

The Office of Advocacy concurs with the Commission's tentative conclusion that an installment payment option be made available to designated entities. Installment payments will permit designated entities to devote their scarce resources to the actual construction and operation of a PCS system. This will enhance their competitive position and survivability in a potentially very crowded market. Thus, installment payments promote one of the goals of the OBRA -- the rapid deployment of new technologies in areas or markets not adequately served by large businesses.²⁹ However, the Office of Advocacy disagrees with the Commission's tentative conclusion concerning the payment

²⁹ The FCC notes that installment payments increase the risk to the government that the winning bidder will default. The Office of Advocacy disagrees. To the extent that mutually exclusive license applications exist, at least one other party was interested in that block of spectrum. The Office of Advocacy suspects many others will be equally interested and the government can always resell the spectrum to another interested party. Thus, a bidder may default but the Office of Advocacy expects that the FCC will have little difficulty in finding a substitute purchaser.

Should a designated entity default in the installment purchase of a reserved block of spectrum, the Commission should first offer the block to any other designated entity who bid on that block. If the Commission is unable to find a designated entity, it then could offer the block to any bidder. This procedure comports with the SBAC's recommendation on distress sales.

The Office of Advocacy also recommends that the Commission institute some type of debt reorganization plan with the defaulting designated entity before instituting debt collection procedures. The Office of Advocacy has no objection to the FCC's debt collection process. The debt reorganization plan need not be as detailed as one required by the Bankruptcy Code. However, an opportunity to reorganize outside the formal bankruptcy structure will prove beneficial to designated entities should they face cashflow problems or economic adversities not originally contemplated in their bids or business plans.

of interest on installments and believes that the public interest is better served by the government forgoing the payment for the time value of money in return for rapid deployment of PCS and designated entity involvement in new technologies.³⁰

Normally in the purchase of any good through installment payments, the purchaser pays interest because the seller of the product had to purchase the product and the interest payment is compensation to the seller for what is essentially a loan of the seller's monetary resources. The sale of electromagnetic spectrum is not analogous to this standard installment sales transaction because the federal government incurred no expense in acquiring the spectrum; it did so by fiat. Thus, the installment payments do not recompense the government for spent. Therefore,

³⁰ If the Commission does not adopt Advocacy's recommendation to forgo interest payments, then the Commission should charge interest to designated entities at a rate less than the prime interest rate. The Office of Advocacy believes that the interest rate charged by the Rural Electrification Administration (REA) is appropriate. The REA was established to promote infrastructure development in areas typically underserved by private institutions -- a purpose very similar to the special measures contemplated in OBRA. Since the REA loans funds at interest rates substantially below prime, designated entities will have more manageable interest expenses and will be able to compete more effectively in the provision of PCS and other technologies.

If the FCC selects a market interest rate, some competitive problems for designated entities could arise. Rural LECs are eligible for borrowing from the REA could obtain low-interest loans sufficient to make a lump-sum purchase of spectrum. Other designated entities seeking to serve the same area and using installment payments would have to make these payments at a higher interest rate. The Office of Advocacy believes that such a dichotomy is unfair. The simple solution is for the Commission to adopt the interest rate charged by the REA.

the Office of Advocacy opposes the payment of interest for installment purchases by designated entities.

Although left unstated by the FCC, it appears that interest will be used to compensate the government for the time value of money lost due to installments. While this is an admirable goal, it conflicts with the goals of OBRA. First, interest payments, to the extent that they increase costs to designated entities, will reduce their competitive ability in what promises to be a very crowded market.³¹ Second, any increased costs or reduction in the competitive ability of designated entities will severely hinder their capacity to obtain sufficient capital to construct and operate a PCS network. In sum, these reductions in cashflow and capital access will hinder entry by designated entities and conceivably slow the deployment of PCS in high-cost rural areas.

C. Royalty Payments

The Commission also requests comments on adapting the mineral royalty process to the disposition of electromagnetic spectrum. *Id.* at ¶ 70. The federal government disposes of its oil, coal, and natural gas resources by leasing the resources to private parties who return a royalty payment to the government.

³¹ Under the Commission's licensing regime for PCS, there may be as many as seven new entrants in a market in addition to the two cellular providers already serving the area.

