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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: Second 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 customers on fiber optic facilities for their own use.

BACKGROUND: The National Telecommunications and Information Administration (NTIA) published two NOFAs to govern the implementation of BTOP.[1] Section IX.C.2 of 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-

[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.

discrimination and interconnection obligations); and (c) the transaction would be in 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 conduit, dark fiber,[7] or carrying capacity or bandwidth (*e.g.*, lit fiber,[8] capacity, or wave IRUs[9]). 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 Generally Accepted Accounting Principles (GAAP), buyers may treat as akin to a purchase of capital assets.[10]

[3] Second NOFA, 75 Fed. Reg. at 3809-10.

[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 334-35 (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 336-37.

[10] *See* Accounting Standards Codification of the Financial Accounting Standards Board ¶ 840-30-25-1. 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

On February 25, 2011, NTIA granted a partial programmatic waiver (First Programmatic Waiver) of Section IX.C.2 of the First and Second NOFAs' restriction on the sale or lease of BTOP-funded assets without prior NTIA approval to the extent that the restriction applies to the recipients' provision of IRUs in BTOP-funded fiber optic networks to other broadband service providers for the provision of broadband service.[11] The First Programmatic Waiver applies only in cases where there is no transfer of legal title and the transaction meets the following proportionality restrictions: (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. The First Programmatic Waiver explicitly excludes fiber swaps.

NTIA requested the National Oceanic and Atmospheric Administration (NOAA) Grants Office to add a "Sale/Lease IRU" Special Award Condition (SAC) to notify recipients of the First Programmatic Waiver and its terms.[12] Pursuant to that waiver, the Sale/Lease IRU SAC required that the terms of each IRU must include an acknowledgement that the property is subject to NTIA's undivided equitable reversionary interest, known as the Federal Interest, for its useful life.

In its request for the First Programmatic Waiver, NTIA committed that "in case-specific situations meriting such action and where technically feasible," it would direct BTOP recipients 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.[13] NTIA included language in the Sale/Lease IRU SAC requiring all recipients to include such provisions in the terms of their fiber IRUs. The inclusion of such language allowed recipients to take advantage of the First Programmatic Waiver without first consulting NTIA to determine whether these requirements would apply.

Many BTOP recipients have now completed substantial portions of their networks and have been negotiating IRU arrangements with potential customers. As they have conducted these

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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.

[11] *See* Memorandum from Anthony G. Wilhelm, Ph.D., Director, BTOP, to Lawrence E. Strickling, Assistant Secretary for Communications and Information, Re: Programmatic Waiver of the Restriction on the Sale of BTOP Project Assets for Indefeasible Right-of-Use Arrangements for Fiber Optic Networks (signed Feb. 25, 2011).

[12] *See* Sale/Lease IRU Special Award Condition, attached to each BTOP Infrastructure or Comprehensive Community Infrastructure (CCI) award.

[13] *See id.* at 5.

negotiations, they have encountered two separate limitations to the First Programmatic Waiver that prevent them from engaging in transactions.

First, recipients have indicated that some potential service provider customers have expressed significant reluctance to agree to the BTOP nondiscrimination and interconnection obligations. As a result, recipients have found it difficult to achieve sustainability and ensure the greatest utilization of their networks. The effect of imposing nondiscrimination and interconnection requirements on recipients' customers, therefore, appears to defeat the purpose of the program by undermining recipients' ability to continue operating the networks for community anchor institutions (CAIs) and other beneficiaries, and by inhibiting the development of competitive end-user service that an open access middle mile network should otherwise promote.[14]

Second, some recipients have been approached by data centers, CAIs, and other end-users that wish to utilize BTOP-funded fiber for their own dedicated, high-capacity broadband use. However, recipients cannot take advantage of the First Programmatic Waiver to provide such IRUs because that waiver applies only when the purchaser is a broadband service provider. In many cases, these customers seek a small proportion of the total fiber available on a BTOP-funded route, such that the provision of an IRU would not interfere with the provision of broadband service on the route. To the extent customers for these IRUs include CAIs, job-creating facilities, and public safety, providing broadband access to them fulfills BTOP's core purposes.[15] Moreover, supplying high-capacity broadband to data centers should fulfill another BTOP core purpose of stimulating the demand for broadband, as those data centers supply useful Internet services to other entities and end-users.[16] Supplying high-capacity broadband to other businesses, such as manufacturers, is also likely to fulfill the BTOP core purpose of stimulating demand for broadband, economic growth, and job creation.[17] Finally, allowing recipients to provide IRUs supports BTOP purposes by helping them financially sustain their networks and keep other fiber strands available for other beneficiaries.

