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The new name for PacTel

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May 31, 1994

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

EX PARTE

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

RE: GEN Docket 90-314, Amendment of the Commission's Rules to Establish New Personal Communications Services and Implementation of Section 309(j) of the Communications Act, Competitive Bidding, PP Docket No. 93-253

Dear Mr. Caton:

On Tuesday, May 31, 1994, on behalf of AirTouch Communications, R. Preston McAfee and I met with Jane Mago, Senior Legal Advisor to Commissioner Chong regarding the above-referenced proceedings. Please associate the attached material with the above-referenced proceeding.

Two copies of this notice were submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me at 202-293-4960 should you have any questions or require additional information concerning this matter.

Sincerely,

Kathleen Abernathy

Kathleen Q. Abernathy

Attachments

cc: Jane Mago

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List ABCDE

Auction Design Issues

Presentation to:

Federal Communications Commission
Washington, D.C.

by

R. Preston McAfee
University of Texas

and

Analysis Group, Inc.

on behalf of
AirTouch Communications

May 27, 1994

Major Issues in Auction Design

The *Winner's Curse*

"The winner is the firm that most overestimated the object's value."

- Bidders lower bids to adjust for winner's curse
- Winner's curse effects reduced by ascending bid auctions
- Most important when there is a significant uncertainty about value of object common to all bidders

Information Release

- Two types of information: value of object and level of competition
- Release of information about value tends to increase average sale price
  - Works by reducing winner's curse
  - Ascending bid auctions provide more information to release to bidders
- Release of information about competition may reduce average price

Major Issues in Auction Design (continued)

Efficiency (sell license to firm that values it most)

- Improved by ascending bid auctions
- Reserve prices create inefficiencies
- Issue most important when there are significant observable differences among bidders

Collusion

- Reduced by concealing identities of bidders
- Ascending bids make collusion easier
- Reduced by bundling licenses together into a single package

Major Issues in Auction Design (continued)

Bundling

- Can be used to increase revenue
- May induce inefficiencies
- Unnecessary provided goods are auctioned simultaneously

Risk Aversion

- Revenues increased by sealed bids
- Most important when bidders have limited resources relative to the value of the object for sale

Designated Entities

Goal: Increase participation of designated entities at least cost

Economic Solution: Price-preference (or bidder credits)

A price-preference lets a member of a preferred group submit a lower bid and still win the auction.

How much lower is the amount of the price-preference:

Example: Minority-owned business gets a 10% preference
- The highest non-minority firm bid is $1,000
- Minority wins if it bids at least $909.10
- Minority bid evaluated at 1.1 × $909.10 = $1,000.01

Used to favor domestic suppliers (6%-12% for Buy American Act, up to 50% for domestic defense contractors)

Advantages of Price-Preferences Over Set-Asides

- Price-preferences increase competition in *all* auctions
  - Designated entities become more viable competitors in auctions *not* set-aside
    - Non-preferred bidders bid higher than without preferences
  - All firms compete in all auctions

- Price-preferences establish values for implementation of unjust enrichment provision
  - If preferred group sells, should pay the amount of the preference to the government
  - Eliminates need to estimate unjust enrichment necessary with set-asides

Advantages of Price-Preferences Over Set-Asides (continued)

- Price-preferences minimize inefficient sale
  - Designated entities win if nearly competitive
  - Designated entities lose when they are much less efficient
    - This need not occur with set-asides

- Price-preferences may increase government revenues
  - A result of increased competition in all auctions
  - May increase revenues even over the outcome without favoritism
    - Since non-preferred firms choose higher bids
  - May implement preferring disadvantaged groups for free

- Price-preferences don't banish disadvantaged groups to set-aside
  - Disadvantaged groups compete effectively in *all* auctions

Advantages of Price-Preferences Over Set-Asides (continued)

- Price-preferences are a versatile instrument

  - Can set distinct preference levels for minority owned business, female owned business, rural telephone companies
  - Can adjust level of preference to achieve desired goals

- Price-preferences can be used for partial ownership

  - A firm owned by a preferred group obtains *part* of the preference
    - E.g., with a 10% preference, a 60% minority owned business would get a 6% preference
    - If it drops to 40%, must rebate 2% to government
      [60% - 40% = 20% of the 10% preference is 2%]
    - This gives incentives for all firms to include minorities

Disadvantages of Price-Preferences Over Set-Asides

- *Only* disadvantage is that it is difficult to compute an optimal preference

- Can be estimated by experimentation with 10 MHz licenses

- Past bids may be useful

  - See by how much disadvantaged groups missed winning
  - Use this as initial preference in experiments

Issues Relating to Bid Preferences for Designated Entities, Cont'd

- Scaled Bid Preferences Based on Equity or Board Participation (or Minimum of These)
  - One Option is to Scale Bid Preference Without a Minimum Minority Ownership
    - For Example, Thirty Percent Equity or Board Participation Yields a Six Percent Bid Preference (30% Ownership times 20% Bid Preference)
    - This Provides Relatively Large Rewards for Participation By Designated Entities
  - Second Option is to Allow Bid Preference Only if Designated Entity Controls Firm
    - For Example, Sixty Percent Equity or Board Participation Yields a Twelve Percent Bid Preference (60% Ownership times 20% Bid Preference)
    - This Provides Relatively Small Rewards for Participation By Designated Entities
- Either Option Rewards Increased Participation by Women and Minorities
- Difficult to Quantify Management Decision-Making Role