Royalties are not paid during the exploration or extraction phase but only after the federal lessee has received payment for the resource. The Office of Advocacy strongly endorses the use of royalty payments, at least for designated entities.

Royalty payments have one major benefit; they tie payments directly to the receipt of income. Installment payments³² and lump sum payments require the expenditure of scarce capital prior to the receipt of income. For designated entities, these initial payments without the concomitant receipt of income can divert scarce capital from the construction of a PCS network.³³ The lack of capital will slow the introduction of new wireless services by designated entities in contradiction to one of the primary goals of OBRA.

The FCC recognizes the potential benefit of delaying payment. Nevertheless, the Commission opines that the costs of administering such a system may outweigh any benefits and the

³² The Commission could delay the installment payments for designated entities until their services are operational (akin to waiting nine months after cessation of enrollment for commencing payment of federally-guaranteed student loans). The Office of Advocacy would support such an alternative.

³³ The failure to tie payments for spectrum to income also could inhibit the construction of PCS systems by large businesses. While the Office of Advocacy believes that scarcity of capital will not be problematic for large entities, the Commission must plan for that contingency and provide a royalty system for all licensees.

Commission tentatively concludes that royalties are an inappropriate alternative payment plan. *Id.* at ¶ 70.

The Commission first notes that royalties paid on federal resources are directly tied to a barrel of oil, a thousand cubic feet of gas, or a ton of coal. The Commission claims no similar measurable output exists with electromagnetic spectrum. The Office of Advocacy disagrees.

OBRA prohibits competitive bidding unless the Commission finds that "the principal use of such spectrum will involve, or is reasonably likely to involve, the licensee receiving compensation from subscribers...." OBRA, § 6002(a)(2)(A)(i). Thus, OBRA contemplates a measurable output -- subscription fees. The Commission can take a percentage of the subscription fees as its royalty.

Despite protestations by the FCC to the contrary, a royalty system based on fees for spectrum which is allocated by competitive bidding is neither costly nor complex to administer. In the case of the competitively bid spectrum, the licensee only needs to identify those services for which the licensee receives a subscription payment. For most services, such as PCS, that will be the total income from minutes of use. Royalties only have to be collected until the government has received the amount bid for the particular block of spectrum. Since the Commission

successfully administers a complex rate regulatory and tariff filing scheme for dominant wireline carriers and cable operators, the Office of Advocacy is convinced that the FCC is capable of collecting royalties.

D. Down Payments

The Commission proposes to require some type of down payment to demonstrate the earnestness of entities wishing to participate in the auction. NPRM at ¶¶ 102-03, 126. In addition, the FCC tentatively concludes that the winning bidders must provide a significant cash payment in addition to the down payment at the conclusion of the auction. *Id.* at ¶¶ 106-08. The FCC believes that a substantial bid deposit and significant cash down payment immediately after cessation of the auction will deter bidders more interested in trafficking their license than building a working PCS operation. *Id.* at ¶¶ 102-03. According to the Commission, this will speed the development of new technologies and prevent the delays associated with the deployment of cellular telephony that arose due to traffickers.

The Office of Advocacy supports the Commission's attempt to deter trafficking and speed the installation of PCS. However, the Office of Advocacy believes that designated entities may have difficulty in obtaining the cash needed to meet the down payment requirements.

The Federal Energy Regulatory Commission (FERC) faced a similar problem in its rules concerning the development of hydroelectric power projects. Environmental studies by the FERC and other federal agencies are required prior to the issuance of license. The Federal Power Act and the FERC require that the party seeking the license pay for these studies. To ensure that the federal agencies are not forced to use their own budgets to fund the studies, the FERC requires substantial deposits for the studies -- normally fifty percent of the cost of the studies.³⁴ However, the FERC also permits applicants to provide a bond for 100 percent of the cost in lieu of an initial cash deposit. Since completion bonds usually cost only 10 to 20 percent of their face value, small hydroelectric power developers save significant sums of scarce capital.

The Office of Advocacy believes that the FERC's procedures can be adopted for use in a competitive bidding regime. Designated entities should have the option to meet their down payment requirement (or any post-auction cash payment)³⁵ with the use of a bond or other financial instrument. A bond requirement frees scarce cash resources to be utilized in the

³⁴ The environmental studies associated with the licensing of a small hydroelectric power project can cost anywhere from \$300,000 to \$1,000,000.

