

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Auction of Licenses in the 747-762 and 777-) DA 02-260
792 MHz Band Scheduled for June 19, 2002)
)
Comment Sought on Adding to Auction)
Inventory and Further Modifying Package)
Bidding Procedures)
)

To: Chief, Wireless Telecommunications Bureau

**COMMENTS OF SPECTRUM EXCHANGE GROUP, LLC
AND ALLEN & COMPANY INCORPORATED**

Spectrum Exchange Group, LLC and Allen & Company Incorporated (“Spectrum Exchange/Allen”) hereby submit these comments in response to the Wireless Telecommunications Bureau’s (“Bureau’s”) February 4, 2002 Public Notice (“Public Notice”) seeking comment on adding to the auction inventory and further modifying package bidding procedures in an auction (“Auction No. 31”) of licenses in the 747-762 and 777-792 MHz band (“Upper 700 MHz Band”) to commence on June 19, 2002.¹

¹ *Auction of Licenses in the 747-762 and 777-792 MHz Band Scheduled for June 19, 2002; Comment Sought on Adding to Auction Inventory and Further Modifying Package Bidding Procedures*, Public Notice, DA 02-260 (WTB, rel. Feb. 4, 2002).

I. THE COMMISSION SHOULD NOT IMPOSE A HIGH AGGREGATE RESERVE PRICE FOR AUCTION 31.

Most importantly, we oppose the Bureau's suggestion that an aggregate reserve price of \$2.6 billion be considered for the auction of the Upper 700 MHz Band licenses. In past auctions, the Commission has set minimum opening bids (which have doubly served as reserve prices) at relatively low levels, and has relied on market forces to determine the value of the licenses being auctioned.² This deliberate policy has worked. For example, in Auction No. 35, the C and F Block Broadband PCS Spectrum Auction of December 2000 – January 2001, the minimum opening bids were set at \$449 million, while the auction yielded net high bids of \$16.8 billion. A very similar picture is obtained from looking at any of the earlier major U.S. spectrum auctions (e.g., Auction No. 4, the Broadband PCS A and B Block auction, and Auction No. 5, the Broadband PCS C Block auction). The policy of low reserve prices has served the public interest well, by encouraging broad participation and robust bidding in the auction.

The \$2.6 billion figure is apparently based on a late-1999 Congressional estimate of auction revenues. Setting the reserve at the price the auction is “expected” to achieve is inconsistent with the Commission’s mandated objective of ensuring “efficient and intensive use” of the spectrum. Such a reserve would discourage bidder participation and increase the possibility that use of the spectrum would be further delayed. A more consistent policy would set the reserve at a relatively small fraction of what the auctioneer expects to collect. A low reserve price has the benefit of assuring broad participation in the auction process while maximizing the likelihood that all the licenses are sold and put to use.

² For example, the Commission set the minimum opening bids for 15 MHz licenses in Auction No. 35 at 5 % of the most recent net high bid for a 30 MHz C block license in the same BTA. (DA 00-2259, October 5, 2000, p. 31.)

It is worth emphasizing that the minimum opening bids in Auction No. 35, adjusted for the geographic markets being offered, translate to minimum opening bids for 30 MHz of spectrum nationwide totaling \$832 million. This is very close to the previously established minimum opening bids for Auction No. 31. Since the Nasdaq peak two years ago, and especially in the year since Auction No. 35, there have been adverse developments in capital markets that have likely constrained the financial wherewithal of potential bidders.

Consider the three stand-alone, publicly-traded major wireless incumbents in the U.S.: AT&T Wireless Services Inc. (AWE); Sprint Corp. (PCS), and Nextel Communications Inc. (NXTL). AWE closed its first day of trading, on April 27, 2000 at 31.8125; its close, last Friday, was 10.12, a decline of 68%. PCS closed trading in 1999 at 51.25; its close, last Friday, was 9.27, a decline of 82%. NXTL closed trading in 1999 at 51.5625; its close, last Friday, was 4.86, a decline of 90%.





Even if there were merit to changing the current policy on the level of reserve prices (or minimum opening bids), it is clear from the above data that now is not the right time to be attempting it. The Commission would be increasing the reserve price at exactly the same time that bidders' ability to finance bids may be impaired.

Any rules of thumb for setting reserve prices should be adjusted to account for the level of uncertainty in any particular auction. When uncertainty is lower, such as when auctioning supplemental spectrum using current technology to existing operators, then a higher reserve can safely be used. By way of contrast, in situations with greater uncertainty, say because of

technological or clearing uncertainties, then a lower reserve is better. At present, both technological and clearing factors create substantial uncertainties with respect to the value of the Upper 700 MHz Band licenses. In addition, as seen above, the financial resources available to the wireless industry (the likely bidders for the Upper 700 MHz Band licenses) are uncertain. The wireless investment community appears reluctant to make additional large investments.

