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Height Commentary

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Spectrum Policy

C-Band FAQ - Why the Market-Based Approach Will Prevail

THE TAKEAWAY

In the months since the Federal Communications Commission (FCC) adopted its Notice of Proposed Rulemaking (NPRM) on rebanding the C-band downlink for terrestrial mobile use, we have received a multitude of questions from investors seeking to understand how the process could be derailed given the potential for C-band operators to reap billions in windfall proceeds from private-market sales of the spectrum. While we detailed our views on the major risks to this proceeding in our August 20 report, we felt it would be helpful for investors to revisit the various issues and how they could play out. Our core thesis remains unchanged: we expect the FCC to issue a final order in mid-2019 allowing C-band operators to use the C-band Alliance (CBA) consortium to negotiate private-market deals to clear 200 MHz of spectrum in the next three years, and a total of 300 MHz over the next seven to eight years. Furthermore, we see few avenues for opponents of the market-based approach to stymie the process, much less upend it. In this note, we address some of the most common questions received from investors. For more detailed analysis of the C-band proceeding, please see our December 31, November 15, November 2, October 10, August 20, and July 11 reports.

Q: Why wouldn't the FCC take a portion of the proceeds given the potential for billions in windfall profits for the C-band operators?

As we detailed in our July 11 report, we believe the FCC will choose the market-based proposal put forward by Intelsat (**I**) and the CBA primarily for the speed at which it could deliver spectrum to the market. In the NPRM, the FCC made very clear that it was "pursuing the joint goals of making spectrum available for new wireless uses while

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balancing desired speed to market, efficiency of use, and effectively accommodating incumbent…operations in the band." In addition, FCC Commissioner Michael O'Rielly, who is currently spearheading the C-band initiative, has stated on numerous occasions that the market-based proposal should be thoroughly considered "particularly because of the speed in which it could bring the spectrum to the market."

However, as we noted in our August 20 report, it is our understanding, reinforced by our conversations with industry experts, that unlike an auction, in which the law requires the FCC to keep all of the proceeds, the FCC currently has no legal authority to take any proceeds from such a secondary market sale. For the FCC to take a piece of the proceeds in a secondary market sale, Congress would need to pass new legislation authorizing the Commission for this activity specifically for the C-band. We view this prospect as unlikely, which we will discuss in more detail below.

This may raise the question "why would the FCC not just auction the spectrum and keep all of the proceeds?" The answer, in part, goes back to the paramount goal of speed to market. As the Obama administration's National Broadband Plan notes, historically, the process of rebanding spectrum through auctions typically takes six to 13 years from conceptualization to implementation. As Commissioner O'Rielly stated in his official statement on the C-band NPRM, "(w)e cannot wait five or ten years to open the band for flexible wireless use." We believe this means that the idea of an auction is untenable.

Moreover, Section 309(j)(7)(A) of the Communications Act of 1996 specifically states that when the FCC is deciding whether or not to pursue an auction, "the Commission may not base a finding of public interest, convenience, or necessity on the expectation of Federal revenues from the use of a system of competitive bidding." This suggests to us that even if the FCC did desire to take a portion of the proceeds, it cannot use that as a reason for justifying an auction.

Q: Does the FCC have the authority to use private market arrangements to sell the C-band spectrum?

In response to comments made by T-Mobile (**TMUS**) and others on the FCC docket, many investors have started to question the FCC's legal ability to use private market sales to reband the C-band. The reasoning here is that under Section 309(j)(1) of the Communications Act, if the Commission receives mutually exclusive applications for a given spectrum license the FCC must "grant the license…through a system of competitive bidding," or, in other words, an auction.

In our view, this misrepresents the FCC's obligations in the broader context of Section 309(j) in the Communications Act. The market-based proposal effectively seeks to circumvent this requirement by having the CBA privately negotiate the sale of licenses, such that by the time the FCC receives an application for a new C-band license, there is only one applicant for any given license. In fact, Section 309(j)(6)(E) of the Act specifically says that nothing in the rules governing competitive bidding procedures "shall be construed to relieve the Commission of the obligation to the public interest to continue to use engineering solutions, negotiation, threshold qualifications, service regulations, and other means in order to avoid mutual exclusivity in…licensing proceedings." Here, we believe the law makes it clear that the FCC's obligation is to avoid auctioning spectrum unless it is completely necessary.

