

C-Band: What Does the First Week of C-Band Version 3.0 Tell Us?

November 22, 2019 by Blair Levin

With another big news week, we are splitting the Weekend Update into two notes; this C-Band focused one and another, to arrive Sunday night, providing an update on the merger and other telecom policy news. (We are also publishing this morning a note discussing why DISH should be able to sell its licensees without the government taking the proceeds, a question that came up a lot this week: [LINK](#)).

In this C-Band note we discuss what we have learned, and the critical questions still to be answered, in the first week of the FCC's new C-Band direction (which we refer to as Version 3.0) of running the auction itself. We think the initial stakeholder and political reactions demonstrate that the question of the private v. public auction is no longer in play, that CBA's leverage to obtain funds lies not in threats about litigation or the narrative about how political leadership is depriving America of leadership in 5G, but only in its leverage related to the time to clear 300MHz, that the process is likely to go down both a legislative and regulatory track but the FCC is likely to finish before Congress, probably rendering Congressional efforts moot. We think both tracks will be bipartisan, which is important for reducing any political risk of election results causing another rethink and a C-Band version 4.0. We don't have new insight into what may be the most important investment question, which is which enterprises the FCC believes should receive funds beyond relocation expenses and, further, between those enterprises, how should any funds be sized and allocated.

Once those questions are answered, however, there are multiple ways of effectuating that distribution though each carries different political and litigation risks. Part of the calculus requires estimating the results of the auction and calculating those requires understanding the other spectrum bands that will also be coming into the market.

C-Band: The First Week of the Rest of the Process

For many, the whiplash created by Monday's announcement that Chairman Pai, as well as Senators Thune and Wicker, now favor an FCC run auction and that the FCC had to send to the Treasury no less than 50% of the auction proceeds caused massive confusion and a reorientation of thinking. Here are the most important things we think we have learned or affirmed in the last week in terms of how the FCC's revised effort to reallocate C-Band spectrum will proceed.

How will CBA approach the new reality? CBA unlikely to relitigate the public/private auction issue, but if they do, they will likely lose. The first question, to us, is whether the CBA is going to seek to try to reverse the Pai/Thune/Wicker decision to join Senator Kennedy and Commissioner Starks in favoring the FCC run auction. We think CBA is likely to realize the cement on that decision is close to dry, if not already there. Further, we have heard from numerous sources, including our colleague Jonathan Chaplin, that CBA's most important backer, Verizon, has said that there is a way for an FCC led auction to satisfy CBA. CBA must realize they don't have any loyal friends^[1] on that issue and are highly likely to lose both allies and leverage if they continue to

press that issue. If we are right, the FCC process will quickly turn to auction structure and the many issues on the transition.

If we are wrong, however, and CBA continues to press for it to run the auction, it will throw sand in the gears of the FCC process, potentially slowing down the proceeding or, alternatively, leaving CBA out of the now central issues of the transition about which CBA arguably has the most information.^[2]

CBA has little leverage in terms of threatening litigation to delay the auction. We have heard from the beginning that CBA has leverage because it can tie up the auction in court for many years. We disagree. To convince a court to enjoin the auction, CBA would have to argue that the auction proceeding would cause it irreparable damage. CBA, however, has already conceded that it would not damage CBA's members current business to transition their services from using 500MHz to using only 200MHz. To the extent that CBA wishes to argue that its members are entitled to the auction proceeds—a claim we don't believe it would win—that does not create irreparable damage. The government can always pay CBA members the amount collected after the resolution of that court process.

CBA has little leverage in terms of the 5G narrative. Another thing we heard was that the CBA has leverage over all the policy makers who have emphasized how important it is to act quickly to beat the Chinese at 5G. We think that ship has sailed. Other than a couple bad editorials in the Wall Street Journal, nearly all the persons and enterprises quoted in the press about Pai's decision praised it. There was bi-partisan support as well, making it more difficult to put pressure on policy makers in terms of press. For CBA to be a credible threat to policy makers on this front, CBA would have to line up the mobile carriers to argue that Pai's decision puts American leadership in jeopardy. None did so; if anything, they did the opposite.

