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D.C. CIRCUIT DECISION IN NEXTWAVE LITIGATION UPSETS PCS REAUCION

On June 22, 2001, a three-judge panel of the U.S. Court of Appeals for the District of Columbia Circuit issued its ruling in the three-year-old bankruptcy dispute between NextWave Personal Communications, Inc. ("NextWave") and the Federal Communications Commission ("FCC") regarding the status of the C Block Personal Communications Services ("PCS") licenses granted to NextWave. In its decision, the court reversed and remanded to the FCC for further consideration the FCC's cancellation of NextWave's licenses for failure to meet its \$4.74 billion license installment payment obligations. This decision will have enormous near-term effects on the FCC and the U.S. wireless industry.

The D.C. Circuit's decision is the most recent in an ongoing series of court battles regarding the fate of NextWave's spectrum. The course of this litigation has been dramatically affected by the ebbs and flows in the market value of PCS spectrum, which dropped sharply in late 1996, but which more recently has tripled from NextWave's \$4.74 billion bid in light of the scarcity of spectrum, the increasing demand for wireless services, and the perceived value of "third generation" (or "3-G") wireless offerings such as data and Internet access.

NextWave was the largest winning bidder in the FCC's 1996 C block PCS auction. Shortly after its licenses were granted, NextWave had difficulty making its installment payments for the licenses and filed for protection under Chapter 11 of the U.S. Bankruptcy Code. In bankruptcy court, NextWave sued the FCC under a fraudulent conveyance claim, arguing that by the time the FCC actually granted NextWave's licenses (approximately six months after the close of the

auction), the licenses were worth far less than what NextWave had promised to pay. The bankruptcy court ruled in NextWave's favor, reducing the debt for its licenses to \$1.02 billion, and the District Court for the Southern District of New York affirmed. The U.S. Court of Appeals for the Second Circuit reversed those decisions in December 1999, concluding that the bankruptcy court lacked authority to overturn what the court concluded were the FCC's regulatory actions in canceling the licenses.

Last year, NextWave filed a new bankruptcy reorganization plan, seeking to keep its licenses in return for payment of its entire original winning bid, plus interest. The FCC objected, asserting that NextWave's licenses had automatically cancelled, and sought to reauction them under relaxed eligibility rules. The bankruptcy court rejected the FCC's views, and again the Second Circuit reversed. NextWave then sought review of the FCC's cancellation and reauction notice in a different forum, the D.C. Circuit. Meanwhile, in January 2001, the FCC completed its reauction of NextWave's licenses, notwithstanding that pending appeal (and after having successfully opposed NextWave's efforts to stay the reauction). Winning bids for the spectrum, principally by wireless carriers seeking to expand their existing footprints or offer advanced wireless services in their existing markets, reached over \$15 billion under the new rules.

The D.C. Circuit's decision upsetting that reauction addresses the intersection of federal bankruptcy law, the FCC's auction rules and security arrangements for installment payment licenses, and the extent to which NextWave was permitted to relitigate these issues after having lost

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its two earlier appeals in the Second Circuit. The court ruled that in “having chosen to create standard debt obligations as part of its licensing scheme” by establishing installment payment plans, the FCC “is bound by the usual rules governing the treatment of such obligations in bankruptcy.” Thus, under Section 525 of the Bankruptcy Code, the FCC is barred from revoking a license awarded to a bankrupt entity “solely because such bankrupt . . . has not paid a debt” that is discharged in bankruptcy. The court rejected the FCC’s position that NextWave was barred from raising this issue after having lost in the Second Circuit. It agreed with NextWave that the Second Circuit had decided *only* that bankruptcy courts lack jurisdiction to entertain the bankruptcy law arguments raised by NextWave, without addressing the merits of those arguments themselves. The decision has the peculiar result of depriving the bankruptcy courts of jurisdiction to interpret the Bankruptcy Code as applied to government agency creditors where (as is typical) there is an alternative path for judicial review of those agencies’ decisions.

The court’s ruling blocks the FCC’s issuance of licenses to the C-block reauction winners of the former NextWave licenses. Ultimately, the FCC’s next steps will be determined by a complex combination of factors, including an assessment of the government’s likelihood of persuading the Supreme Court to reverse the D.C. Circuit’s decision, the importance of the revenues from the reauction to the Federal budget (in which they have already been counted), and the prospects

of achieving a settlement with NextWave and the winning bidders. Under one such settlement scenario, some or all of NextWave’s licenses would be awarded (or sold) to the C block reauction winners, while NextWave would be compensated for some portion of the discount from present market value that it would enjoy if it were to retain them. However, such a settlement may be difficult to accomplish because of the many competing interests involved. It is unclear, for example, how it would conform to the FCC’s licensing rules (including the small business eligibility rules applicable to NextWave’s licenses), and whether any participation by the government in such a payment would receive the necessary Congressional authorizations.

The effects of this decision are likely to reach far beyond NextWave and the winning bidders in the reauction. The decision has the potential to threaten other federal programs as Congress evaluates its impact on government budget policies. The decision also is likely to slow down other key elements of Chairman Powell’s near term wireless agenda, as FCC and industry resources will be diverted from their current focus on issues such as the reexamination of the CMRS spectrum cap, allocation of spectrum for 3-G services, and creation of a secondary market for spectrum. On the other hand, the potential loss of this spectrum to major wireless carriers highlights their need for additional spectrum to deploy advanced services, a matter also currently under review.

This letter is for general informational purposes only and does not represent our legal advice as to any particular set of facts, nor does this letter represent any undertaking to keep recipients advised as to all relevant legal developments. For further information on these or other telecommunications matters, please contact one of the lawyers listed below:

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