To that end, we believe the FCC confirms our view that it is obligated to use negotiations to avoid mutually exclusive applications for licenses in the C-band NPRM. In its discussion on the market-based approach, the Commission suggests making a negotiated agreement with the C-band consortium "a prerequisite for applying

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for a license" in the band and asks for comment on whether this negotiation would "satisfy the Commission's obligation in the public interest to use negotiation to avoid mutual exclusivity pursuant to Section 309(j)(6)(E) of the Communications Act."

In terms of precedence, we believe one of the best examples of the FCC's authority to use private market transactions to transition spectrum in the public interest is the Commission's approval of the 2012 sale of AWS-1 spectrum licenses to Verizon (**VZ**) by SpectrumCo LLC, a consortium of cable companies of which 63% was owned by Comcast (**CMCSA**). In this transaction, the FCC said "where existing licensees do 'not fully utilize or plan to utilize the entire spectrum assigned to them,' the Commission has encouraged the use of secondary market transactions such as the one before us to transition unused spectrum to more efficient use and allow network providers to obtain access to needed spectrum for broadband deployment."

Q: Assuming the FCC chooses the market-based approach, what stops companies who didn't win the licenses they wanted from applying for the licenses anyway, creating a mutual exclusivity problem?

While this situation seems like an obvious problem on its face, we think the FCC already addressed it in the NPRM. In the same section on negotiations quoted above, the FCC says "a market-based approach would not likely result in mutually exclusive applications for the Commission to consider, if, for example, a negotiated agreement with the Transition Facilitator (CBA) is a prerequisite for applying for a license in this band." This requirement would be set out in the final order and would obviously preclude any applications for licenses not won in the private negotiations, so we do not see this as a problem. In addition, absent a rule requiring a negotiated agreement with the CBA, any company that would apply for a license they did not win in negotiations would understand that they are a "repeat offender" with the FCC in the sense that they will have to go to the FCC later on for license renewal and rebanding requests, which we believe is also likely to keep disenfranchised applicants from coming forward.

Q: Won't the optics of the FCC handing foreign companies a windfall for spectrum they didn't pay for drive Congress to pass legislation either forcing an auction or allowing the FCC to collect proceeds?

In general, we believe this situation poses the biggest threat to the market-based proposal. Such a visible transfer of taxpayer money to foreign entities could certainly galvanize lawmakers to push for bipartisan legislation, which as we mentioned above, is the only real way to derail the private-market approach, and this would be beyond the FCC's control.

However, we would first note that the reality of the situation is that Intelsat and SES (**SESG:EN**), who control around 90% of the U.S. C-band, did not receive their C-band spectrum for free, per se. While it is true that C-band spectrum was doled out for free by the U.S. government in the 1960s, these two entities did not receive their C-band allocations until much later. Intelsat, for example, received its C-band rights through its acquisition of PanAmSat in 2006 for a total of $3.2 billion. In addition, SES received its C-band rights through its acquisition of GE Americom in 2001 for a total of $5 billion. So, in our view, it is disingenuous to say that these companies did not pay for their C-band rights.

Regardless, we believe getting new legislation through both chambers of Congress would be very difficult. An investor would have to believe that this issue was so galvanizing that the Republican-controlled Senate would go against its own Republican-controlled FCC, a prospect we believe is very unlikely.

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To be clear, it is not as if the C-band is not on Congress' radar. To our knowledge, four letters have been sent to FCC Chairman Ajit Pai in the last year concerning the C-band process, two from Senators and two from Congressmen. In each case, the letters have focused on ensuring the FCC requires the C-band end-users, such as broadcasters and content providers, be fairly compensated for their relocation expenses. Given that the CBA's proposal already addresses this issue, and that no member of Congress has made any public mention of a windfall, we believe it is unlikely that legislators are concerned enough with the windfall issue to come together in support of new legislation. However, it is certainly possible that the subject receives more attention as we get closer to a final FCC order, and we will be keeping a close eye out for any developments.

Q: Even if the FCC and Congress don't derail the market-based approach, won't President Trump issue an executive order to stop the handing of a windfall to foreign companies?