CBA's leverage resides in its role in the transition. Where CBA has leverage is in how it would assist with the transition. The transition effort is highly technical and the details will now occupy the FCC staff in working to finalize a new order next year. For now, we simply note that to the extent that CBA members want to exercise that leverage, it is a double-edged sword. An accelerated transition is important to the policy makers and, at least some of, the stakeholders. So the strongest argument CBA can make is that payments made to CBA will speed things up. But making an argument that sounds like 'nice transition you got there; be a shame if something happened to slow it down' has a problematic ring to both those policymakers and stakeholders.

There will be a dual track for the process at both the FCC and the Congress, but the FCC process is likely to finish before Congress can act. As a practical matter, Chairman Pai has to move forward with the auction planning on the assumption that Congress will not adopt legislation simply because no legislation, in the current environment, is anywhere close to likely. In addition to the Thune/Wicker approach, Senator Kennedy introduced a bill that would require all the auction proceeds go to the Treasury while \$10 billion would be earmarked for rural broadband, while a group of Democratic Senators introduced a similar bill but earmarked "nearly all" the auction proceeds for a Digital Divide Trust Fund for rural broadband and next generation 911. If the Senate were to coalesce around any of these versions, we think the House Democrats could get on board with any approach (though they may have their own bill). If they did so, that would mean that a combination of Democrats and Republicans in the Senate supportive of the effort would be far more than the 60 needed to break any filibuster by Senators who may disagree with one part or another.

The partisan element appears greatly diminished meaning the election risk is also greatly diminished.

Not only do we think the effort will be bipartisan in Congress, we think the Democratic Commissioners at the FCC are likely to also be supportive of the effort. While the auction will likely start after the election, that bipartisanship greatly reduces the risk that the election results may cause a delay in the auction starting.

The fundamental economic questions are still far from being solved. From a policy perspective, there are two big economic questions: those related to direct relocation expenses in terms of how much needs to go to whom, and those related to incentives to cooperate in an accelerated transition (or viewed through a different lens, those related to rights that entitled enterprises to share in the increase in the value of the spectrum). The first are simpler but the record is still unclear on the details. The second is complicated as there are a wide variation in terms of who gets paid, the formula allocating between eligible payees, whether the payment amounts are guaranteed or are set as a percentage of auction proceeds, and the legal and political consequences of these choices.

There are ways for the FCC to pay CBA funds beyond direct relocation expenses. Once those economic issues are resolved, however, then the issue becomes—and this was the issue most on the mind of the investors this past week—whether there is a legal structure by which the FCC can allow CBA to receive sufficient funds to cause the CBA members to forego litigation and cooperate in the transition. One way to do so would be to hold an incentive auction, as proposed by T-Mobile and also recently endorsed by Comcast. The T-Mobile proposal did not seem to gather momentum and we see no signs that an incentive auction structure is back on the table with the Commission staff, though we would not be surprised to see questions about such a structure in the next FCC order. Further, there are a variety of mechanisms one could envision—such as creating transferable bidding credits and different kinds of licenses—which could create a framework in which an incentive auction would be more attractive to the FCC.

As we explained in some detail last week,^[3] however, the FCC can also use a more traditional auction structure to provide funds to CBA and other stakeholders. Investors should understand three elements that would be part of such a structure.

The law requires all auction proceeds to go to Treasury. First, the current law requires that that all auction proceeds be deposited with the US Treasury.^[4] Congress could, of course, change that in a new law, such as that offered by Thune/Wicker or by Senator Kennedy, which we discuss below.

The FCC can organize and require winning bidders to pay into a fund to pay relocation expenses. Second, while the FCC does not have authority to designate the use of auction proceeds to any other use other than to send to the Treasury, the Commission, can, as it has done in the past, require winning bidders in spectrum auctions to reimburse others for relocation costs. In this case the FCC can organize a relocation fund, whose monies could be expended for paying existing users for expenses related to the spectrum reallocation. The FCC could require winning bidders to put money in that fund. For example, if the FCC learns that the relocation expenses will be \$4B, and Verizon wins licenses costing it 25% of the total auction proceeds, Verizon would be liable for putting \$1B in the relocation fund.

