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

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**REPLY COMMENTS ON REMAND OF
AMERICAN PERSONAL COMMUNICATIONS**

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SUMMARY

I. American Personal Communications ("APC") filed its Supplemental Comments on Remand to demonstrate that the "competitive advantage" arguments advanced by Pacific Bell and Bell Atlantic, and adopted by the Commission as the basis for its Mtel Order, rest on a simple economic blunder known as the "sunk cost" fallacy. In their Joint Response, Pacific Bell and Bell Atlantic have wholly abandoned those arguments. Not one of their economists asserts that other PCS licensees will be at a competitive disadvantage if the pioneers are not charged for their licenses, or that awarding pioneers' licenses without charge will reduce the amounts bid for other PCS licenses. Instead, in what can only be viewed as an act of desperation, Pacific Bell and Bell Atlantic have now put forward different economic arguments that blatantly contradict their prior arguments. They now argue that, far from having a competitive advantage, the pioneers are likely to be rather ineffective competitors. And they now argue that pioneer awards will increase the amounts bid for PCS licenses. The Joint Response of Pacific Bell and Bell Atlantic is a stunning admission that the arguments they pressed on the Commission, and that the Commission adopted as the basis for its decision in Mtel, are simply untenable.

II. The Commission, having been led into serious error by Pacific Bell and Bell Atlantic, must surely view their new arguments with skepticism. And properly so, for the attached reply affidavit of Professor Gould and Dr. Bamberger

demonstrates that their new arguments also rest on fundamental economic errors.

A. The argument that pioneers should participate in the auction, or at least make a substantial payment, to prove that they will be efficient competitors ignores the central fact in these proceedings: the pioneers have already competed in, and won, the race to develop new, innovative uses of the spectrum. Moreover, auctions are neither necessary nor sufficient to ensure that PCS licensees are the most efficient competitors. They are not sufficient because, as Pacific Bell's own economist has explained, the successful bidders at auction may not turn out to be the most efficient competitors. And they are not necessary because, as Pacific Bell's economists also concede, efficiency concerns would be entirely answered by removing restrictions on resale of PCS licenses.

B. Professors Nalebuff and Milgrom assert that the pioneer's preference awards constitute "undue enrichment" and are "economically unjustified" by comparing the amounts the successful pioneers spent on their licenses with their own estimates of the value of those licenses. But it is a fundamental economic principle that the appropriate return to consider when making an investment decision is the "ex ante" return, i.e., the expected return at the time of the investment. Professors Nalebuff and Milgrom violate this fundamental principle not once, but twice. First, they consider only the cost of successful pioneering investments,

when the economically relevant figure is the value of all pioneering investments, successful and unsuccessful. Second, Professors Nalebuff and Milgrom err by comparing the value of the pioneers' investments with their own (inflated) estimates of the current value of the PCS licenses. The relevant comparison is between the amount invested in pioneering and the estimated value of the licenses at the time the investments were made. When the economically relevant comparison is made, there is no basis for asserting that the pioneer's preference awards are unduly large.

III. Pacific Bell and Bell Atlantic are wrong in contending that Section 309(j) confers on the Commission authority to charge for licenses that are not subject to mutually exclusive applications and thus not subject to competitive bidding. The Commission previously eschewed any reliance on § 309(j) in its Mtel Order, and it was right to do so. Though Pacific Bell and Bell Atlantic argue that Sections 309(j)(3) and (j)(4) apply to licenses not issued by competitive bidding, those sections plainly concern the Commission's authority to regulate the competitive bidding process; they have no application to licenses -- such as renewal licenses and licenses not subject to mutually exclusive applications -- that cannot be issued through competitive bidding.

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TO COMMISSIONERS QUELLO, BARRETT AND NESS:

REPLY COMMENTS ON REMAND OF AMERICAN PERSONAL COMMUNICATIONS

In it Supplemental Comments on Remand (filed July 26, 1994), American Personal Communications ("APC") demonstrated the invalidity of the "competitive advantage" arguments advanced by Pacific Bell and Bell Atlantic and adopted by the Commission as the basis for its Mtel Order in the Narrowband Proceedings[1/] and its Emergency Motion for Remand in the Broadband Proceedings. Pacific Bell and Bell Atlantic have filed a Joint Response that wholly abandons those arguments, in effect conceding that their prior arguments -- and the Commission's rationale for its Mtel Order -- cannot be defended successfully. In what can only be described as an act of desperation, Pacific Bell and Bell Atlantic now put forward different economic arguments that