³⁵ For designated entities, the Office of Advocacy believes that the initial down payment represents a sufficient showing of intent to own and operate a system. Thus, the Office of Advocacy opposes the Commission's imposition of any immediate further post-auction cash payments for designated entities.

further development of a wireless system. Nor does the use of the bond place the government at greater risk. The company providing the bond will do a significant examination of the designated entity's financial capacity before providing the bond. An entity willing to submit to this type of thorough financial examination certainly demonstrates its sincerity in the auction process and interest in constructing a PCS network.

The Commission also requests comments on whether the down payment should be kept if the bidder is found ineligible or unable to pay the balance of the bid. *Id.* at ¶ 109. The Office of Advocacy opposes the forfeiture of the down payment for designated entities. In many instances, the designated entity will seek additional outside financing. A change in commitment from these financiers, for whatever reason, often is beyond the control of the designated entity. The Office of Advocacy does not believe that designated entities should be punished for actions beyond their control and the down payment should be returned to the designated entity. In lieu of return, the Commission may wish to keep a percentage of the down payment to reimburse it for the transaction costs associated with the conduct of a new auction.

E. Preference for Innovators

The Commission currently grants access to specific parts of the electromagnetic spectrum for pioneers in the development of new technologies. Under the Commission's current rules, these pioneers would not have to compete in lotteries against other mutually exclusive applicants. These so-called pioneer preferences³⁶ have been issued to a number of designated entities. The SBAC recommends that these pioneers or other innovators receive some type of credit or bid preference in an auction. *Id.* at ¶ 80 & n.61. The Commission requests comment on this proposal.

The Office of Advocacy fully endorses the use of some type of preference in the bidding process for pioneers or other type of innovators. The Office of Advocacy does not believe that the preference should be limited to designated entities but, at a minimum, must be made available to designated entities.³⁷

³⁶ The Commission recently issued a notice of proposed rulemaking to consider whether the pioneer preference program should be eliminated. In the Matter of Review of the Pioneer's Preference Rules, ET Docket No. 93-266 (October 21, 1993). The Office of Advocacy plans to file comments in that proceeding but notes here, in particular, that we oppose the removal of any preferences already issued.

³⁷ The Commission also must address an innovative bid credit within the context of joint ventures or consortia. To enhance opportunities for designated entities, if an innovator is a designated entity and forms a consortium solely of other designated entities, then the bid preference should apply to the entire venture. If the innovator is part of a consortium that
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Since most of the innovative research in the field of wireless communication is being done by small businesses, a failure to provide some benefit for these technical advances will inhibit entry by designated entities and slow the deployment of new technologies.

In accordance with the recommendation of the SBAC, the preference should take the form of a bid credit.³⁸ The bid would be reduced by a certain amount based on the innovativeness of a bidder's technology or service plan. For example, if two bidders entered an auction and one bid \$100 and the other bidder had a superior service or innovative technology but only bid \$90, the Commission could award an \$11 credit to the innovative bidder giving that bidder the spectrum. However, the innovative bidder would only have to pay the \$90 bid price. Since the OBRA does not require the Commission to develop an auction process that maximizes revenue to the government, the FCC has the authority to tailor the bidding process to meet other objectives of the OBRA.

³⁷ (...continued)
includes non-designated entities, then the attribution rules discussed in Part IV, *supra* apply. Under the attribution rules, a bid preference, like the eligibility for other special measures, will not be available to a consortium not controlled by an innovator.

³⁸ Report of the SBAC at 13-15 *reprinted in* PCS Order, App. C.

VI. *The Bidding Process*

The adoption of the special measures for designated entities³⁹ (other than spectrum set aside) may be irrelevant if the FCC prescribes a bidding process that results in maximized revenue, not in maximized opportunity, for designated entities. The Commission proffers a number of auction methodologies, *id.* at ¶¶ 34-67, and tentatively concludes that a combinatorial bidding process utilizing both sealed and oral bids is the most effective auction plan. *Id.* at ¶¶ 57-61. The Office of Advocacy strongly disagrees and believes that open, sequential bidding is more likely to achieve the goals of OBRA -- rapid development of technology combined with maximum opportunities for designated entities.