The FCC can organize and require winning bidders to pay into a fund to provide incentives to accelerate the transition. Third, the FCC can do more than require reimbursement of relocation costs. Given the FCC's broad latitude to insert conditions protective of the public interest, it can also organize a fund to provide incentives to be paid to various parties to accelerate the transition. Importantly, such payments are not compensation for a government resource or service, or payments covering a government expense or obligation, and thus would not be considered "money for the Government" under the Miscellaneous Receipts Act. The question of how to set

the formula for contributing to the fund and allocating the proceeds are likely to be the heart of the next round of the policy debate.

We can see many possibilities for how to do so. As a general rule, the clearer the case that the funds are being used to provide an incentive to create the public good of a faster transition, the less political and litigation risk for the fund. The more it looks like the funds are being used to reward entities who are claiming an ownership right of spectrum, the greater the political and litigation risk. As to the political risk, we think that the “not less than 50%” parameter laid out by Thune and Wicker mean that Pai could seek to obtain more money for the government but we think it would be difficult, unless Thune and Wicker concur, for Pai to agree to accept less. As to the litigation risk, it depends a lot on the actual fund structure, but we are not sure at this time who would have the motive and standing to raise the issue in court.

The bid/ask spread between Senator Kennedy and the CBA remains large, with Pai/Thune/Wicker playing a mediating role. Senator Kennedy has not given up on his efforts to capture all the potential payments for the government, introducing a bill that would cause all the proceeds to go to the government. He has also not given up on his interest in using a significant portion of those funds to subsidize rural broadband deployments, which is also part of his legislation. On the second point, we assume that CBA has no objection. We are still, however, a long way from knowing how to reconcile Senator Kennedy’s goals with CBA’s objectives. Of course, as noted above, Senator Kennedy, who has already won in significant ways, may not be able to block legislation or an FCC action that pays out significant funds to CBA but his current stance provides leverage to Pai, Thune and Wicker as they play a mediating role and seek to come to an agreement with the CBA.

A big unknown—how much will the auction raise—is still unknown but we know that 2020 will be a year in which issues surrounding huge untapped spectrum capacity are likely to be resolved. For investors trying to model the C-Band’s impact, the auction proceeds are a big unknown. But we already know that 2020 will be a critical year for the deployment and utilization of spectrum. Among the major spectrum events we see happening next year are:

- *Resolution of the TMUS/S trial.* The trial will determine if T-Mobile can start to deploy 160 MHz of valuable 2.5 GHz spectrum. If the court blocks the deal, the spectrum will be a key component in how Sprint restructures itself, including the possibility of selling all or part of the spectrum to another mobile operator.
- In June, the FCC will auction 70 MHz of 3.5 GHz for Priority Access Licenses, as part of a 150 MHz band that will also include 80 MHz of General Authorized Access spectrum that can be used on a non-exclusive basis.
- *6 GHz.* We expect that in 2020, the FCC will set new rules for the 6GHz band, which Wi-Fi interests see as the band that, like mid-band for 5G, can take unlicensed to a new level. The band creates the possibility that next year, [for the first time in over 20 years](#), Wi-Fi will get additional mid-band spectrum. While the FCC has not yet finalized all the conditions it will require for use of the band, we do expect access to a broad swath of spectrum that will, [as Cisco notes](#), “at least at first, be uncrowded by legacy devices, and will contain more contiguous, uninterrupted ranges of spectrum than any of the existing Wi-Fi bands.”
- *C-Band.* As discussed throughout, the nearly 300MHz that will be auctioned next year is likely to be the most valuable spectrum for deploying 5G. (See our colleagues report on this topic ([LINK](#)).

1. We are sure team CBA has oft repeated to itself in the last week President’s Truman’s famous insight that “In DC, if you want a friend, get a dog.”

2. This is not to say there is agreement that CBA’s information is accurate. See, for example, ACA’s [most recent ex parte](#) in which ACA argues that CBA is wrong on its estimate of transition costs by nearly 100%. (Slide 7)

3. While we explained it in detail, we don’t think we explained it well. While our explanation was conceptually correct, there were unintended inferences that were wrong. We apologize and believe the explanation here is simpler, clearer and more on point. Again, there are many ways to structure the payments and our effort is describe it conceptually, rather than predict the exact structure the FCC

will adopt in the first half of next year.

4. The law has an exception for FCC auction expenses, which we don't think is relevant here.