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August 1, 1994

AUG - 1 1994

BY HAND DELIVERY

William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: ET Docket No. 93-266/ Review of the Pioneer's Preference Rules; Gen. Docket No. 90-314, Amendment of the Commission's Rules to Establish New Personal Communications Services

Dear Mr. Caton:

Enclosed are an original and six copies of a Joint Response of Pacific Bell and Bell Atlantic Personal Communications to American Personal Communications' Post-Remand Filings in the above-captioned proceedings. Please return a date-stamped copy to the person delivering them. Copies have been served on all parties to the proceedings.

Sincerely,

Michael K Kellogg/JL

Michael K. Kellogg

Enclosures

cc: Commissioner Quello
Commissioner Barrett
Commissioner Ness
William Kennard, Esq.
Chris Wright, Esq.
John Ingle, Esq.
Jim Carr, Esq.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matters of

Review of the Pioneer's
Preference Rules

Amendment of the Commission's Rules
to Establish New Personal
Communications Services

ET Docket No. 93-266
Gen. Docket No. 90-314

**Joint Response of
Pacific Bell and Bell Atlantic
Personal Communications to
American Personal Communications'
Post-Remand Filings**

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August 1, 1994

Summary

In response to the Commission's Emergency Motion for Remand filed in the Court of Appeals and the Court's decision to grant that motion, American Personal Communications (APC) has filed a series of pleadings in which it argues that giving the pioneers licenses for free will have no competitive effect.

I. Contrary to APC's assertions, competitive and policy considerations favor requiring payment.

A. The Commission has authority to impose a payment requirement not just under Section 4(i) of the Communications Act but also under 47 U.S.C. Section 309(j). APC strenuously asserts that Section 309(j) does not apply unless there are mutually exclusive applications, but only competitive bidding is precluded when mutual exclusivity is absent. The rest of Section 309(j) -- including the requirement that the Commission consider competitive implications, avoidance of enrichment, and recovery of the spectrum's value -- applies to any class of licenses that, like PCS licenses, is designated for competitive bidding. Consequently, if requring payment will promote competition and avoid unjust enrichment, Section 309(j) requires the Commission to consider it. In fact, Section 309(j)(4)(E) specifically contemplates the use of payment schedules where eligibility criteria (like the pioneer's preference program) reduce the number of qualified entities and thereby cause licenses to be issued for less than full market price.

B. Because auctions allocate licenses to the users that value them most highly, they maximize competition; the most competitive

firms stand the most to gain from purchase and, as a result, bid highest. Giving away preference awards for free interferes with this allocation mechanism because it awards licenses to pioneers even if they are the least effective competitors. The inevitable result is diminished competition.

The best way to eliminate this evil is to abolish the awards. Because the Commission believes it appropriate to balance competitive implications against perceived equitable concerns, however, imposing a payment requirement is an appropriate accommodation. If the pioneer is willing to pay some percentage of market price, at least the Commission can be assured that the pioneer is within a reasonable range of being a good competitor. If the pioneer is not willing to pay, then awarding it the license would have permitted an inefficient competitor to obtain an extremely valuable license, impairing competition and damaging consumer welfare.

C. Although insisting (incorrectly) that it is entitled to some sort of "reward," APC makes no effort to determine how large that "reward" should be. Nowhere does APC indicate how much it spent in reliance on the preference program, or what portion of its investment accrued to the public rather than its own private benefit. Even taking APC's total investment of $20 million as the relevant figure, it is clear that a license valued at approximately $750 million would be a grossly excessive "reward" by any standard.

D. A more appropriate award would be either (1) to reserve licenses for the pioneers, conditioned on payment of some amount

approaching market value, or (2) to give the pioneers a bidding credit for use toward an MTA or any license within that MTA at auction. The latter is clearly superior in terms of its effect on the auction and competition. If the Commission reserves a license for the pioneer and the pioneer ultimately elects not to buy it (after learning the price), the license will have to be sold at a separate auction. This defeats the Commission's goal of using simultaneous multiple round bidding. Bidders will not be able to adjust their bidding strategy based on license availability and licenses that are more valuable together may not be sold together. In any event, either method is clearly superior to giving away a license for free, and anything more than a 5% discount would be economically unjustified.

