

Spectrum auction offers new opportunities for TV broadcasters



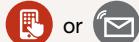
The planned 2015 FCC auction of spectrum currently used for television broadcast across the United States presents a potential opportunity for broadcasters to monetize a valuable asset—their wireless spectrum—in a new way. Despite this opportunity, multiple concerns surrounding the auction exist including the costs, potential for business disruption, efficiency and effectiveness of such a broad initiative, and the potential impact to channel brand recognition. As such, participating in the auction needs to be supported by careful strategic, financial, and tax planning. Auction paths such as channel sharing and band migration may be lucrative options, while tax treatments such as like-kind exchanges and involuntary conversions may further assist broadcasters in preserving the value received in the auction. Careful consideration of these options is critical in making the decision whether to buy/sell and maximizing asset value.

by Dan Hays and Adam Handler

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The sale and purchase of wireless spectrum has become commonplace in the mobile communications industry. For television broadcasters, however, the planned 2015 auction of their spectrum is an event that is both unprecedented and unusual. The complexity of the planned auction, coupled with the ability for broadcasters to receive a share of the cash paid for their spectrum holdings, creates a strong need for thoughtful and deliberate strategic, financial, and tax planning.

The auction, which was mandated by the United States Congress in the 2012 Spectrum Act, is unprecedented in that it allows television broadcasters, for the first time ever, to sell the spectrum currently used for their broadcast services.¹ Similarly, the auction is unusual, as it will consist of both reverse (selling) and forward (buying) auctions. The “incentive auction,” as it has been termed, will allow broadcasters to bid to relinquish their spectrum rights in exchange for a share of the proceeds from an auction of the repurposed spectrum to parties who will bid on licenses for flexible use in mobile communications networks.

Surging demand for mobile communications has caused the telecommunications industry to seek out significant new swaths of wireless spectrum. A projected 61% increase in wireless data consumption over the next five years (2013-2018 CAGR) means (in PwC's view) that there is a significant demand

for spectrum to provide more bandwidth to support growth in mobile data traffic.²

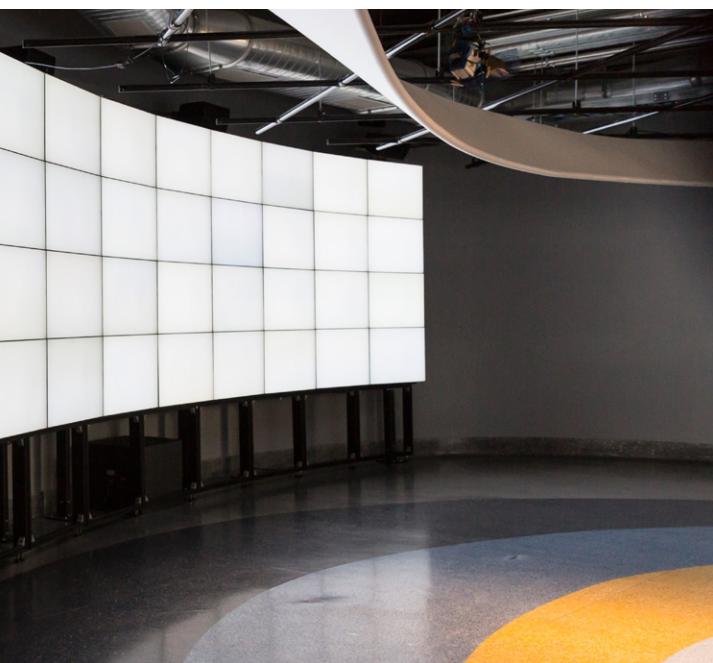
Spectrum used for television, which propagates long distances and penetrates both foliage and buildings, is an ideal solution to the mobile industry's needs. And, while television viewership is still popular, and over the air viewing provides free access to vital information that serves a public interest, 93% of households do not rely on over-the-air, instead watching primarily via cable, satellite or online, resulting in a relatively inefficient use of the allocated spectrum.³ As a result, Congress and the Federal Communications Commission (FCC) have decided to provide an incentive for broadcasters to give up a portion of their spectrum so that it may be reallocated for newer, more efficient uses.

Today, the opportunity for many broadcasters to receive a significant payout from the planned spectrum auction is on the horizon. However, there are potentially significant implications to broadcasters such as channel change costs and brand concerns, changes in their fundamental operating model or the termination of the broadcast of the TV station signal all together. Therefore, understanding the mechanics of the auction, evaluating potential options and deals to take advantage of the process, assessing the value of existing broadcast stations, and planning for the potential windfall require broadcasters to start planning now.

1 FCC incentive auctions overview <http://wireless.fcc.gov/incentiveauctions/learn-program/faq.html>

2 Cisco 2014 Visual Networking Index

3 2013 Consumer Electronics Association study



Selecting the best option

The planned incentive auction has several key differences from past spectrum auctions and private transactions. First, unlike past auctions, broadcasters have several potential options to choose from for the future of their business. They may:

1. **Continue broadcasting** as is, but be subject to a channel change ("repacking") which will be paid for by the overall auction proceeds.
2. **Move from UHF to VHF** to free up higher-band spectrum in exchange for a new VHF channel plus a share of auction proceeds.
3. **Share a channel** with one or more other stations in the same market, relinquishing at least one of the broadcasters' spectrum and sharing the proceeds among themselves.
4. **Distribute without broadcast** by continuing to provide content via cable, satellite, or online channels, receiving auction proceeds for the sale of spectrum.
5. **Close operations** by going off the air in exchange for a portion of the auction proceeds.

