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Maximizing Revenue Opportunities With Free Government Spectrum Licenses

By Tony S. Lee

The mission of independent schools is to provide a high quality and enriching educational experience to their students. However, as the cost of operating independent schools continues to increase, the search for additional revenue sources consistent with the school's educational purposes is quickly rising in the list of priorities. The advent of new wireless technologies has created opportunities for independent schools that hold wireless licenses issued by the Federal Communications Commission ("FCC") to enter into long term spectrum leases with for-profit service companies to provide schools with additional, and often significant, revenue streams. While such relationships can enhance the school's resources, it is important that schools thoughtfully enter into such leases as failure to do so may significantly decrease the potential proceeds. To obtain the maximum benefit, schools must ensure that the appropriate performance benchmarks, indemnifications, and other protective terms and conditions are contained in the lease agreement, and that wireless service companies are providing "market rates."

Background

In 1963, the Commission established the "Instructional Television Fixed Service" ("ITFS"), which is now known as the "Educational Broadband Service" ("EBS"), envisioning that it would be used for the transmission of instructional material to accredited public and private schools, colleges, and universities for the formal education of students. ITFS/EBS licenses can only be held by certain educational institutions, and independent schools are among those that qualify to hold an ITFS/EBS license. In 1983, in an effort to encourage more intensive use of the spectrum and to help ITFS licensees generate needed revenue, the FCC began to relax use restrictions on ITFS licensees so that they could lease excess capacity on their facilities to commercial entities.

As restrictions relaxed, license "mills" began approaching schools offering to prepare and file the necessary applications with the FCC to obtain ITFS licenses, and commercial wireless service providers did the same so they could lease access to spectrum in which those providers would not normally be permitted to operate. Many of the early lease agreements with the wireless companies were for the provision of wireless cable television services, and generally provided schools with monthly lease payments based on subscriber counts. System operators today are generally providing either analog or digital video services, or one or two-way digital data services, such as wireless Internet service through technologies such as WiMAX.

Spectrum Lease Issues for Independent Schools

With the ubiquity of the Internet and the advent of lucrative and cutting edge wireless devices such as the iPhone, broadband companies are exploring ways to deploy Internet services as quickly and as economically as possible. One option is wireless broadband services, which has significant costs and speed-of-deployment advantages over wireline based services since the need for expensive and time consuming in-ground facilities constructed to reach each subscriber are avoided. Beginning in 1994, the FCC favored issuing wireless licenses through auctions, which generated billions of dollars for the U.S. Treasury. Commercial wireless companies that can utilize EBS spectrum prefer to enter into long term leases with schools that are EBS licensees because it gives service providers the ability to obtain spectrum on an exclusive basis without the significant upfront capital expenditures required to purchase licenses through auctions.

Lessons From the Field

Spectrum leases can be a positive experience for independent schools, and provide them with not only additional sources of revenues, but also with reduced or free services, courtesy of the wireless system operators. However, some service providers are more than willing to take advantage of a school's relative inexperience with spectrum leasing issues for financial or strategic gain. Unfortunately, a number of independent schools entered into agreements whereby lease payments were significantly below market rates – in some cases, less than 10% of the rates paid by larger and more reputable service providers. Such agreements are generally very one sided, and do not provide for a readily apparent way to modify or terminate the agreement. Other schools have encountered performance

issues, whereby the agreements do not provide a date by which the providers must construct or tender payments. Indeed, some agreements allow wireless providers to delay performance indefinitely, or to thwart attempts to terminate leases for non-performance by invoking arbitration procedures. Some of the most egregious actions have been taken by spectrum lease “flippers,” who have no intention of ever making any lease payments or constructing a wireless system themselves. Rather, they negotiate extremely low lease rates with schools, and then sell the leases to a large wireless company for a profit.

Due Diligence in Negotiations

While engaging in the business of spectrum leasing can serve as a profitable resource for a school, it is not without its risks. Clearly, many reputable companies operate in the market place in a manner that benefits independent schools. Having said that, not all companies in the spectrum leasing market have the school's best interest in mind. Careful preparation in advance of the lease negotiation is not only prudent, but a school's fiduciary obligation. Some of the considerations when negotiating a lease are as follows:

- Does the lease clearly state when the wireless provider will begin construction of the broadband system and begin making lease payments?
- Who is responsible for the necessary filings with the FCC?
- Will the wireless provider pay for all engineering and filing fees required to maintain the license?
- Are market rate lease payments paid to the school?
- Are provisions to ensure that lease payments do not fall below market rates in the future included in the agreement?
- Are there assurances that the wireless provider will actually perform?
- Does the lease permit the provider to “flip” the lease to another provider?
- Are there terms that permit the wireless provider to delay performance indefinitely?
- Can the school terminate the lease if it later determines that the agreement no longer serves the interests of the school, or that services are being provided that are inconsistent with the best interests of the school?

Many WiMAX providers have entered into spectrum leases with schools providing system operators with exclusive long term access to the school's EBS spectrum to the detriment of the institution. Given that EBS licenses are such valuable assets and can provide independent schools with significant supplemental revenues to further their educational goals, schools should make certain that they are aware of critical spectrum leasing issues and industry practices to ensure favorable leasing terms are achieved.

Tony S. Lee is a partner in the Washington, DC office of Venable LLP. He focuses his practice on matters involving telecommunications, high technology and the Internet. Mr. Lee has assisted schools in negotiating spectrum lease agreements, and by providing advice on strategies to handle inequitable agreements.

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