III. Finally, the Commission must reconsider its decision to give pioneers MTA licenses. The sole justification for awarding the pioneers regional licenses -- the unavailability of 30 MHz BTA licenses -- disappeared when the Commission changed its spectrum allocation scheme. Moreover, the Commission's entire rationale for giving pioneers anything was reliance. The pioneers, however, could not have and did not rely on receiving regional licenses. In addition, awarding the largest and most valuable licenses to pioneers maximizes the adverse effect on the auction and the competition that will follow.

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Introduction

In addition to filing an Emergency Request for Oral Argument (July 21, 1994) ("Argument Request") and a set of Further Comments on Spectrum Blocks for Competitive Bidding and Scope of Preference Awards (June 22, 1994) ("Further Comments"), American Personal Communications ("APC") has now filed an unsolicited set of Supplemental Comments on Remand (July 26, 1994) ("Remand Comments"). In this latest round of pleadings, APC attempts to demonstrate that it and the other broadband pioneers preference winners are not only entitled to the largest and most valuable licenses in the country, but that they should get the licenses for free. Reasoned economic analysis, however, demonstrates that giving away licenses for free would distort the auction process, impair competition, and unjustly enrich the pioneers at the expense of the federal fisc -- all in contravention of longstanding Commission policy and express statutory command. We attach the affidavits and declaration of Professors Paul Milgrom, Jerry Hausman, and Barry Nalebuff, three eminent economists with extensive knowledge of the PCS industry, in support of this response.

I. Competitive and Policy Considerations Overwhelmingly Support Requiring Payment

The essence of APC's argument is that nothing changed when Congress revised Section 309(j) of the Communications Act and authorized the use of competitive bidding. Even though APC's competitors now must pay large sums of money for their licenses, APC urges the Commission to give the broadband pioneers their licenses for free. APC's arguments are based on faulty economic analysis and ignore a traditional (and statutorily mandated) concern -- the

avoidance of unjust enrichment.

A. The Commission Must Consider the Effect on the Auction Process, the Impact on Competition, and the Possibility of Unjust Enrichment

Time and again, APC asserts that nothing in Section 309(j) affects the pioneers preferences and that the Commission lacks authority to impose a payment requirement.[1] The foundation of this argument is APC's impression that Section 309(j) is irrelevant unless mutually exclusive applications are filed. APC's assertions are incorrect, for two reasons.

First, APC misreads Section 309(j). It is true that Section 309(j) does not permit a license to be sold at auction unless there are mutually exclusive applications. 47 U.S.C. § 309(j)(1). But that does not mean that the rest of Section 309(j) has nothing to say about the terms of PCS licenses awarded through other means, including the pioneer's preference program. On the contrary, by its terms, much of Section 309(j) establishes criteria -- including avoidance of unjust enrichment and recovery of the spectrum's value for the public -- applicable to the terms of all PCS licenses. Indeed, Congress expressly gave the Commission regulatory authority to devise payment terms for such licenses.

Specifically, Section 309(j)(3) establishes criteria that apply to decisions "identifying the classes of licenses and permits to be issued by competitive bidding" and "specifying the eligibility and other characteristics of such licenses." 47 U.S.C. § 309(j)(3)

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[1]See, e.g., Further Comments at 2 n.3; APC's Response to Emergency Motion to Remand, No. 94-1148, at 5-8 (D.C. Cir. July 12, 1994).