Under the combinatorial bidding process, the Commission would seek sealed written bids for all licenses in a particular spectrum block and then conduct an oral auction of individual licenses in the same spectrum block. If the sealed bid for all licenses exceeds the value of bids for individual licenses, the license would be awarded to the bidder for the combined licenses. The FCC also would allow oral bidders on individual licenses one final opportunity to raise their bids after revelation of the sealed combined bids. The Commission believes that combinatorial

³⁹ The Office of Advocacy, while not directly addressing these issues, supports the other recommendations in the SBAC report to provide special measures for designated entities.

bidding will promote optimal aggregation of licenses and efficient allocation of resources.

The Office of Advocacy does not dispute the Commission's conclusion from a purely theoretical perspective. However, the OBRA imposes other objectives on the FCC's allocation of electromagnetic spectrum. The Office of Advocacy believes that combinatorial bidding will be detrimental to the attainment of those objectives.

One of the key goals of the OBRA is to enhance opportunities for participation by designated entities. Combinatorial bidding, by stressing firm size and access to capital, prohibits all but the largest enterprises from submitting a combined bid.⁴⁰ A designated entity that orally made the best possible offer for a block of spectrum and its concomitant license might not win because of the action of other bidders. If the other participants in the oral auction for individual licenses and spectrum blocks seriously underbid, the value of the combined bid might very well exceed the value of the individual bids. The designated entity, despite putting forth an optimal bid, would not be awarded a license. The Office of Advocacy opposes any

⁴⁰ The Office of Advocacy seriously doubts whether a consortium of designated entities has access to the capital necessary to bid on all licenses in a MTA.

bidding methodology in which the uncontrolled action of others denies an opportunity to designated entities.⁴¹

Combinatorial bidding, by its own terms, is designed to concentrate ownership of spectrum. The OBRA directs the FCC to establish a bidding mechanism which prevents undue concentration of spectrum ownership. Thus, combinatorial bidding is antithetical to another goal of OBRA.

Nor does any certainty exist that combinatorial bidding will result in more rapid deployment of new technology across all blocks of spectrum or in all markets. Rather, some firms may wish to purchase all of the spectrum and develop some technologies with greater celerity than others. Or a firm might obtain a combinatorial bid in which urban areas are served before rural areas. The Office of Advocacy does not support a bidding methodology which leaves the development of some areas to the whims or interests of a large business or any other party whose

⁴¹ The lack of control over other individual bidders in a combined auction must be distinguished from being outbid for an individual license. In the latter case, an individual bidder always had the opportunity to submit a higher bid. In combinatorial bidding, any one bidder has no control over what others might bid, and the opportunity to obtain spectrum rests, not on the determination of a single bid, but on the collective action of disparate parties.

goals may lead to detrimental treatment or reduced opportunities for designated entities.⁴²

The Office of Advocacy recommends that oral sequential bidding be conducted for individual licenses. Open sequential bids provide designated entities the opportunity to gauge their bids on the bids of the competition. In sealed bidding, some or designated entities may overvalue the spectrum relative to other participants in the market.⁴³ Open, sequential bidding will prevent this overvaluation and ensure that all entities are purchasing blocks of spectrum for prices in line with their market value.⁴⁴

⁴² The Office of Advocacy also notes that combinatorial bidding may give certain firms an opportunity to create nationwide licenses despite the FCC's rejection of that concept in the PCS Order.

⁴³ The failure to prevent overbidding by designated entities would saddle them with payments for spectrum that are substantially out of line with the true market value. Those competitors in the PCS market that made lower, but ultimately successful bids for other spectrum blocks, could price their services at lower rates and still recapture the cost of purchasing the spectrum blocks. Given the relative lack of staff resources for designated entities, it is far more likely that designated entities would misread the market and overbid. Moreover, designated entities probably would not have the financial wherewithal to withstand errors in bidding judgment. Thus, the sealed bids could prove detrimental to the competitive position of designated entities.

⁴⁴ A key prerequisite to allocative efficiency in a free market is knowledge of supply and demand. Open sequential bidding (similar to that used on commodity exchanges -- the preeminent example of a free market's effectiveness in efficient allocation) ensures that all market participants are basing their decisions on similar information of supply and demand. Under open sequential bidding, participants cannot rig the bidding without illegal collusive behavior.