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[1/] In re Nationwide Wireless Network Corp., No. 22888-CD-P/L-94 (July 13, 1994) ("Mtel").

blatantly contradict their prior arguments. They now argue that, far from having an insurmountable competitive advantage, the pioneers are likely to be ineffective competitors in the new PCS marketplace. And they now argue that the pioneer awards will increase the amounts bid for the remaining PCS licenses -- precisely the opposite of their prior position. The Commission, having been led into serious error by Pacific Bell and Bell Atlantic, must surely view their new arguments with skepticism. As the attached reply affidavit of Professor Gould and Dr. Bamberger demonstrates, these arguments also rest on fundamental economic errors and are thus invalid.

Pacific Bell and Bell Atlantic also address the Commission's statutory authority to require the pioneers to pay for licenses, and urge the Commission to rely on Section 309(j) as well as Section 4(i). But the Commission was correct not to rely on Section 309(j) in its Mtel Order. The arguments of Pacific Bell and Bell Atlantic to the contrary are plainly wrong.

I. PACIFIC BELL AND BELL ATLANTIC HAVE ABANDONED THE "COMPETITIVE ADVANTAGE" ARGUMENTS THAT ARE THE BASIS FOR THE COMMISSION'S MTEL ORDER

APC filed its Supplemental Comments on Remand to address an economic argument advanced by Pacific Bell and Bell Atlantic and adopted by the Commission in its Mtel Order. Pacific Bell and Bell Atlantic had argued that "[f]ailure to require some payment [by the successful pioneers] would

undercut competition," because "[t]hose who purchased licenses at auction -- who must recover millions of dollars in capital costs -- would find it difficult to compete with preference recipients who received licenses for free." Brief for Petitioners at 18-19, in Pacific Bell v. FCC, No. 94-1148 (D.C. Cir.). See also id. at 13 ("[g]iving PCS preference awardees their licenses for free even though all other PCS licensees must buy theirs at auction undercuts competition by giving one group of competitors an unfair cost advantage.") Pacific Bell and Bell Atlantic had also argued that "[s]o long as the preference awards remain in effect, auction participants will discount their bids to account for the prospect of having to compete with a licensee that paid nothing for its license." Pacific Bell Motion for Expedited Consideration at 9, in Pacific Bell v. FCC, No. 94-1148 (D.C. Cir.); see also id. at 7 ("[a] license is worth substantially less when the purchaser will have to compete with an entity that, because it receives an equivalent license gratis, does not have to recover the multi-million dollar purchase cost").

The Commission adopted those arguments in its Mtel Order. In Mtel, the Commission concluded that "the award of a free license to Mtel would create an unfair competitive advantage for Mtel at the expense of licensees who may pay significant sums for their licenses." Mtel, ¶ 15. The Commission reasoned that

> a pioneer's preference recipient who receives a free license would likely enter the competitive market with significantly lower capital investment than the other licensees who bid and pay for their licenses. The difference would likely provide the pioneer's preference recipient with a substantial competitive advantage over its rivals.

Id. ¶ 19. The Commission further concluded that bidders for PCS licenses "may be discouraged from bidding 'top dollar' or from bidding at all because of their concerns over entering a new competitive market saddled with significantly greater capital costs that could place them at a competitive disadvantage." Id.

The affidavit of Professor Gould and Dr. Bamberger submitted with APC's Supplemental Comments demonstrated that the reasoning of Pacific Bell and Bell Atlantic, adopted by the Commission, rests on an elementary economic blunder known as the "sunk cost fallacy." It is a fundamental economic concept that a firm's fixed costs do not affect its pricing and marketing decisions. The amount that competitors pay for PCS licensees is a fixed cost -- i.e., a one-time payment that is not changed by the licensee's subsequent business activities. Consequently, charging a pioneer for its license, rather than awarding it a license without charge, will have no effect on its business activities, and thus no impact on competition in the PCS industry. Furthermore, because pioneers' business behavior will not be affected by the amount

they pay for their licenses, that factor will have no effect on the amounts bid for licenses at auction.