(emphases added). Clearly, PCS licenses -- including those awarded to the pioneers -- are part of the "class of licenses" that the Commission can (and has) designated for public bidding. See Notice of Proposed Rule Making, Implementation of Section 309(j) of the Communications Act, 8 FCC Rcd 7635, 7654, ¶ 116 (1993) ("Specifically, we expect the principal use of PCS spectrum, considered as a class, is reasonably likely to involve the licensee receiving compensation from subscribers . . . ." (emphasis added)); Fifth Report and Order, Implementation of Section 309(j) of the Communications Act, FCC No. 94-178, PP Docket No. 93-253, at ¶ 22 (released July 15, 1994) ("In the Second Report and Order, we concluded that PCS as a class of service would satisfy the Section 309(j)(1) criteria for auctionability" (emphasis added)). As a result, the factors listed in Section 309(j)(3) must be considered in establishing the characteristics of PCS licenses, including those awarded to the so-called pioneers. Indeed, those criteria must be considered in deciding the fate of the pioneer's preference program as a whole: The preference program is nothing more than a set of eligibility criteria, and Section 309(j)(3) specifically governs rules specifying "eligibility" for licenses in a class that, like PCS, is designated for public auction.

Section 309(j)(3)'s criteria not only validate but virtually mandate the decision to consider the anticompetitive effects of giving away licenses for free. Under 47 U.S.C. § 309(j)(3)(B), the Commission must pursue the objective of "promoting . . . competition" when establishing license characteristics. Moreover,

Section 309(j)(3)(C) requires the Commission to consider "recovery for the public of a portion of the value of the public spectrum resource made available for commercial use and avoidance of unjust enrichment through the methods employed to award uses of that resource." Surely imposing a payment requirement avoids unjust enrichment and assures recovery of the spectrum's value better than giving away a billion dollars' worth of spectrum for nothing.

In fact, Section 309(j)(4)(E) expressly contemplates a payment requirement. It authorizes the Commission to "require such transfer disclosures and antitrafficking restrictions and payment schedules as may be necessary to prevent unjust enrichment as a result of the methods employed to issue licenses and permits." 47 U.S.C. § 309(j)(4)(E) (emphasis added). This provision plainly anticipates that the Commission may need to impose charges or other restrictions where the use of eligibility criteria -- such as the pioneer's preference program -- would otherwise permit licensees to acquire spectrum at less than full market value. See Second Report and Order, Implementation of Section 309(j) of the Communications Act, 9 FCC Rcd 2348, 2385, ¶¶ 212-213 & n.158.

Second, even if Section 309(j) did not apply, the Commission has authority to impose a payment requirement under Section (4)(i) of the Communications Act. It has long been the law that competitive concerns are a legitimate basis for Commission action. FCC v. RCA Communications, Inc., 346 U.S. 86, 94 (1953). Similarly, the Commission has long attempted to ensure that licensees and

license applicants are not unjustly enriched.[2] If imposing a charge on preference recipients is an appropriate method of avoiding anticompetitive effects and preventing unjust enrichment, it is within the Commission's power to do so. The Commission has already so held, and APC does not seriously contend otherwise. See Memorandum Opinion and Order, Application of Nationwide Wireless Network Corp., FCC No. 94-187, File No. 22888-CD-P/L-94, at ¶ 25 (released July 13, 1994) (the "Mtel Order").[3] Giving preference awardees their licenses for free offends each of these statutory concerns. It impairs competition by causing an inefficient allocation of licenses; it unjustly enriches the preference awardees by giving them licenses that exceed the value of their investment by an order of magnitude; and it denies the public the ability to recover the value of the spectrum.

B. Giving Licenses Away For Free Will Distort the Auction Process and Impede Competition

APC argues that giving the pioneers free licenses will "accomplish nothing in terms of improving competition" because sunk costs do not affect pricing decisions. Remand Comments at 2; Affidavit of John Gould and Gustavo Bamberger at ¶¶ 15-16. APC, however, is looking at the wrong end of the elephant. The purchase price of a license only becomes a sunk cost after the license has been purchased. Before the purchase is made, its cost is not yet

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[2]See, e.g., California Broadcasting Corp., 2 FCC Rcd 4175, 4192-93, ¶ 54 (1987); LiTel Telecommunications Corp. v. U S West Communications, Inc., 9 FCC Rcd 1619, 1626, ¶ 33 (1994).

[3]Nothing in the Mtel Order, of course, precludes the Commission from achieving the same result under Section 309(j).