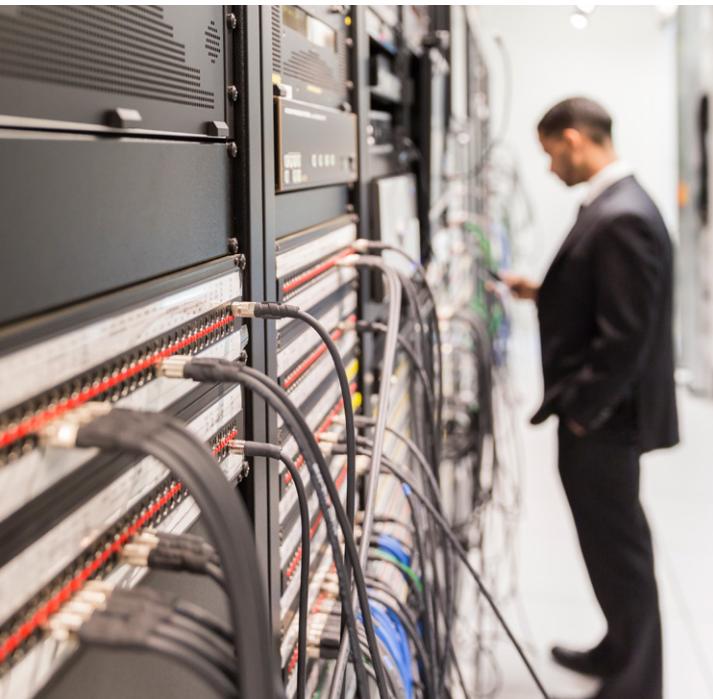
Selecting from among these options is a critical decision for broadcasters, and it needs to be informed by a clear business strategy, view of future demand, and financial valuation of each viable scenario. For publicly-traded or multi-owner broadcasters, thoroughly evaluating auction options and values is a fiduciary duty which is already being recognized by many boards and management teams. For many stations, such as major network affiliates, closing operations or ceasing broadcast activities will likely not be the most economical choice. However, recent trials of channel sharing held in Los Angeles make that option a potentially lucrative one with strong technical feasibility.⁴

⁴ Overview of the KLCS/KJLA Channel Sharing Pilot <http://www.ctia.org/docs/default-source/fcc-filings/technical-report-of-the-klcs-kjla-channel-sharing-pilot.pdf>

Additionally, this auction is expected to attract significant interest given the low-band frequencies to be made available which provide strong in-building coverage for dense, urban areas and outstanding coverage for less dense, rural areas. This could greatly increase the value to broadcasters, with some industry experts anticipating that the auction could generate as much as \$20 billion to \$30 billion in total proceeds.⁵ While the specific mechanisms to distribute proceeds to broadcasters for each of these options are still being finalized by the FCC, the resulting proceeds could generate anywhere from tens to hundreds of millions of dollars for television station owners, particularly those in the largest, most desirable, urban markets such as New York, San Francisco, Los Angeles, Chicago, and Boston.

Finally, as highlighted in the recently-published *Overview of the KLCS/KJLA Channel Sharing Pilot*, the available options will potentially require new operating models for broadcasters. Channel sharing will require well-defined governance and cost-sharing approaches. These must also be balanced with ownership structures and operations in order to fairly allocate both capacity and cost. Furthermore, this must all be evaluated in light of the potential tax implications of the funds received via the spectrum auction.

⁵ <http://www.attpublicpolicy.com/public-safety/more-on-auction-limits/>



Making an informed decision

Tax considerations will play an important role in evaluating which option is best for a broadcaster. A clear picture of the tax characteristics of the broadcaster will be needed to determine their potential after-tax benefit from each option. In addition, depending on the option chosen and what is done with the proceeds, there could be significant opportunities for deferring tax, given the low tax basis many broadcasters have in their stations.

A key question for broadcasters is whether participation in the auction is voluntary for tax purposes. If participation is not voluntary, then the tax could be deferred if the incentive auction is an "involuntary conversion" and the broadcaster reinvests in property that is "similar or related in service or use" within the applicable two year period.⁶ However, the availability of these rules is unclear both in whether the planned incentive auction meets the requirements for an involuntary conversion and in what would constitute property that is similar or related in service or use. It may take guidance from the Internal Revenue Service in order for this tax planning strategy to be implemented with confidence.

Alternatively, the tax could be deferred by the broadcaster by engaging in a "like-kind exchange."⁷ This strategy would require the broadcaster to acquire property that is of a "like kind" to the property that was disposed of in the auction within 180 days of a

spectrum sale. While the like-kind exchange rules are more certain in their application to the planned incentive auction, they are more restrictive in terms of timing and require the cash received to be held by a third party. In addition, the acquisition of replacement property of a like kind is likely to be more limiting than replacement property that is similar or related in service or use.

Under either tax deferral strategy, the broadcaster likely would have to remain invested in the broadcasting business in order to achieve tax deferral.

Reaping the benefits

Broadcasters need to carefully plan for whether they are going to participate in the planned incentive auction. Which option is best will depend on a multitude of factors, including their business outlook, future strategy, ownership structure, and available options under the auction rules. Since the value of the various options should include a comparison of the after-tax proceeds, the ability to defer taxes should play an important role in the decision-making process.

SOLICITATION

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⁶ Internal Revenue Code Section 1033

⁷ Internal Revenue Code Section 1031