

Verizon is Selling Spectrum but is anyone buying their spectrum shortage argument in favor of acquiring SpectrumCo and Cox AWS Licenses?

On April 19, Verizon Wireless surprised many people [by announcing](#) that it would sell its 700MHz A-and B-block holdings if the Federal Communications Commission approves its proposed \$3.9 billion purchase of SpectrumCo and Cox Communications' Advanced Wireless Spectrum (AWS) holdings (as well as a smaller spectrum swap with Leap Wireless). This comes despite Verizon's recent [well-publicized assertions](#) that it will start running out of LTE capacity by 2013 if it doesn't get approval for the SpectrumCo deal. That's led some of us to wonder whether Verizon is really as short on spectrum as it claims.

However, what's more intriguing is whether Verizon can actually pull off this sale and meet Verizon CFO Fran Shammo's claims on its [Q1 2012 results call](#) that Verizon will be able to get a "return" on its original investment:

"I think there were some articles written that this is going to be a fire sale. This is nothing near a fire sale. We bought this spectrum back in 2008. We've had carrying costs, and we will be prudent to our shareholders to make sure we get the return our investments. We know what the value of this spectrum is in the free market, and obviously, we're going to an auction to allow many different parties to participate through a third-party auctioneer. And look, if we don't get the price that we think is a fair price, then we won't go through with the sale, and that's at our discretion."

As [Public Knowledge's Harold Feld points out](#), Verizon is making as an incredibly smart move to wrong-foot both its competitors and the FCC. In a single stroke it can get its SpectrumCo transaction approved without allowing smaller competitors to close the "spectrum gap" between themselves and AT&T and Verizon. Moreover, if the FCC allows Verizon to set a reserve price on its 700 MHz licenses based on its apparent intention to make a profit over what was paid in 2008, it is possible that Verizon may be able to get its AWS while keeping many of the A-and B-block licenses it claims to be sacrificing. Verizon paid relatively high prices for those licenses in 2008, and it is far from clear whether smaller competitors are in a position to pay more for these licenses today than they were prepared to bid back in 2008.

Verizon's spectrum, block by block

If we take out the Chicago A-block license that is being swapped with Leap, then Verizon is selling a total of 1.65 billion MHz-POPs (The total megahertz of spectrum multiplied by the population covered) of A-block spectrum, which cost \$2.42 billion in the auction, or \$1.46 per MHz-POP, plus a further 556 million MHz-POPs of B-block spectrum, which cost it \$2.05 billion, or \$3.69 per MHz-POP. The Leap transaction provides one potential benchmark for a sale of 700MHz A-block spectrum. Verizon is [reportedly valuing it at \\$204M](#), or \$1.65 per MHz-POP, which would be a 34 percent premium over the \$152 million that Verizon Wireless paid for this license in the 2008 auction. But since this deal involves a spectrum swap, and not a cash transaction, neither side had any incentive to reduce the price of these assets. When looking at

the much bigger sale now being proposed by Verizon, we need to consider who has a need for this spectrum and what they might be prepared to pay.



As many have indicated, AT&T is the most obvious potential buyer, but it is important to realize that AT&T didn't buy any A-block spectrum in the 2008 auction and has objected vehemently to making its LTE phones compatible with the A block, due to interference concerns. As a result, AT&T would hardly be likely to undermine its arguments to the FCC by buying this spectrum. AT&T would clearly be interested in the B block, where it bought a total of 2.1 billion MHz-POPs of spectrum in the 2008 auction for \$6.64 billion (\$3.15/MHz-POP). Of course this was to complement the 2.4 billion MHz-POPs of Aloha 700 MHz spectrum that [AT&T bought beforehand](#) for only \$2.5 billion (\$1.06/MHz-POP).

In other words, AT&T's current 700MHz spectrum holdings cost only \$2.05 per MHz-POP (a 44 percent discount to what Verizon paid for the B-block) and even AT&T's B-block auction purchases cost 15 percent less than Verizon paid. It's easy to see why this is the case: Verizon's auction strategy in the B-block involved pushing up the price AT&T had to pay, before switching to the much cheaper upper C-block (where the price of only \$0.76 per MHz-POP was kept low by the open access conditions imposed by the FCC at Google's behest). So the licenses that Verizon was left with in the lower B-block were mainly the ones on which AT&T was unwilling to outbid it.

The classic example is Chicago. In the Windy City, Verizon paid \$892M for a license covering 97M MHzPOPs, which works out to be \$9.16 per MHz-POP, a substantial premium over other licenses. If AT&T wasn't willing to exceed that price in 2008, it probably isn't willing to do so today. While AT&T may be willing to pick up a number of the other B-block licenses at close to the prices Verizon paid, Verizon may well be left holding at least the expensive Chicago license unless it is prepared to sell this license at a substantial discount.

Do we have an A-block problem?

Verizon also faces a challenge to achieving a profitable sale in the A block. At this point in time there is uncertainty over the outcome of the FCC's 700MHz interoperability proceeding, which could require AT&T to make its phones compatible with the A-block. That would boost the value of the A-block spectrum considerably, making it easier for smaller lower 700 MHz holders to get phones and roam on AT&T's networks. However, Verizon paid far more than most other bidders those licenses back in the 2008 auction. While Verizon paid \$1.46 per MHz-POP for its A-block spectrum, the other winners of A-block licenses paid only \$0.79 per MHz-POP).



Of course, Verizon's licenses cover far more attractive urban markets, but the big cities are the areas most subject to interference caused by neighboring Channel 51 TV broadcast stations. In addition there are relatively few bidders: T-Mobile has [implicitly said that it is not interested](#), Sprint is not in a position to buy more spectrum, Leap probably can't afford it, and Dish Network has bought all the spectrum it needs for a network buildout. That leaves us with MetroPCS (which bought the Boston A-block license in the 2008 auction for \$313M, or \$3.28 per MHz-POP), but MetroPCS has little reason to pay a premium for this spectrum if it isn't feeling any immediate competitive pressure from other wireless operators to up its bid.

The outcome of the auction may therefore be significantly affected by how the FCC decides to approach the proposed sale. The FCC could allow Verizon to make a voluntary sale (which may then be predicated Verizon turning a profit on the spectrum – potentially causing licenses to go unsold), or it could impose a condition that this spectrum must be sold within a defined period after completion of the AWS transactions. If it's the former, Verizon may well get its cake and eat it, too. If it's the latter, the dynamic would change significantly, giving bidders like AT&T and MetroPCS much more leverage to negotiate on price. As a result, if Verizon was forced to sell all of the 700 MHz spectrum within a certain time frame, it could wind up taking a significant loss, raising questions about whether buying this spectrum was really such a good investment after all.