"sunk." See Hausman Aff. at ¶¶ 5-6. Consequently, giving pioneers their licenses for free will affect license allocation at auction and, as a result, competition. As Professors Hausman, Milgrom, and Nalebuff demonstrate in their affidavits and declaration, the effect is distinctly negative.

The primary reason for holding auctions is that they promote competition by allocating spectrum to the users that are most likely to offer new, better, or lower cost services. The Commission has explained that, "[a]warding licenses to those who value them most highly . . . will likely encourage growth and competition for wireless services and result in the rapid deployment of new technologies and services." Second Report and Order, Implementation of Section 309(j) of the Communications Act, 9 FCC Rcd 2348, 2349-50, ¶ 5 (1994); accord, Hausman Aff. at ¶ 10; Milgrom Aff. at ¶ 12. However, a system that allocates licenses to lower-value users -- users that cannot employ the spectrum as efficiently as others -- impairs competition by substituting a less efficient (and less effective) competitor for a more efficient and better one. Milgrom Aff. at ¶ 8.

What APC proposes here will interfere with the auction's efficient allocation of spectrum. Unlike the auction, the pioneer's preference system is virtually certain to allocate licenses to lower value users, that is, to firms that will be less efficient competitors. Hausman Aff. at ¶¶ 11-12. Giving licenses to less effective competitors, of course, impedes competition; firms that would have provided superior or lower-cost service are excluded from

the market, while those that provide inferior or higher-cost service are permitted to participate. As a result, "efficiency will be lower, competition will be affected and consumers will be adversely affected." Hausman Aff. at ¶ 17; accord, Milgrom Aff. at ¶ 12. The only circumstance in which this anticompetitive result would not occur is if, among other things, the Commission happened to select the very best competitors for each of those MTAs as pioneers -- a very unlikely event, especially given that such was not the Commission's goal. Hausman Aff. at ¶ 17; see also id. at ¶ 16.

This inefficiency is of particularly great concern given the terms of the preference licenses. Because pioneers are not permitted to sell their licenses to a more efficient competitor or cease using their innovation for a number of years, competition would remain impaired for quite some time. Hausman Aff. at ¶¶ 21, 22; see Milgrom Aff. at ¶ 6.[4] Moreover, the inefficiency will not be confined to the particular licenses allocated to the pioneers. Instead, because tying up the license increases the cost of substitute licenses, competitive firms might be barred from entering, see Hausman Aff. at ¶ 9, and more efficient firms might be deterred from purchasing licenses for which the pioneers' licenses are complements, Milgrom Aff. at ¶ 6; Hausman Aff. at ¶ 13. Not just the consumers in the pioneer's region, but consumers in

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[4]One solution to this problem would be to permit pioneers to sell their licenses freely, but this would be contrary to the purpose of the preference program. The idea of the program was to give innovators the opportunity to use their innovation, not to permit them to get rich by "flipping" their license upon receipt. See Hausman Aff. at ¶ 15 at n.4.

adjacent regions, might be denied valuable services as a result. See Milgrom Aff. at ¶ 6; Hausman Aff. at ¶ 13.

Indeed, the fallacy of APC's argument that competition is not affected can be seen most clearly by taking the argument to its logical extreme. If giving free licenses to preference recipients does not affect competition, then the Commission could give away all the licenses for free, subject to the same restrictions imposed on the preference recipients, without adversely affecting competition. Hausman Aff. at ¶ 16 n.5. Obviously competition would be affected, and for the worse. So too where the Commission gives away a few licenses for free. Consequently, it is simply not the case that giving pioneers free licenses will "not have an adverse impact" or will have no effect on the competitive environment. Hausman Aff. at ¶ 16; accord, Milgrom Aff. at ¶¶ 8, 12 ("Gould and Bamberger are quite wrong . . . ").[5]

The best way to ensure competition is to eliminate the preference program and sell all of the licenses at auction. See Hausman Aff. at ¶ 12, 28. Pacific Bell and Bell Atlantic recognize, however, that the Commission wishes to balance its desire to avoid

