ntia.doc.gov/files/fact_sheet_useful_life_schedule_082510_v1.pdf.

[17] 15 C.F.R. §§ 14.32, 14.34-37, 24.31-34. These requirements state that when property acquired under a federal award is no longer needed or being used for the originally authorized purpose, then it must be disposed of in accordance with the provisions of the above-referenced sections, including by selling the property and compensating the awarding agency for the federal share.

Finally, this programmatic waiver request excludes fiber swaps. Recipients wishing to engage in these transactions must continue to submit individual waiver requests detailing the terms and conditions of such arrangements, which the NOAA Grants Office, in consultation with NTIA, must review and approve.

RECOMMENDATION: Therefore, I recommend that you grant this programmatic waiver request. The exercise of waiver authority in these circumstances promotes NTIA's interests in promoting the successful implementation of its BTOP projects by streamlining administrative processes when practicable and helps to ensure the continued viability of the project after the period of performance ends by facilitating revenue-generating opportunities for BTOP recipients.

If you concur with this recommendation, please indicate by signing and dating this memorandum below.

Signature: Lawrence E. Strickling

Lawrence E. Strickling
Assistant Secretary for Communications
and Information

Date: 2/25/11