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NEXTWAVE SUPREME COURT VICTORY ENDS FIVE-YEAR STRUGGLE OVER U.S. WIRELESS SPECTRUM AUCTION RULES

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NextWave Supreme Court Victory Ends Five-Year Struggle Over U.S. Wireless Spectrum Auction Rules.

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Introduction

On January 27, 2003, The U.S. Supreme Court, in a stunning setback for the U.S. telecommunications regulator, the Federal Communications Commission ("FCC"), upheld the right of NextWave Personal Communications, Inc. ("NextWave"), the bankrupt licensee of valuable Personal Communications Service ("PCS") wireless spectrum won at auction in 1996, to retain the spectrum licenses despite its default in payment of 90% of the auction price and the FCC's purported revocation of the licenses.[1] The decision affirmed that of the U.S. Court of Appeals for the D.C. Circuit on June 22, 2001.[2]

U.S. Wireless Spectrum Auctions

U.S. wireless spectrum licenses are awarded by auctions pursuant to Section 309(j) of the Communications Act of 1934, as amended (the "Act"), and regulations promulgated thereto by the FCC. Section 309(j) was enacted as part of the Omnibus Budget Reconciliation Act of 1993 to replace a pre-existing lottery system and to encourage U.S. Government revenue realization from what was increasingly recognized to be a scarce, if non-depletable, resource. Section 309(j)(3)(B) requires the FCC to promulgate rules for "disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies and businesses owned by members of minority groups and women," the so-called "Designated Entities."

The FCC implemented Section 309(j)'s provisions through a proceeding entitled "In the Matter of Implementation of Section 309(j) of the Communications Act – Competitive Bidding" (the "Proceeding"). As part of the Proceeding, the FCC planned auctions of six letter-designated "blocks" of spectrum. Two of these, the "C" and "F" blocks, were reserved for Section 309(j)(3)(B) Designated Entities and dubbed the "entrepreneur" blocks. The Designated Entities eligible to bid in the C and F block auctions were restricted by specification of maximum annual gross revenues and total assets. In order to reduce the pre-and post-auction financing needed to bid, and therefore open the process to more thinly-capitalized bidders, the C and F block licenses fees were to be payable in installments.

The *NextWave* litigation therefore arose from an arguably laudable public policy goal. The result however, was to grant valuable spectrum to a class of thinly-capitalized licensees that had difficulty building out their networks and putting their spectrum to use (a problem know as

"paper licenses"), as well as to a number of companies that, owing to manipulation of the attribution regulations promulgated by the FCC pursuant to are, again arguably, mere nominees for large wireless carriers.

The NextWave Case

At the 1996 auction for C and F block licenses, NextWave was a successful bidder with a high bid of $4.74 billion. The FCC rules for the C and F block permitted financing of up to 90% of the license fee, which NextWave did, paying an initial installment of $474 million. NextWave thereafter had difficulty in obtaining investment to fund the remaining installments and in 1998 filed for bankruptcy protection in New York. NextWave blamed the FCC for the investment climate, taking the position that subsequent auctions had devalued its licensed spectrum, making financing of the remaining installments and build out of its planned network impossible. The FCC then purported to revoke the licenses. Litigation in two U.S. Courts of Appeals, the Second Circuit, with jurisdiction over New York and the bankruptcy filing, and the D.C. Circuit, with jurisdiction over acts of Federal agencies, ensued and culminated in the Supreme Court decision.

The Supreme Court Decision

The Supreme Court held that the FCC, by revoking NextWave's licenses, had violated Section 525 of the U.S. Bankruptcy Code[3], which prohibits a federal agency like the FCC from revoking the license of a bankruptcy debtor "solely because" the debtor has failed to a pay a debt that would be dischargeable in the bankruptcy. In response to the FCC's argument that it had a "valid regulatory motive" for revoking the NextWave licenses, the Court found that the ultimate motive of a federal agency in revoking a license was irrelevant, that Section 525 meant that "the failure to pay a dischargeable debt must alone be the proximate cause of the cancellation-the act or event that triggers the agency's decision to cancel, whatever the agency's ultimate motive in pulling the trigger may be," and that accepting the "valid regulatory motive" argument urged by the FCC would denude Section 525 of all applicability, since some such motive other than the mere failure to pay could always be found by an interested government agency.

The FCC also argued that NextWave's obligation to pay the remaining installments on its winning bids was not a debt that was dischargeable in the bankruptcy proceeding. In rejecting this argument, the Supreme Court found that the Bankruptcy Code provides that virtually all debts that arose before a bankruptcy (with nine Bankruptcy Code-enumerated exceptions, among which FCC licenses are not included) are dischargeable in bankruptcy. The Court stated, echoing the D.C. Circuit Court of Appeals, that a federal agency like the FCC is subject to all federal laws, not merely the statute it administers.

Conclusion

The conclusion of the NextWave litigation saga leaves the FCC's spectrum policy in tatters and the future of the NextWave spectrum itself unclear. While vindicated in court, NextWave's victory may be pyrrhic; the NextWave spectrum today is valued at a fraction of the original auction price. NextWave has publicly stated its intention to build out its network, but has also stated that it might make some of the spectrum available to other carriers. The FCC, faced with a continuing spectrum crunch that the wireless industry asserts is crippling the rollout

of advanced and third generation service, remains under Section 309(j)'s mandate to get spectrum into the hands of Designated Entities, but with six years' of bitter experience to suggest that installment plans are not a method to be repeated.

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[1] *FCC v. NextWave Personal Communications, Inc.,* case nos. 01-653 (January 27, 2003).

[2] *NextWave Personal Communications, Inc., v. FCC,* case nos. 254 F.3d 130,133 (D.C. Cir. 2001), reported on in *Telecom Finance,* Issue 84, October 24, 2001.

[3] 11 U.S.C.