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[5]This adverse impact, of course, did not exist before the Commission had competitive bidding authority. As Professor Milgrom explains (Aff. at ¶ 10): "Before the introduction of the auction authority, the cost to government of a pioneer preference award was the foregone opportunity of assigning the license by lottery or administrative hearing -- mechanisms that were hardly more likely than the pioneer award to assign the license to an efficient user. Since the introduction of the auction authority, however, the opportunity cost of licenses assigned outside the auction process includes . . . likely reduction in the efficiency of the assignment, with a consequent diminution of competition in the PCS industry."

anticompetitive effects against what it considers to be "competing equities." FCC Emergency Motion for Remand at 3, 4 (July 8, 1994). But APC's proposal -- giving it a license for absolutely nothing -- is not a balance at all. Instead, APC abandons the goal of competition entirely and allocates licenses without regard to the effect on competition. Such a one-sided approach is "among the least desirable ways of" meeting the Commission's desired balance, Hausman Aff. at ¶ 21, and simply cannot be reconciled with the Commission's statutory obligation of promoting competition.

The Commission's proposal that preference awardees pay for the licenses, however, substantially reduces the anticompetitive impact of preserving preference awards. Milgrom Aff. at ¶ 13. If pioneers do not have to pay anything for their awards, they will accept them even if they are not able to use them nearly as efficiently as other potential licensees. Milgrom Aff. at ¶ 12; Hausman Aff. at ¶ 21. Hence the adverse effect on competition: Even a very poor competitor will accept a license and hold it for three years if it is free. Nalebuff Decl. at ¶ 22. Introducing a payment requirement, however, introduces an element of market discipline. If the pioneer is required to pay something approaching market rate for its license, it will not choose to accept a license (or select a particular license) unless it expects to compete effectively and thereby earn a decent return on its investment. Because charging the pioneer for its license ensures that it will be among the more efficient -- and therefore more competitive -- users, it promotes competition. Ibid.; Milgrom Aff. at ¶ 13; Hausman Aff. at ¶¶ 22-24.

APC and its economists thus commit precisely the error the Commission sought to avoid when it began a proceeding to reconsider the preference rules in light of the Commission's auction authority: They act as if the auctions simply do not exist. Unless pioneer's preference recipients are charged for their licenses, they will accept their licenses even if they are relatively inefficient competitors. The result will be impaired competition. By charging preference recipients something near market rate for their licenses, the Commission can ensure that the preference winner in fact is among the more effective competitors and that awarding it the license will not unduly impede competition.

C. Giving Pioneers their Licenses for Free Will Afford them a Windfall Recovery Disproportionate to the Extent of their Reliance or any Legitimate Public Interest Goal

Persisting in the revisionist view of history that pioneer's preferences were held out as rewards -- some sort of communications Nobel Prize -- APC continues to assert the inequity of reducing the value of its award by requiring payment. Contrary to APC's assertions, the preference awardees will be more than amply rewarded even if a substantial payment requirement is imposed.

1. As an initial matter, APC is quite wrong in asserting that it had a right to expect something of value for no reason other than to "reward" it. The purpose of the program was not to enrich pioneers but to limit the distorting effects of the Commission's prior methods of spectrum allocation:

> In adopting the pioneer's preference procedures, the Commission was concerned with fostering the development of new services and improving existing services by reducing the delays and risks for innovators associated

> with the Commission's allocation and licensing processes. In particular, the Commission was concerned that an innovator facing a lottery situation would have no assurances of receiving a license and therefore no ability to obtain a license as a reward for its efforts. . . . . The text of the Commission's decisions makes clear that the overriding objective of the pioneer's preference rules simply is to ensure the award of a license to an otherwise-qualified pioneer's preference recipient.