Accordingly, the provisions of the First Programmatic Waiver may be too restrictive and may interfere with the purposes of the BTOP program. Further, it would place an undue administrative burden on both the BTOP program staff and on the BTOP recipients to require

[14] *See* First NOFA at 33133 (noting that "an interconnection condition promotes competition in end-user service provision, consistent with the Recovery Act's directives"); Second NOFA at 3795 ("Open and nondiscriminatory CCI projects funded by BTOP will enable other service providers to serve the community."); FCC Internet Policy Statement, FCC 05-151 (Aug. 5, 2005) ("To encourage broadband deployment and preserve and promote the open and interconnected nature of the public Internet, consumers are entitled to competition among network providers, application and service providers, and content providers.").

[15] *See* American Recovery and Reinvestment Act of 2009 § 6001(b)(3)-(4), Pub. L. No. 111-5, 123 Stat. 115, 514 (Feb. 17, 2009) (Recovery Act).

[16] *See id.* § 6001(b)(5).

[17] *See id.*

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 that does not comply with the terms of the First Programmatic Waiver.[18] However, it remains important to prevent any entity from warehousing BTOP fiber or making routes unavailable for broadband service to a wide variety of end-users.

Accordingly, we seek a second 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 a customer for its own use on six or fewer strands of fiber per route. 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.[19]

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."[20] 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."[21]

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.

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 IRUs in six or fewer fiber strands per customer per route for the customers' own use. 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 NOAA Grants Office who would need to review

[18] 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.

[19] *See id.*

[20] *Id.* at 3813.

[21] *Id.*

and take action on each request. Because BTOP policy favors these types of transactions, it is appropriate for NTIA to streamline the waiver process.

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, CAIs, and business enterprises and increasing competition by bringing additional broadband service providers to the market. The proposed transactions would allow BTOP recipients to earn revenue that will help sustain the projects once the period of grant funding ends and ensure their long-term viability.

Unlike under the First Programmatic Waiver, a recipient would not have to require the purchaser of an IRU issued under this waiver to adhere to BTOP's nondiscrimination and interconnection requirements. By encouraging more customers, service providers, and CAIs to purchase fiber from BTOP recipients, this waiver is consistent with the policy principle articulated in the Federal Communications Commission's Internet Policy Statement (FCC 05-151) that consumers are entitled to competition among network providers, application and service providers, and content providers. In any case, a customer's interconnection requirements on IRUs within the scope of this waiver would have been minimal even if NTIA had required the recipient to impose them on customers, as BTOP requires only that interconnection be offered "where technically feasible without exceeding current or reasonably anticipated capacity limitations."[22]

Also, unlike the First Programmatic Waiver, this waiver would apply where the purchaser is a customer, such as a data center or CAI that intends to use the facilities for its own dedicated broadband service. Such sales of IRUs often promote economic development or support CAIs, including public safety, consistent with BTOP purposes.[23]

NTIA will advise BTOP recipients that intend to provide fiber IRUs under this waiver that they must retain sufficient capacity so that they can still fulfill their broadband service obligations under the award. Therefore, as under the First Programmatic Waiver, IRUs issued pursuant to 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.

[22] First NOFA. 74 Fed. Reg. at 33111; Second NOFA, 75 Fed. Reg. at 3800.

[23] Recovery Act § 6001(b)(3)-(5).

NTIA will require that the terms of each IRU under this waiver include an acknowledgement that the property is subject to NTIA's undivided equitable reversionary interest, known as the Federal Interest, for its useful life.[24]

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.[25] 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, such as economic growth, these property disposition requirements will not apply.[26]

Finally, this programmatic waiver request also excludes fiber swaps or other in-kind transactions. 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 second programmatic waiver request with respect to IRUs on BTOP-funded fiber optic facilities. 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 economic viability and long-term utility of the BTOP projects.

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[24] 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_1.pdf. NTIA's useful life schedule is available at http://www2.ntia.doc.gov/files/fact_sheet_useful_life_schedule_082510_v1.pdf.

[25] 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.

[26] *See, e.g.*, Recovery Act § 6001(b)(5) (defining as a statutory purpose of the BTOP program, stimulating demand for "broadband, economic growth, and job creation").

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: 8/7/13