We wish to make clear that we do not oppose the concept of an aggregate reserve as an instrument; we only oppose the imposition of an aggregate reserve that exceeds the previously established minimum opening bids in Auction No. 31. Establishing an aggregate reserve of \$720 million, coupled with a reduction in the minimum opening bids of the individual licenses, may well be a reasonable course of action. We feel strongly that any aggregate reserve price should be made public before the auction: among other issues, a secret reserve may invite problems of potential corruption.

The Bureau has also solicited comment on whether to include 24 licenses from the 698-746 MHz band (“Lower 700 MHz Band”) in Auction No. 31. We have already addressed this issue in comments filed February 6, 2002 and reply comments filed February 13, 2002 (which we incorporate here by reference) in response to an earlier public notice relating to the auction of Lower 700 MHz Band licenses.³ In addition, as we noted in our February 6 comments, we believe that the Commission should reconsider the current band plan for the Lower 700 MHz Band. Licensing Block C of the Lower 700 MHz Band (740-746 MHz — corresponding to UHF channel 59) according to MSA/RSA boundaries would create an additional free-rider problem in clearing, which could be avoided by simply interchanging the

³ *Auction of Licenses in the 698-746 MHz Band Scheduled for June 19, 2002; Comment Sought on Reserve Prices or Minimum Opening Bids and Other Auction Procedural Issues*, Public Notice, DA 02-200 (WTB, rel. Jan. 24, 2002).

geographic area type of Block C in the Lower 700 MHz Band with that of either Block A or Block B.

II. THE COMMISSION SHOULD ADOPT OPTION 2 FOR SETTING MINIMUM ACCEPTABLE BIDS.

One of the greatest dangers of the FCC's package auction design is that the auction could take very many rounds to reach completion. There are two reasons for this. The first is the complexity of the problem the auction is solving: finding the optimal allocation of packages of licenses requires both a great deal of calculation and the transfer of a great deal of information. Second, with the important exceptions of the activity rules and minimum bids, major features of the auction design appear to encourage bidders to delay making serious bids for as long as possible. The FCC's own experiments with package bidding confirm the theoretical finding that package auctions can take many more rounds to complete than simultaneous multiple round auctions.

The two rules concerning minimum acceptable bids that the FCC has offered for comment are among the parts of the auction design that seek to avoid the problem of excessively long auctions. As a matter of theory, the problem cannot be resolved just by minimum bids without endangering the efficiency of the auction outcome. Both options offered by the Commission will contribute to shortening the auction, but both may also interfere with the efficient allocation of licenses.

Option 1 sets minimum bids using an approximation derived from the actual bids in the auction. Because these approximations can depend quite sensitively on the bids in the auction, they tend to be unstable and unpredictable for bidders, as the Commission's own tests have verified. This instability makes bidding more difficult. Although the proposed "smoothing"

mitigates this problem, it does not resolve it. The principal advantage of Option 1 is that it depends objectively on the actual bids, without introducing subjective elements.

Option 2 has the significant advantage that it creates a simple, predictable, and stable basis for setting minimum bids across rounds, based on the “bidding units” assigned by the Commission to each license. Its principal disadvantage is that it is only as good as the Commission’s assignment of bidding units. Part of the purpose of an effective auction is to discover relative values, and the Commission’s assignment of bidding units can certainly entail significant errors.

Although each option has advantages and disadvantages, we think that a principled choice between the two options can be made. In general, we oppose increases in the complexity of the auction, such as those involved in Option 1, unless there is a clear basis for concluding that they entail a significant improvement over the simpler option. In this case, no basis for that conclusion has been offered. Option 1 sets minimum bids in ways that are less stable than Option 2 and employs heuristics whose performance is unproven. Moreover, to the extent that the choices made for Auction No. 31 set a precedent for future auctions, Option 1 takes a step in the wrong direction. There are procedures—using proxy bidders—that are known to be simpler, more effective for shortening the auction, and less likely to promote inefficient outcomes than Option 1.

Because Option 1 entails known risks and uncertain benefits and because it begins the FCC down a path toward an inferior implementation of package bidding, we advocate the adoption of the simpler Option 2.

For the reasons set forth above, Spectrum Exchange Group, LLC and Allen & Company Incorporated respectfully urge the Commission first, to refrain both from establishing an aggregate reserve for Auction No. 31 and from increasing the previously established minimum opening bids and second, to adopt Option 2 for its calculations of minimum acceptable bids. The current minimum opening bids are substantial, especially given the challenges presented by the Upper 700 MHz Band to a wireless operator as well as the current state of the capital markets.

Respectfully submitted,

**SPECTRUM EXCHANGE GROUP, LLC
AND ALLEN & COMPANY INCORPORATED**

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