Mtel Order at ¶ 16 (emphasis added and footnotes omitted). Clearly a license does not have to be free for this guarantee to serve its function or have value. Indeed, as the Commission has proposed, the licensees could be guaranteed licenses contingent upon payment of something approximating market price.[6] And this payment requirement does not frustrate the pioneers' reliance interests because the pioneers receive exactly what they were supposed to get -- a guarantee of a license on conditions similar to those imposed on their competitors.[7]

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[6]Nextel observed: "The purpose of the pioneer's preference rules, as discussed above, is to assure that innovators have a reasonable opportunity to obtain a license for the service resulting from their innovation. This in no way requires that the license be free, but only that the license be "'reserved' for selected pioneers." Comments of Nextel Communications at 9 (Nov. 15, 1993).

[7]It is true, as APC points out, that the Commission acted to protect reliance interests when it decided that, with respect to applications filed before July 26, 1993, it would continue awarding cellular licenses for unserved areas by lottery -- i.e., for free. APC Argument Request at 10 & n.12. APC, however, neglects mention of the critical factor that distinguishes that decision. There, the licenses were of "questionable commercial value." Memorandum Opinion and Order, Implementation of Section 309(j) of the Communications Act, FCC No. 94-123, PP Docket No. 93-253, at ¶¶ 14-15 (released July 14, 1994). "Few markets," the Commission explained, "would be likely to attract significant bids" and it "would be difficult to articulate a principled basis for distinguishing between markets that would be auctioned and those that would be subject to lottery." Id. at ¶ 15. Consequently, the

It is for this reason that Commissioner Barret's concern about a policy "bait and switch" -- directed at the proposed repeal of the preference program -- does not apply. See Notice of Proposed Rule Making, Review of the Pioneer's Preference Rules, 8 FCC Rcd 7692, 7696 (1993). To the extent that the pioneers had any legitimate expectations (and we do not agree that they did), those expectations will be more than met by the guarantee of a license with terms neither more nor less favorable than those afforded to other PCS licensees. To give the pioneers more than this would constitute unjust enrichment, for it would give them a "reward" that they had no reason to expect.

2. But even if one accepts APC's claim that it is entitled to some sort of "reward" based on reliance, the free license APC claims would constitute not a reasonable award but a windfall -- in short, precisely the type of unjust enrichment that Section 309(j)(C)(3) commands the Commission to avoid.

First, neither APC nor any other pioneer has ever indicated how it relied on its license being free (or substantially cheaper than those of its competitors), even though this shortcoming has

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result of cancelling the lottery and holding an auction would have been administrative upheaval and delay -- including the refund of 10,000 application fees -- with little or no corresponding public benefit. Id. at ¶¶ 4, 16; see also 47 U.S.C. § 309(j)(3)(A) (Commission to promote deployment of new services without "administrative or judicial delays"). Here, in contrast, the licenses at issue are among the most valuable available, and the administrative burden of requiring payment from a few awardees is minimal.

repeatedly been pointed out.[8] Nor do they quantify the extent to which they relied on the program. APC does assert that it spent $20 million in its innovation, see Remand Comments at 2 n.1, but that does not answer the question. The reliance for which APC should be compensated (to preserve "government credibility") is measured by how much it invested because of the program (the additional costs it incurred over those that would have existed absent the program), and that will afford it no benefit as a result of the program's alteration. Milgrom Aff. at ¶ 14; Nalebuff Decl. at ¶¶ 11, 17; see Mtel Order (statement of Commissioner Ness) (award should be proportionate to "public benefits resulting from efforts undertaken in response to . . . the pioneer's preference program"). Yet APC offers no indication whatsoever of the extent of its reliance; we are left to guess how much of that $20 million APC would have spent even if the program had never existed, or how much of that $20 million would be "lost" if the program were altered. Milgrom Aff. at ¶ 14; Nalebuff Decl. at ¶ 11.[9]

Second, even if one accepts APC's $20 million dollar figure as the extent of its reliance, giving APC a free license would unjustly enrich it by giving it a wholly disproportionate reward. The

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[8]See, e.g., Pacific Bell's Motion for Expedited Consideration and for a Briefing Schedule, at 13 (May 6, 1994) and Brief for Petitioners and Intervenors in Support Thereof, at 21-22 (June 17, 1994), in Pacific Bell v. FCC, No. 94-1148 (D.C. Cir.).