Issues Relating to Bid Preferences for Designated Entities

- Three Types of Participation
  - Ownership Equity
  - Board of Directors Participation
  - Management Decision Making
- Goal is to Encourage Participation by Women and Minorities
- Fundamental Trade-Off:
  - Large Rewards for Participation by Designated Entities May Encourage Token Ownership Interests to Capture Bid Preference
  - Small Rewards for Participation May Discourage Large Firms From Soliciting and Cooperating with Designated Entities

Auction Design Issues

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Evaluating the Competitive Effects of Non-Majority Ownership Interest

- Factors that Support Establishing a Relatively High Partial Ownership "Safe Harbor"
  - Allows More Complex Ownership Structures
  - Enables More Efficient Formation of Consortia
  - Reduced Threat of Divestiture Encourages Increased Participation in Auction
  - Reduced Administrative Complexity, While Retaining DOJ/FTC Oversight
- Primary Factor Militating Against A Relatively High Ownership Threshold
  - Variety of Opinions Exist Regarding When Partial Ownership Constitutes Effective Control (see attached opinions)
- Better to Err on Too High a "Safe Harbor"
  - Too Low -- Prevents Efficient Allocations
  - Too High -- Possibility of Anticompetitive Allocations, But DOJ/FTC Enforcement of Antitrust Laws Would Prevent Such Outcomes

A Non-Majority Owner's Ability to Control Depends on the Distribution of Share Ownership

- The More Concentrated the Ownership of Shares, the Less is the Ability of a Non-Majority Owner to Exercise Control
- Empirically, in 78 Percent of *Fortune 500* Firms, the Largest Shareholder Owns at Least Five Percent of the Firm, and the Average Holding of the Five Largest Shareholders is 29 Percent (Schleifer and Vishny, *JPE*, 1986)
- Thus, Non-Majority Shareholders Generally Face Several Other Owners with Significant Ownership Shares, Limiting the Ability of Any One Non-Majority Owner to Exercise Control

Variety of Opinions Regarding When Partial Ownership Constitutes Control

- In a Case Involving Partial Stock Acquisition, A Court Held That a Twenty Percent Ow Need Not be Divested Because There Were No Common Directors, Officers, or Employe No Proof of Control (see *U.S. v. Amax* 402 F. Supp. 956, 974)
- In an Instance of Partial Stock Acquisition Where the Acquiring Firm Apparently Inte Gain Control, a Court Held that Twenty Percent Ownership Was Sufficient to Influe Acquired Firm's Policies (see *Gulf & Western Industries v. Great Atlantic & Pacific Tea* F.2d 687, 694)
- Regarding "Safe Harbors" for Partial Stock Acquisitions, Areeda and Turner Suggest Percent Threshold on *Ad Hoc* Grounds (see *Antitrust Law,* ¶1203)

Creating SubMTAs for Designated Entities Creates a Difficult Bargaining Problem

- Only Matters When Designated Entity Owns Less Than 50%
- SubMTA Improves Designated Entity's Bargaining Position by Providing "Walk-Away" Threat
- If Designated Entity Must Own a Portion of MTA
  - Holdup Threat May Deter Consortia Involving Designated Entities
  - Designated Entity May Get Stuck with Worst Submarket to Minimize Holdup Threat
- Better to Require Repayment of Bidding Credit If Designated Entity Ceases Participation
  - Also Provides "Walk-Away" Threat for Designated Entity
  - Payment Should Be to Government, not Designated Entity
    - To Deter Inefficient Partnership Dissolution

Auctioning C After A & B Versus All Simultaneously

- Auctioning All Simultaneously
  - Improves Allocative Efficiency
  - Ensures That Prices Are Similar
  - Minimizes Bidder Regret
  - Makes "Contingent Consortia" Difficult or Impossible
- Auctioning C After A & B
  - Encourages Losers in A & B Auction to Form Consortia with Designated Entities
  - Permits Consortia Based on Outcome in A & B
- Conclusion Depends on How Important Consortia Are For Designated Entities
  - Tradeoff Between Efficiency and Support for Designated Entities
- May Be Better to Use Bidder Credits Rather Than Sequential Auctions to Encourage Designated Entities

BTAs Versus MTAs for Designated Entities

- Use of BTA-Sized Licenses
  - Encourages Participation of Smallest Firms
  - Permits Assembly of Economically Significant Regions
    - Increasing Efficiency
  - Some Low Value BTAs May Not Sell, But This Would Only Occur If It Were the Efficient Outcome
  - Makes Build-Out Requirements More Costly to Implement and More Complex to Enforce
  - Requires More Complex Auction

Minimum Compatibility Requirements

- Essential if Commission is to Ensure that Industry Standards are Uniform Across Country and that Subscriber Equipment is Compatible on Similar Networks
- Particularly Important to Ensure that Emergency Voice and Data Calls (E911) can be Placed on Any PCS Network in a PCS Frequency Band Using Similar Technologies
- Will be Too Late to Address E911 Issue if Wait Until After the Industry Builds Out and After There are a Number of Crisis with Emergency Calls
- Also Protects Against Interference Between Different PCS Carriers; Cannot Address Interference Issue Without First Addressing Issue of Compatibility
- Need not Mandate Specific Standards to Ensure Minimum Compatibility; Need Only put Burden on Industry Through the Licensing Process
- This Issue is Important Enough to Request Further Comment in Decision on Reconsideration
- Further Comment will not Slow Down the Auction Process Since Parties will Bid for Spectrum Regardless of Whether There is a Standard
- Further Comment will, however, Benefit the Public by Allowing the FCC to Take the Steps Necessary to Ensure that Subscribers have Equipment that is Effective in Emergency Situations and can be Used Across the Country