It is our understanding that President Trump could, indeed, issue an executive order to prevent the private-market sale of C-band spectrum. This could be done before the FCC issues a final order, preventing the Commission from even being allowed to advance the proposal, or after the final order, by neutering the FCC's ability to actually execute the approval process of the order. However, much like with the Republican-controlled Senate, we find it hard to believe that President Trump would go against the Republican FCC Chairman he appointed.

In addition, we believe Trump would be unlikely to derail a market-based sale of spectrum in favor of an auction, especially given the recent presidential memorandum he signed, which requires all government agencies to review and justify their spectrum needs so that any unused spectrum can be freed up for commercial 5G use. This is a reflection of the administration's overall drive to win the race to 5G and, in our view, makes it very unlikely that Trump would move against the market-based approach.

Q: If the market-based approach makes it all the way to a final order, won't the process be slowed or even upended through litigation?

While taking the FCC to court over its final order could result in the court issuing a stay, and potentially even overturning the FCC's decision, we do not see either outcome as likely. For a court to issue a stay, stalling the implementation of the market-based approach, the plaintiffs in the case must establish that they are likely to succeed on the merits of the case and that they are likely to suffer irreparable, non-monetary harm stemming from the implementation of the order. In our view, supported by our conversations with industry professionals, proving they would suffer irreparable harm would likely be very difficult. For example, if the C-band operators began the transition and clearing process, the C-band operators could easily just not vacate the spectrum were the court to overturn the FCC.

In terms of final decisions by the courts on the order, we see three possible outcomes: (1) the court sides with the FCC; (2) the court remands the case back to the FCC for further consideration; and (3) the court reverses the FCC's decision.

If the court sides with the FCC, obviously the case is over and the order remains intact. If the court remands the case back to the FCC, the regulations would effectively remain in limbo until the FCC addresses the court's concerns. If the court decides against the Commission directly, the order would be overturned.

Given our view of the legal basis for the FCC's allowance of the market-based approach, the first two scenarios are most likely, while it is highly unlikely that the court will flatly overturn the order. The industry experts we spoke

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to generally believe the FCC would be favored in the final outcome, citing the aforementioned legal basis, as well as the Pai FCC's outstanding track record in court. This record is not surprising given Chairman Pai's extensive background as an attorney for the Department of Justice (DOJ) antitrust division.

We believe the best-case scenario for opponents is for the courts to remand the order back to the FCC, setting the stage for a different FCC, possibly with a Democratic majority, to review the order and come to a different conclusion. Again, however, we do not believe this is likely given the well-established legal basis for the FCC using the market-based approach.

Q: Why do you believe the FCC's final order will allow for a total of 300 MHz of spectrum to be cleared over time?

Admittedly, this question is unrelated to the topic of what could derail the market-based approach but given the difference in value the companies stand to gain in selling 300 MHz of spectrum versus just 180 MHz drives us to reiterate our views on the subject.

Since we began writing on the C-band in July 2018, we have held that the total amount of spectrum that can physically be cleared without disrupting C-band operations is 300 MHz, a view driven by our conversations with industry professionals. While it would require additional time beyond the 18-36 months the CBA has cited for clearing the C-band, these professionals were adamant that the entirety of the C-band can technically be operated in 180 MHz, with a 20 MHz guard band and 300 MHz of spectrum being sold in the secondary market. This foots with Commissioner O'Rielly's call for at least 200-300 MHz of C-band spectrum to be freed up through the process.

As we mentioned above, we believe the FCC will allow the CBA to clear 200 MHz of C-band over the next three years and a total of 300 MHz over the next seven to eight years. The FCC actually laid the groundwork for this staged process in the NPRM, in which the Commission stated "the market-based process need not be a one-time event – a Transition Facilitator could negotiate with parties for compensation and protection, seek Commission review and conditional authorization, and clear new spectrum multiple times to ensure the total spectrum dedicated to flexible use meets market demands." Given our aforementioned view that more spectrum can be cleared than what the CBA can manage over the 18-36 timeline it has given, we believe the door is solidly open for additional spectrum sales above and beyond the 200 MHz currently proposed.

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COMPANIES MENTIONED IN THIS REPORT

Comcast Corp (CMCSA), SES SA (SESG:EN), T-Mobile US Inc (TMUS), Verizon Communications Inc (VZ), Intelsat SA (I), Eutelsat Communications SA (ETL:EN)

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