[9]In fact, the amount of investment is entirely irrelevant. All of the preference applicants invested large amounts of money in their innovations, and many of them invested far more than APC. If they will be required to pay full market value at auction -- and they will -- there is no reason the preference recipients should not as well.

licenses APC and the pioneers seek are not worth tens of millions; each of them is worth several hundred million or billions of dollars. Hausman Aff. at ¶ 18; Nalebuff Decl. at ¶ 6. What APC proposes then is not that it recapture its otherwise lost investment plus a reasonable return, but that it be given an award worth more than twenty times its total investment. One does not have to be an economist to recognize the disproportion, although economists are quick to recognize it as well. See Milgrom Aff. at ¶ 15; Hausman Aff. at ¶ 18; Nalebuff Decl. at ¶¶ 6, 12; accord, Mtel Order (Separate Statement of Commissioner Ness) ("[C]omplete exemption from a payment obligation could result in a pioneer being unjustly enriched by Commission action bestowing valuable rights which may be arbitrarily disproportionate to any public benefits resulting from efforts undertaken in response to . . . the pioneer's preference program"). Under the Commission's precedent and Congress' express command, unjust enrichment is to be avoided where possible. If giving away nearly a billion dollars' worth of privileges on account of a $20 million investment is not unjust enrichment, then it is hard to imagine what is.

Giving pioneers their licenses for free offends another statutory mandate -- the requirement that the Commission attempt to recover a portion of the spectrum's value for the public. If the pioneer's receive their licenses for free, they eventually will be able to sell their licenses for hundreds of millions or billions of dollars. While such a private auction will move the license to its most efficient user, it would result in the pioneers recovering the

full value of the license and the United States Treasury recovering none of it. Under the clear language of Section 309(j)(3), the Commission must prefer recovering part of the value of spectrum for the public to lavishing it upon (and thereby unjustly enriching) a select few. See Mtel Order (concurring Statement of Commissioner Quello) (giving pioneer a license for free "is inconsistent with the basic reason for having auctions, which is to capture the value of spectrum for the public).[10]

D. Preference Recipients Would be More than Adequately Compensated by the Guarantee of a License without a Discount or a Bidding Credit of Less than 10 Percent

Given that preference recipients should not receive their licenses for free, the issues are how much they should pay and how

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[10]APC's bald assertion that Section 309(j) prohibits the Commission from taking auction revenues into account, APC Argument Request at 7, finds no support in the statute. Although APC offers no citations, presumably APC relies on Section 309(j)(7)(A). That provision, however, only bars consideration of revenues in two situations: (1) when the Commission is "making a decision pursuant to Section 303(c) . . . to assign a band of frequencies to a use for which licenses or permits" may be sold at auction, and (2) when the Commission is "prescribing regulations" under 309(j)(4)(C) dealing with "area designations" and "bandwidth assignments" for each proposed service. 47 U.S.C. §§ 309(j)(7)(A), (j)(4)(C) (emphasis added). Since the question here is not whether the frequency will be used for PCS, or the scope and size of licenses for PCS as a class, Section 309(j)(7)(A) is inapplicable.

Moreover, construing Section 309(j)(7)(A) to bar any consideration of revenues would make the statute internally inconsistent. First, 47 U.S.C. § 309(j)(3)(C) requires the Commission to consider "recovery for the public of a portion of the value of the public spectrum" when establishing the eligibility criteria for and the characteristics of licenses that, as a class, are designated for auction. The only way the Commission can "recover" the value of the spectrum, of course, is in the form of auction revenue. Second, 47 U.S.C. § 309(j)(7)(B) instructs the Commission not to rely "solely or predominantly on the expectation of Federal revenues" when making certain decisions (emphasis added); if the Commission were barred from considering revenues altogether, Section 309(j)(7)(B) would be superfluous.

the payment should be collected.

1. As the Commission is undoubtedly aware, there are at least two ways it can require payment. First, the Commission can require the preference recipients to participate in the auction but give them a discount toward an MTA or any license within the MTA; the discount would compensate the preference awardees for any research and development performed in reliance on the preference program. Second, the Commission can do what it did with Mtel -- withhold the license from the auction but condition its award on payment of a sum approaching auction price.