APC's Supplemental Comments thus undermined the arguments of Pacific Bell and Bell Atlantic and the rationale for the Commission's Mtel Order. In their Response, Pacific Bell and Bell Atlantic have now abandoned those arguments. Not one of their economists argues that competitors who purchase their licenses at auction will be at a competitive disadvantage to pioneers who are not required to pay for their licenses, or that awarding pioneer licenses without charge will decrease the amounts bid for other licenses.

Instead, without even acknowledging their earlier position, Pacific Bell and Bell Atlantic have now adopted precisely the opposite position. Pacific Bell and Bell Atlantic now argue that successful bidders may have a competitive advantage over the pioneers, because the pioneers may turn out to be "less efficient (and less effective)" competitors. Joint Response 6. And Pacific Bell and Bell Atlantic now contend that the effect of awarding licenses to the pioneers (with or without requiring a payment) will be to inflate the amounts bid for other licenses. Joint Response 16.

In short, the Joint Response of Pacific Bell and Bell Atlantic is a stunning admission that the arguments they pressed upon the Commission, and that the Commission adopted as the basis for its decision in Mtel, are simply untenable.

II. THE NEW ECONOMIC ARGUMENTS ADVANCED BY PACIFIC BELL AND BELL ATLANTIC ARE INVALID

In their Response, Pacific Bell and Bell Atlantic advance new economic arguments that contradict their prior arguments. They now contend that, unless the pioneers are required to pay for their licenses, they may turn out to be "inefficient" competitors who will use "obsolescent" technology. Joint Response 10; Hausman Aff. ¶ 15. They also contend that awarding pioneers 30 Mhz MTA licenses without charge would constitute "undue enrichment." Nalebuff Aff. ¶ 15. As Professor Gould and Dr. Bamberger demonstrate in the attached reply affidavit, these arguments also rest on fundamental economic errors, and thus are just as invalid as the prior, discredited economic arguments of Pacific Bell and Bell Atlantic.

A. The "Efficiency" Argument is Invalid

Pacific Bell and Bell Atlantic now contend that the pioneers should be required to participate in the auction like everyone else, or at least make a substantial payment for their licenses, in order to demonstrate that they will be efficient competitors. Passing the implausibility of Pacific Bell's and Bell Atlantic's complaint that they may be forced to compete against a "less effective" PCS licensee, Joint Response 6, their "efficiency" argument simply ignores the central fact in these proceedings: the pioneers have already competed in and won the race to develop new, innovative uses

of the electromagnetic spectrum. In effect, the losers of the race -- Pacific Bell and Bell Atlantic -- are saying that the winners may not be able to use the prizes as efficiently as the losers, and therefore the prizes should be auctioned off rather than awarded as promised.

Of course, APC believes that it will be a highly efficient and effective competitor in the emerging PCS industry, and that its innovations are far from obsolete. Pacific Bell and Bell Atlantic do not deny that the pioneers may be efficient competitors, but assert that requiring them to participate in the auction, or to make a substantial payment, will demonstrate that they are efficient competitors. As Professor Gould and Dr. Bamberger demonstrate (¶¶ 14-20), however, auctions are neither necessary nor sufficient to ensure that licenses will find their way into the hands of the most efficient competitors. Indeed, Pacific Bell's own economist, Professor Milgrom, explained in a prior affidavit that successful bidders may make errors in their bidding decisions, and thus may not be the most efficient competitors.[2/] In addition, a successful bidder may rapidly become an inefficient competitor due to changed conditions. Consequently, efficiency is achieved not by allocating licenses through an auction, but by allowing licenses (however

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[2/] Affidavit of Paul R. Milgrom and Robert B. Wilson, ¶ 71, attached to Comments of Pacific Bell and Nevada Bell, PP Dkt No. 93-253 (filed Nov. 10, 1993).

they are initially allocated) to be resold. As Pacific Bell's economist concedes, the efficiency concerns that he and his colleagues raise would be entirely answered by removing the (already modest) restrictions on resale of licenses by pioneers. Hausman Aff. at 6-7 n.4. And even if the pioneers were required to make a substantial payment for their licenses, they would still be subject to whatever inefficiencies may be created by the restrictions on transfer of pioneer's licenses. Consequently, to the extent the Commission is troubled by the efficiency concerns raised by Pacific Bell and Bell Atlantic, the proper response to those concerns is to consider eliminating the transfer restrictions on pioneer licenses.

