

DA 98-1888

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Re: Request for Letter Ruling Regarding Application of
47 C.F.R. § 24.709(b)(7)

Dear Counsel:

This letter responds to your request for a letter ruling, filed on behalf of DiGiPH PCS, Inc. ("DiGiPH" or the "licensee"), regarding a proposed modification to a financing arrangement between DiGiPH and its foreign lender (the "lender"). Specifically, you seek confirmation that affording a contingent right of conversion in a note held by the lender would not result in the note being considered on a fully diluted basis, pursuant to Section 24.709(b)(7) of the Commission's rules.¹ You have also requested confirmation that, despite the proposed change, DiGiPH's corporate structure would continue to comply with the foreign ownership limitations of Sections 310(b)(3) and (b)(4) of the Communications Act.²

According to your request, DiGiPH, a C block licensee for eight BTAs, is wholly owned by a parent company, DiGiPH Communications, Inc.³ DiGiPH's vendor, a foreign manufacturer, provided primary funding for system build-out via six separate, secured debt instruments. The second and fifth of these notes have since been retired. The first and third

¹ 47 C.F.R. § 24.709(b)(7).

² 47 U.S.C. § 310(b)(3), (4).

³ Counsel represents that DiGiPH Communications, Inc. is a wholly owned subsidiary of DiGiPH Holding, Inc., which in turn is owned 50 percent by Gulf Coast Services, Inc. and 50 percent by Millry Management Corporation.

notes give the lender the right to convert the loan amount to non-voting common stock in the licensee's parent company and the licensee, respectively. The sixth note contains no conversion rights. The fourth note is the subject of this letter ruling.

DiGiPH proposes to modify the terms of the fourth note ("Note 4") to provide the lender with a right of conversion to non-voting stock in DiGiPH's parent company in exchange for a reduction of the interest rate associated with Note 4. According to DiGiPH, reduction of the interest rate associated with Note 4 would result in a net savings for DiGiPH of over \$500,000 in interest annually.

DiGiPH has structured itself pursuant to the 49.9 percent passive equity exception in Section 24.709(b)(4) of the Commission's C block eligibility rules.⁴ Under this exception, if the lender's equity interest does not exceed the 49.9 percent threshold of Section 24.709(b)(4), its gross revenues are not included in determining DiGiPH's eligibility for a C block license. Section 24.709(b)(7) of the Commission's rules requires that for the purpose of calculating the ownership level held by the lender, agreements such as stock options and convertible debentures generally be considered on a fully diluted basis. Thus, under Section 24.709(b)(7), the conversion rights in Notes 1, 3, and 4 would be treated as if the rights thereunder have been fully exercised. Exercise of the conversion right in Note 4, in combination with the conversion rights contained in Notes 1 and 3, would increase the lender's passive equity in DiGiPH above the 49.9 percent threshold of Section 24.709(b)(4).

To avoid this result, DiGiPH proposes that the conversion right in Note 4 be contingent, vesting only in the event that the lender first assigns or transfers all interest in the first note to a qualified unaffiliated third party⁵ and/or receives a letter ruling from the Commission that its rules permit Note 4 to be converted without such assignment. Thus, the licensee's proposed contingent right of conversion would only be exercised upon divestiture of enough equity associated with the other notes to allow the lender to remain below the 49.9 percent equity limit in Section 24.709(b)(4). According to DiGiPH, the right to convert Note 4 would be contingent upon its ability to do so in compliance with all applicable law, including the Commission's C block eligibility rules and foreign ownership rules in effect at the time of the conversion. DiGiPH further represents that the lender is and will remain solely a passive investor, and will not participate in the management of the licensee. DiGiPH states that under the proposed debt structure, the lender at no time will exercise either *de facto* or *de jure* control over the licensee. Based on these representations, DiGiPH seeks a determination that the contingent conversion right in Note 4 would not be treated on a fully diluted basis, but instead would be considered as having been fully exercised only when it is actually converted to an equity interest.

⁴ 47 C.F.R. § 24.709(b)(4).

⁵ In its letter requesting a ruling, DiGiPH indicates that such unaffiliated third party could be a member of DiGiPH's control group.

The Commission's C block attribution rule provides that for purposes of calculating the equity held in an applicant or licensee, certain stock interests, such as stock options or conversion rights, will *generally* be treated as if the rights thereunder already have been fully exercised.⁶ The underlying purpose of the rule was to include ownership interests that do not leave the ownership decision in the designated entity's control, because such agreements can potentially force the designated entity to sell its ownership interests.⁷ However, by including the word "generally," in Section 24.709(b)(7), the Commission recognized that for purposes of calculating ownership levels, some ownership interests need not be treated as "fully diluted."⁸ In its *Fifth Memorandum Opinion and Order*, the Commission established two exceptions to the rule, for rights of first refusal and "put" options, which it did not codify in Section 24.709(b)(7). Although these exceptions are inapplicable to the facts you have presented, their adoption and the Commission's inclusion of the word "generally" in Section 24.709(b)(7) suggest that the Commission understood that it could not foresee every possible situation in drafting the rule.