From the perspective of maximizing competition in broadband PCS and avoiding unjust enrichment, the former approach is preferable. Keeping the preference awardee's license out of the auction inflates the price of the remaining licenses, distorting the bidding process. Hausman Aff. at ¶ 9. In addition, withholding the license from the auction prevents true simultaneous multiple round bidding; if the preference winner ultimately elects not to accept the license, the license will have to be the subject of a separate and later auction, substantially impairing efficient license allocation and therefore competition. See Milgrom Aff. at ¶ 17; Hausman Aff. at ¶ 24; Nalebuff Decl. at ¶ 25-26.

Of course, in the Mtel Order, the Commission chose to set the license aside rather than offer a bidding credit. The narrowband licenses, however, were all national in scope. The broadband licenses, in contrast, encompass regions or localities. Because adjacent regions are often more valuable when acquired together, the

value of broadband licenses are more interdependent than the value of narrowband licenses. As a result, simultaneous bidding has heightened importance in the broadband context. See Nalebuff Decl. at ¶ 21 n.2. Consequently, the Commission's decision to set aside the award for the narrowband pioneer does not preclude using a bidding credit for broadband pioneers; the differing cost of a set-aside may well justify a different approach.[11] In any event, requiring payment by some means will serve competition far better than giving away licenses for free, regardless of the payment mechanism employed. Hausman Aff. at ¶ 24.

2. Understandably eager to maximize the value of its award, APC urges the Commission to offer it a substantially greater discount than that the Commission gave Mtel. See APC Oral Argument Request at 9-13. APC, however, offers no economic analysis to support this request, and with reason -- it is clear that even giving the broadband preference winners the <u>same</u> deal as was given to Mtel would still overcompensate them, and by a very substantial margin.

(a) APC contends that affording it only a 10 percent discount would be insufficient to account for the equities because "APC's costs would consume, and exceed, the 10 percent 'balance.'" APC

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[11]In addition, the effect of a set aside on license prices will be more pronounced for broadband than it was for narrowband. The license awarded to Mtel was by no means unique; it was just one of many, substantially interchangeable license. As a result, eliminating Mtel's license from the auction should not have had an appreciable effect on the price of the remaining licenses. In broadband, however, there are only 2 30 MHz MTAs for each region; removing one of those from the auction could have a great impact on the price of the license that remains.

Argument Request at 13. APC is clearly wrong. For starters, the 10 percent discount would far exceed the amount necessary to protect the pioneers' reliance interests. The licenses currently reserved for the pioneer's are probably worth at least $750 million each. See Milgrom Aff. at ¶ 15; Nalebuff Decl. at ¶ 14; Hausman Aff. at ¶ 8. Again, 10 percent of that is $75 million, a very handsome return for an initial investment of $20 million. Milgrom Aff. at ¶ 15 ("Much larger awards are economically unjustified"); Nalebuff Decl. at ¶ 18. Beyond this, APC fails to account for the value of receiving the guarantee of a license (and the guarantee is all the preference program was supposed to deliver). Such a guarantee is quite valuable indeed, for it gives the holder a great advantage in bidding on complementary, geographically adjacent licenses at auction. Nalebuff Decl. at ¶¶ 27-28; Hausman Aff. at ¶ 25. In addition, the guarantee has value after auction since it functions like a (non-transferrable) options contract. If the pioneer decides (based on post-auction evidence) that bids were too high, it can refuse to pay for the license and give it up; if it decides that bids were reasonable, it can choose to pay up and acquire the license. Hausman Aff. at ¶ 25; Nalebuff Decl. at ¶ 27. Because this guarantee alone is worth as much as 5 percent of the license's value -- or about $37.5 million -- it alone is more than sufficient to compensate the pioneers for the portion of their investments that were made in reliance on the program. Nalebuff Decl. at ¶ 27.

(b) Next, APC asks the Commission not to calculate the price of its license based on what a comparable license yields at auction;