VII. Miscellaneous

There are number of technical and procedural aspects to the conduct of an auction and post-auction behavior that the OBRA requires the Commission to consider. Some are directly related to achieving rapid deployment of infrastructure while others exist to prevent "bad behavior."

A. Unjust Enrichment

Both the Congress⁴⁵ and the Commission are concerned about trafficking in licenses. Obtaining licenses simply to turn around and sell them to another party more interested in construction and development of a wireless system will add unnecessary costs and delay the deployment of PCS and other technologies. OBRA authorizes the Commission to develop rules against trafficking. OBRA also raises concomitant concerns about unjust enrichment if a transfer occurs at a rate substantially greater than the bid price.

The Commission is not particularly concerned about trafficking in licenses purchased at an open auction involving

⁴⁵ In the legislative history to OBRA, Congress noted that trafficking in cellular telephony licenses dramatically delayed the widespread availability of that technology and may have contributed to increased rates for subscribers. H.R. Rep No. 111, 103d Cong., 1st Sess. 248, reprinted in 1993 U.S. Code Cong. & Ad. News 378, 575.

all potential bidders for licenses. Any subsequent sale will simply reflect the market price paid at the auction plus any subsequent development of the system by the original licensee. However, the Commission is concerned that licenses obtained in auctions reserved solely for designated entities may not reflect the true market value of those licenses. To prevent trafficking in these licenses and unjustly enriching designated entities, the Commission offers a number of alternatives to reduce the potential for profiting in the turnover of licenses. *Id.* at ¶¶ 83-89.

The Office of Advocacy concurs in the Commission's efforts to battle trafficking and the rapid turnover of licenses. Trafficking, by any party, prevents truly interested designated entities from obtaining access to licenses, competing in the marketplace, and providing the type of innovation that is the hallmark of small business. However, any unjust enrichment and anti-trafficking proposals must not prevent transfers that will lead to more rapid development of new technology or are required by business necessity.⁴⁶

The Commission proposes to prevent trafficking by requiring transferors to disgorge all of the transfer price in excess of

⁴⁶ An example would be if the financial backers of the designated entity decide to withdraw some or all of their resources to concentrate on other business ventures; another would be if the licensee needs to raise capital to handle a severe business setback in another line of business.

the bid price except insofar as the price received by the transferor reflects costs incurred subsequent to the award of the license. The Office of Advocacy supports this proposal and believes that it will be a potent weapon against trafficking.

The Office of Advocacy also endorses the FCC's proposal to automatically cancel a license upon the determination that a transfer was for the purposes of unjust enrichment. This latter proposal is simple to administer and still permits transfers required by business necessity or that serve the public interest.

The adoption of both proposals will provide an adequate disincentive to almost all trafficking designed for the purpose of unjust enrichment of the designated entity or for that matter, any transferor involved in trafficking of licenses.

B. Collusion

In any bidding methodology, the potential for collusion exists. The Office of Advocacy need not perorate the number of criminal actions filed by the Department of Justice against firms that colluded on bids for government contracts. Given the vast stakes at issue in this proceeding, the Office of Advocacy fully suspects that some enterprises will not be able to resist the temptation. Collusive behavior is not only detrimental to the public at large but seriously hampers the entry opportunities for

designated entities that are not part of the anti-competitive cabal. The Office of Advocacy strongly endorses the Commission's proposal, *id.* at ¶¶ 93-94, to require the immediate forfeiture of a license if collusive action was taken to obtain a license or fix the bid price. As a further deterrent, the Office of Advocacy recommends that any party required to forfeit a license by collusion be debarred from all subsequent auctions.⁴⁷

C. Performance Requirements

Auctions provide the opportunity for firms with the financial capacity to obtain licenses for large numbers of spectrum blocks. These entities then can warehouse them for subsequent future development or simply retain them to prevent competition. Warehousing reduces the opportunities for new entrants in telecommunications and slows the deployment of new technologies, especially in the potentially crowded field of PCS.⁴⁸ OBRA requires the Commission to adopt appropriate performance standards to ensure that all spectrum is adequately utilized. The Commission requests comments on the type of performance standards needed to protect the public interest.

