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MetroPCS hit over patent, options

Dallas telecom, which plans \$1.1 billion IPO, discloses key problems in SEC filing

BY JEFF BOUNDS | STAFF WRITER

Since launching its phone service in 2002, MetroPCS Communications Inc. has become one of Dallas-Fort Worth's shiniest success stories.

Now generating more than a billion dollars in revenue a year, the company has carved a niche for itself in a competitive business by offering cheap, all-you-can-talk service, which it's targeted at recent immigrants and people who move around frequently, such as college students. The company is planning a \$1.1 billion initial public offering.

But in the prospectus for its IPO filed with the Securities and Exchange Commission, Dallas-based MetroPCS (www.metropcs.com) discloses some behind-the-scene trouble that could prove costly to the company — and even derail its business plan altogether.

The biggest potential problem involves a patent suit filed by two competitors. If that litigation goes the wrong way, MetroPCS says, the business could be forced to undergo major changes, or to pay royalties to its rivals.

The other problem involves stock options, an issue that's bedeviled many public companies lately.

MetroPCS declined to comment for this story, citing SEC rules restricting public statements by companies with pending public offerings.

The patent litigation, filed by Leap Wireless International Inc. and Cricket Communications Inc. in federal district court in Marshall, alleges MetroPCS infringed on a patent that covers the plaintiffs' network and business method for providing wireless phone service, including flat-rate billing, according to court documents and patent records.

MetroPCS has denied wrongdoing, and claims in a countersuit that the plaintiffs stole its trade secrets.

If the plaintiffs are successful, "we could be enjoined from operating our business in the matter we operate currently, which could require us to redesign our current networks, to expend additional capital to change certain of our technologies and operating practices, or could prevent us from offering some or all of our services using some or all of our existing systems," MetroPCS's IPO prospectus says.

Beyond that, if the plaintiffs succeed in securing monetary damages, "we could be forced to pay (them) substantial damages for past infringe-

ment and/or ongoing royalties on a portion of our revenues. (That) could materially impact our financial performance," MetroPCS' SEC filing says.

"It's a real risk factor" for MetroPCS, says Bill Carmody, a partner at Susman Godfrey who's representing Leap and Cricket. "The entirety of the patent we're asserting out there (in Marshall) covers the entirety of Metro's business operation. ... We can put them out of business (with a successful result)."

According to Carmody, there are three related cases ongoing — in federal courts in Tampa, Fla., and Dallas, and in state court in Modesto, Calif. — in markets where both Leap and MetroPCS operate. None of those three cases are mentioned in MetroPCS' IPO filings with the SEC as "risk factors" that investors should be aware of.

A recent U.S. Supreme Court decision involving online auction giant eBay Inc. could make it tougher for the plaintiffs to secure an injunction they are seeking against MetroPCS. The justices tossed an appellate court ruling that said judges must nearly always stop business operations if a valid patent was deemed to be infringed.

"There have not been many reported cases since eBay came out," says Greg Carr, managing partner of Carr LLP, a Dallas law firm specializing in intellectual property. But based on cases he's seen, Carr says the number of instances in which permanent injunctions have been denied by courts has gone from the 10% range to closer to 30% or more.

Meanwhile, MetroPCS says it may have violated federal and state securities laws since January 2004 when it issued certain options to purchase its common stock, as well as when it issued shares based on those options.

Options give their holders the right to buy set amounts of stock at prescribed dates and prices. Private companies, which have stock the same way public companies do, sometimes issue options as an incentive for their employees to risk remaining aboard, with the carrot that the options may become more valuable if the firm goes public or is acquired.

MetroPCS says that because it may have broken securities laws in connection with the issuance of options and stock, the holders of those



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options and shares may be able to force the company to give them their money back. The company did not detail what went wrong when the options were issued.

To address the problem, MetroPCS plans to offer to buy 655,055 shares of its stock from 524 current and former officers and employees after the IPO is done. If everyone agrees to sell back their stock, the company could spend up to \$2.6 million, the prospectus says.

Shareholder lawsuits possible

In addition, the company's prospectus says it failed to register stock options granted under its 1995 and 2004 options plans, as it was required to do. It's unclear from the SEC filing if this is related to the violations of federal and state securities laws that MetroPCS refers to elsewhere in its prospectus.

Had it registered its stock options, the company would have been required to file financial and other public reports with the SEC. Prior to the IPO filing, the last time MetroPCS filed any public disclosures with the agency was April 30, 2006.

By not filing financial and other disclosures, the company says in its IPO prospectus that it could face lawsuits from current and former shareholders, who might claim they suffered damages because of that.

Bill Banowsky, trial practice leader and senior partner in the Dallas headquarters of Thompson & Knight, believes the stock-option issues shouldn't hurt MetroPCS much, or crimp its IPO. Neither Banowsky nor Thompson & Knight are involved with MetroPCS or the stock-option matters.

"It's something they have to get cleaned up," he says. "At least that's what you can tell with this disclosure."

Banowsky says the typical remedy when a company fails to register stock is to give shareholders their money back. It would be difficult for option- or stock-holders to prove they were damaged by MetroPCS' failure to file public disclosures with the SEC, he adds.

"My guess is that with the pending IPO, people would just as soon hold onto their options," Banowsky says.

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