Upon consideration of DiGiPH's request, we find that Section 24.709(b)(7) requires us to consider the conversion rights in Note 4 on a fully diluted basis. However, we also find that the policy underlying Section 24.709(b)(7) can be furthered without considering all existing stock conversion rights as having been fully exercised simultaneously in a case where the various conversion rights are mutually exclusive by their terms. Based on your representation that the lender could exercise its stock conversion rights only upon the condition that DiGiPH's control group maintained the necessary 50.1 percent total equity interest in and control of the licensee, and your representation that the lender, as the holder of only passive equity, will have no ability to exercise control over the licensee's operations, it appears that the modified debt arrangement that DiGiPH contemplates will not transfer *de facto* control to the lender in violation of the designated entity eligibility rules.⁹ Accordingly, we interpret the "fully diluted" requirement in Section 24.709(b)(7) to permit the lender's conversion rights or stock options to be considered individually rather than collectively when they are mutually exclusive. Under our interpretation, for the purpose of calculating ownership interests, we continue to calculate all stock interests on a fully diluted basis, but if a stock interest is by its terms mutually exclusive of one or more other stock interests, we will treat the various ownership interests as having been fully exercised only in the possible combinations in which they can be exercised by the lender. For each combination, the lender

⁶ 47 C.F.R. § 24.709(b)(7)(emphasis added).

⁷ See Implementation of Section 309(j) of the Communications Act-Competitive Bidding, *Fifth Memorandum Opinion and Order*, 10 FCC Rcd 403 at ¶ 95 (1994) ("*Fifth M O & O*").

⁸ See *Fifth M O & O* at ¶ 94.

⁹ See 47 C.F.R. § 24.709(b)(6)(i).

will be considered to have exercised its stock conversion rights, and each combination will be subject to the 49.9 percent equity limit in Section 24.709(b)(4).

We emphasize that this ruling does not constitute a waiver of the fully diluted requirement in Section 24.709(b)(7), but only an interpretation of the rule that addresses how such stock interests will be calculated when the rights thereunder are granted on a contingent basis that makes them mutually exclusive of other existing ownership interests. We also caution DiGiPH that we will consider one ownership interest to be mutually exclusive of another only if the agreement that conveys the first interest contains explicit language making it clear that the rights conveyed by that agreement cannot be exercised unless all ownership rights associated with the other agreement are either terminated or transferred or assigned to a qualified unaffiliated third party.

We also conclude that the addition of contingent conversion rights in Note 4 would not violate the foreign ownership restrictions of Sections 310(b)(3) and (b)(4) of the Communications Act.¹⁰ Under the Commission's decision in *Data Transmission*, direct foreign investment in the licensee and direct foreign investment in the licensee's parent are not aggregated for purposes of calculating foreign ownership.¹¹ In *DCR PCS, Inc.*,¹² the Wireless Telecommunications Bureau addressed the foreign ownership limitations in Section 310(b)(4) and held that while Section 24.709(b)(7) does provide that stock options will be generally treated as fully exercised for the purpose of determining eligibility as a small business, with respect to foreign ownership questions, an option held by a foreigner to buy stock in a licensee or the parent of a licensee is not cognizable until it is exercised. Furthermore, DiGiPH represents that the rights of conversion associated with Note 4 would require prior divestiture of any other holding that would result in a violation of the Commission's foreign ownership rules. Based on this representation and the precedent cited above, it is our opinion that the contingent conversion rights DiGiPH proposes to include in Note 4 would not violate the foreign ownership limitations in Sections 310(b)(3) and (b)(4).

This opinion is based on our understanding of the facts as explained in your letter and the supplemental information provided on several occasions both orally and in documentary form. The Division has not conducted an independent investigation of the proposed financing arrangement. Our assessment of the financing arrangement could change if the facts change significantly from those you have presented in connection with your request for a letter ruling.

¹⁰ 47 U.S.C. § 310(b)(3), (4).

¹¹ *Request by Data Transmission Co. for a Declaratory Ruling Concerning Alien Ownership*, 52 FCC 2d 439 (1975).

¹² *DCR PCS, Inc.*, 11 FCC Rcd 16849, 16858 ¶ 24 (1996).

This action is taken pursuant to delegated authority under Section 0.331 of the Commission's rules. 47 C.F.R. § 0.331.

Sincerely,

Amy J. Zoslov
Chief, Auctions and Industry Analysis Division
Wireless Telecommunications Bureau