WILMER, CUTLER & PICKERING

Washington ■ Baltimore ■ New York ■ London ■ Brussels ■ Berlin

December 30, 1999

TELECOMMUNICATIONS LAW UPDATES

Second Circuit Releases Decision on NextWave Bankruptcy Proceeding; Future of NextWave Spectrum Unclear

On December 22, 1999, the United States Court of Appeals for the Second Circuit released its decision resolving the longstanding battle between the FCC and NextWave Personal Communications, Inc. over that company's PCS licenses. NextWave had convinced two lower courts to apply Chapter 11 bankruptcy provisions to reduce its license payment obligations to the FCC and seemed poised to emerge from bankruptcy with a revised business plan and significant new financing. But the FCC viewed NextWave's victory before the lower courts as threatening the agency's jurisdiction and the integrity of the auction process. The Second Circuit's decision, which reverses the two prior decisions, represents a significant "win" for the FCC, might finally end the FCC's efforts to obtain a legislative fix to its bankruptcy woes (*see* Telecommunications Law Update, January 14, 1999), and generally signals that bankruptcy will not be an effective means of avoiding FCC license debt in the future.

The NextWave bankruptcy resulted from the C block "small business" PCS auction, held in 1995-1996. Winning bidders were allowed to pay for their licenses in installments over the ten year license term. This, together with sizeable bidding credits, led many to bid highly inflated amounts for the spectrum. NextWave, which won the most licenses, bid over $4.74 billion for a total of 63 C block licenses in the original C block auction and a subsequent reauction.

The subsequent auction of additional PCS licenses at far lower prices quickly deflated the value of the C block licenses. Almost immediately, many C block licensees found it difficult to obtain the financing necessary to make their installment payments. The FCC provided some relief from payment obligations, suspending interest payments for a time and permitting licensees to return some or all of their spectrum to the FCC without having to make default payments. Unsatisfied with the FCC's relief measures, NextWave followed in the footsteps of the two other largest C block winners (Pocket Communications and GWI PCS) and filed for bankruptcy in June 1998. Before the bankruptcy court, NextWave fought to set aside its license debt as a constructive "fraudulent conveyance" under section 544 of the Bankruptcy Code. The bankruptcy court agreed and reduced NextWave's overall FCC debt by $3.7 billion, and the U.S. District Court affirmed that reduction. The FCC appealed this decision and obtained a stay of NextWave's reorganization pending that appeal.

The result of the Second Circuit's decision will be a complete reworking of NextWave's reorganization plans. The future of NextWave's licenses therefore remains unclear. The FCC might allow NextWave to keep its licenses, provided that the company acknowledges its original obligation to the FCC and makes payment of all interest and principal accrued to date. NextWave now suggests that it would welcome such an approach, especially in light of potential equity investments from Global Crossing Ltd. and Liberty Media Corporation. It is unclear, however, how NextWave's installment payments would be calculated under such a scenario, and whether the FCC would choose – or have the right necessarily – to impose late fees or other penalties as a result of NextWave's failure to make installment payments over the past two years. It also is unclear how NextWave's anticipated new financing would be consistent with the FCC's rules that prohibit non-"small business" entities from holding certain interests in C block licensees.

Another possible outcome is that the FCC will revoke and reauction NextWave's licenses. Such a reauction would make available licenses for 30 MHz of spectrum in major metropolitan areas throughout the United States. Eligibility for such a reauction likely would again be limited to entities meeting the definition of "small business," which might produce lower proceeds than would result from NextWave's preferred approach. Nevertheless, in the wake of the negative press and intense interest following the FCC's consideration of an offer by Nextel for the licenses, the FCC would have to tread carefully in abandoning the C block eligibility restrictions for NextWave's spectrum, even in a reauction scenario.

The impact of the Second Circuit's decision rejecting the application of the "fraudulent conveyance" principle to FCC license obligations will extend far beyond NextWave's licenses. The decision means that the FCC's role as spectrum regulator insulates the agency in its role as a creditor, as well. This has implications for all licenses subject to FCC installment payments; these include not only the C block, but also F block PCS, narrowband PCS, 900 MHz SMR, MDS and IVDS licenses.

While it is possible that other U.S. courts of appeals would rule differently, the Second Circuit is the highest court to have examined the impact of bankruptcy on FCC license obligations, and the decision is likely to be followed by other courts. Existing licensees subject to installment payments therefore likely can forget bankruptcy as a meaningful alternative in the face of financial distress. This will force distressed licensees to negotiate rather than fight with the FCC. Future auction bidders and their lenders and investors should be forewarned that license debt will be treated with a wholly distinct approach in the event of bankruptcy.

Lynn R. Charytan (202/663-6455)
Josh L. Roland (202/663-6266)

Scott Blackmer	**202-663-6167**	**SBlackmer@wilmer.com**
Lynn Charytan	**202-663-6455**	**LCharytan@wilmer.com**
John Harwood	**202-663-6333**	**JHarwood@wilmer.com**
William Lake	**202-663-6725**	**WLake@wilmer.com**
Daniel Phythyon	**202-663-6545**	**DPhythyon@wilmer.com**
William Richardson	**202-663-6038**	**WRichardson@wilmer.com**