A Win/Win, Not a Windfall

Congress Should Seal the NextWave Deal

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The negotiated settlement between NextWave Telecom and the Federal Communications Commission (FCC) is a good deal for the American public and for fundamental economic principles of fair dealing in a free market economy, including allocation of property rights by free and fair auctions, financial discipline for risk-taking, and limited government.

Superficially, it looks like the deal lets NextWave walk away with wads of cash for doing nothing more than gaming federal auction policy. If that sounds too good to be true, that's because it is. And that is not at all what this deal will do. Still, the proposed deal is drawing instant fire on that basis from people who obviously don't know the issues or who haven't bothered to do the math.

Browbeating public policy always is easy and sometimes is on target, but not in this case. The proposed NextWave deal is a triumph of efficient capital markets over the flawed logic of the bankruptcy court and D.C. Circuit which would have handed the company a multi-billion dollar windfall courtesy of the taxpayers.

This is not a cookie-cutter case of corporate greed or bad public policy. It is the result of underdeveloped institutional arrangements between regulators, companies, and the courts. No one could have fully anticipated how to efficiently handle claims to highly valuable assets in the new market for wireless communication. Neither the FCC nor NextWave is a villain. This is new territory for all sides. And the proposed deal will create an institutional context that will make the future better.

In 1996, NextWave, armed with federal subsidies for 90 cents on the dollar, bid more than $4.7 billion for the licenses at the C-block auction for Personal Communications Service (PCS) licenses. The auction was a defining battle between GSM and CDMA technologies. The resulting bids at risk, when leveraged by public subsidy, represent, in our opinion and based on a thorough analysis, just a fraction of the value of being first to market with a global standard for wireless voice and data transmission.

NextWave's founder and CEO is a former top executive of a major U.S. hardware company with a huge stake in the quest for a global wireless standard. The company was founded specifically to qualify for the C-block auction and to champion CDMA against GSM as the global standard. And behind the scenes, with piles of money, were venture capitalists and giant foreign corporations with interests in establishing a global technological standard based on CDMA.

Still, NextWave failed to fulfill the license obligations when Wall Street refused to fund its build-out. It saw the auction as an unprecedented global opportunity with no downside. Direct and indirect equity owners would realize all of the significant upside potential and the taxpayers would bear the downside risk. The only capital the bidders risked was whatever small share of their winning bids a bankruptcy court would decide they had to pay. And, even then, the investment capital came from huge well-diversified portfolios or strategic investment coffers.

The bankruptcy court failed miserably in determining the fair market value of the licenses despite the fact that the valuation of the capital markets was, at the time, only about 20% less than the auction value. After a lengthy court battle, the Second Circuit had the wisdom to see that the bankruptcy court badly stumbled on the economics and the FCC received the licenses back. At the January 2001 re-auction, large wireless carriers bid $16 billion for the licenses, fully 30 times the amount NextWave claimed in the bankruptcy proceedings.

But a D.C. Circuit ruling in July would have returned the licenses to NextWave at or below its $4.7 billion bid price. That would have rewarded NextWave for holding up more than 50 licenses covering over 100 million potential PCS customers. NextWave had every right to pursue its own financial interests by trying to undo the results of a highly competitive auction at the expense of taxpayers and capital markets. But, the right response for the long run is not to let them walk with a windfall, and the proposed settlement does not.

Instead, the deal closely approximates the efficient capital market solution to NextWave's lingering legal drama. At today's prices, the licenses are worth about $12 billion. The deal lets NextWave keep $5 billion of that after taxes. So the company effectively "pays" the government $7 billion—or the net present value of its original $4.7 bid price.

So, in the end, NextWave to pay the government its bid price and walks away from the licenses with the return it would have realized from selling them at current market value. That is fair and efficient payment for its property rights under the D.C. Circuit ruling. The re-auction winners also pay the government their bid prices for the right to take control of the licenses. So the deal is a win for federal auction policy, a win for the taxpayers, and a win for competitive capital markets.

The deal also is a welcome win for the slumping wireless telecommunications market, already flooded with too many competitors and too little bandwidth. The large wireless carriers that get the licenses—Verizon, Cingular, VoiceStream and AT&T Wireless—are best positioned to put the licenses to their highest-valued use in the shortest possible time. That, of course, also makes the deal a big win for the millions of actual and potential PCS users in these markets.

Federal authorities and Congress should seal the proposed NextWave deal. As a matter of simple economics, the deal isn't a wrong number; it's a good call.

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