⁴⁷ The debarment only can be lifted if the debarred entities demonstrate that the individuals responsible for the collusive activity have severed all ties with the firms involved in the collusion.

⁴⁸ Spectrum may be purchased for use after any shakeout occurs in PCS. This will leave those firms with warehoused spectrum the opportunity to obtain an even greater return on their investment simply by waiting.

The Office of Advocacy does not believe that warehousing of spectrum can ever satisfy the public interest. Therefore, the Office of Advocacy recommends that the Commission require performance standards identical to those currently imposed on licensees to construct and operate facilities. Performance requirements will further the FCC's efforts to prevent trafficking and, more importantly, will ensure the rapid utilization of the spectrum.

D. Application Procedures

The Commission proposes that each party interested in entering an auction submit a short-form application. The short-form application requires minimal information and the Office of Advocacy does not object to the Commission's dismissal with prejudice of incomplete short form applications. *Id.* at ¶ 100. However, the Commission may wish to grant an exception to those designated entities that are not currently Commission licensees.⁴⁹ To prevent them from resubmitting their applications as a result of their unfamiliarity with Commission procedures will not achieve the goal of increasing opportunities for small, women-and minority-owned businesses.

⁴⁹ Designated entities currently licensed by the Commission should be sophisticated enough or have access to appropriate legal advice. The Commission could and should demand that these designated entities comply fully with the FCC's application requirements.

Once the entrants have been identified and their applications reviewed, the Commission will announce a date for the auction in the FEDERAL REGISTER. The FCC proposes that the auction will be conducted at least 45 days after the announcement in the FEDERAL REGISTER. *Id.* at ¶ 101. The Commission also proposes that some type of expedited schedule shall be adopted to auction spectrum for broadband PCS. *Id.* Finally, the FCC proposes to prohibit any modifications to the application after filing. *Id.*

The Office of Advocacy believes that as much time as possible should be given to all entities, but particularly to designated entities, in preparation for the first auction -- the one for PCS. Entities will need time to study the market, obtain financing, and, if necessary, develop joint ventures. For designated entities, most of which have relatively small staffs, performance of these tasks in an expedited timeframe may be impossible. If the Commission wishes to conduct the PCS auction on an expedited basis, then the Commission should consider delaying any auction reserved for designated entities until after the general auction has taken place. This will not only provide designated entities with more time to prepare their bids but will give them a better sense of the PCS marketplace.⁵⁰

⁵⁰ Holding the auction for designated entities at a later date has one major drawback -- delay of entry into the market. In a field as dynamic as telecommunications late entry into the marketplace may prove to be a serious disadvantage that

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The Office of Advocacy also is concerned with the prohibition against license modifications. While the Office of Advocacy fully understands the Commission's concern about administrative burdens (especially given the FCC's other major responsibilities), the Office of Advocacy opines that one exception must be made to the general prescription against modifications. If a designated entity wishes to modify its license to include other designated entities in its bid as part of a consortium or joint venture, the Commission should permit it. This will ensure that designated entities have the fullest opportunity to obtain the resources necessary to compete in the auctions and the marketplace. The Office of Advocacy does not believe that this minor modification will pose an undue administrative burden on the FCC staff.

VIII. *Conclusion*

The United States stands on the threshold of the 21st century and a revolution in communications technology. To meet problems associated with allocating spectrum, the Congress authorized the Commission to seek competitive bids. The FCC has done its usual, admirable job under severe resource constraints in developing a proposed rule to auction spectrum. The Office of

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designated entities may be unable to overcome. The Office of Advocacy is not sure whether the appropriate balance favors more rapid entry with less information or slower entry with more complete information.

Advocacy supports the use of auctions but believes that safeguards are necessary to ensure rapid development and, more importantly, access by small businesses, rural telephone companies, and minority-and women-owned businesses. The Office of Advocacy endorses a spectrum set-aside in conjunction with a variety of other special measures to ensure maximum participation by designated entities. The Office of Advocacy is of the opinion that participation by designated entities will provide competition and significant technical innovation in new communication technologies. The ultimate beneficiaries will be the millions of customers of this new technology -- many of whom will be small businesses.

Respectfully submitted,



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