B. <u>The "Undue Enrichment" Argument is Invalid</u>

Although Professors Nalebuff and Milgrom assert that the pioneer's preference awards constitute "undue enrichment," Nalebuff Aff. ¶ 5, and are "economically unjustified," Milgrom Aff. ¶ 15, they fail to define the meaning of those terms, an unpardonable sin for economists who claim to be offering objective analysis rather than subjective opinion. Professors Nalebuff and Milgrom base their assertion solely on a comparison of the amounts the pioneers spent to obtain PCS licenses with their own estimates of the value of the licenses. As Professor Gould and Dr. Bamberger note (¶¶ 21-27), this analysis rests on yet another fundamental economic error.

It is a basic economic principle that the appropriate return to consider when making an investment decision is the expected return at the time of investment (the ex ante return). Professors Nalebuff and Milgrom make a fundamental error by considering the value of the return after the investment has been made (the ex post return). They make that basic error not once, but twice.

First, Professors Nalebuff and Milgrom consider only the cost of successful pioneering investments by APC, Cox, and Omnipoint. The economically relevant comparison is to the cost of all pioneering investments, including the investments of the 93 unsuccessful applicants. As Pacific Bell and Bell Atlantic argue, "[a]ll of the preference applicants invested large amounts of money in their innovations, and many of them invested far more than APC." Joint Response 13 n.9. The Nalebuff/Milgrom analysis is equivalent to arguing that a firm faced with deciding whether to invest in drilling for oil should consider only the cost of drilling wells that produce oil and ignore the cost of drilling "dry holes." That is plainly fallacious.

Second, Professors Nalebuff and Milgrom err by comparing the cost of the pioneers' investments to current valuations of the licenses rather than the expected value of the licenses at the time the 96 firms made their pioneering investments. Professor Nalebuff's estimate of the current value of the broadband PCS licenses is based on a simplistic

extrapolation from winning bids in the narrowband auction. He makes no effort to justify this simplistic analysis, and virtually all informed observers in industry and government agree that his estimate of $5.15 billion is much too high. But even accepting his simplistic approach for the sake of argument, the current estimated value of the licenses exceeds the economically relevant ex ante valuation by a factor of 10 (because the narrowband auction raised ten times more money than expected). The relevant valuation is thus not $5 billion, but $500 million -- or roughly the amount that APC has estimated the 96 preference applicants invested in pioneering activities.[3/] Consequently, there is no economic basis for the assertions of Professors Milgrom and Nalebuff that the size of the pioneer awards is "economically unjustified."

III. PACIFIC BELL'S AND BELL ATLANTIC'S INTERPRETATION OF § 309 IS CLEARLY WRONG

Pacific Bell and Bell Atlantic contend that Section 309(j) confers on the Commission authority to charge for licenses that are not subject to mutually exclusive applications and thus not subject to competitive bidding.[4/]

[3/] APC's Request for Separate and Expedited Treatment of "Existing Pioneer Preference Issues, ET Docket No. 93-266 (filed Oct. 23, 1993), at 3.

[4/] Pacific Bell and Bell Atlantic offer a tepid endorsement of the Commission's position, set forth in its Mtel Order, (continued...)

That argument is inconsistent with the text, structure, and legislative history of Section 309(j); it has also already been rejected by the Commission, which correctly concluded in its Mtel order that "Section 309(j) . . . applies only when the Commission has accepted 'mutually exclusive applications' for licenses or construction permits." Mtel, ¶ 24 (emphasis added).

Section 309(j) confers on the Commission authority "to grant [a] license or permit . . . through a system of competitive bidding," 47 U.S.C. § 309(j)(1), if three conditions are met: "First, there must be mutually exclusive applications that have been accepted for filing by the Commission; second, these applications must be for an initial license or construction permit; third, the license must be for a use described in Section 309(j)(2)." Notice of Proposed Rulemaking, Implementation of Section 309(j) of the Communications Act - Competitive Bidding, 8 FCC Rcd 7635, 7636 ¶ 11 (1993); see also Second Report and Order, Implementation of Section 309(j) of the Communications Act - Competitive Bidding, 9 FCC Rcd 2348, 2350-51 ¶ 12 (1994) (§ 309(j) authority is applies only where "mutually exclusive

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[4/] (...continued)
that § 4(i) provides authority to charge pioneers for the licenses. APC fully agrees with the analysis of Cox Enterprises demonstrating that § 4(i) cannot be stretched to this extent. See Comments of Cox Enterprises, Inc. on American Personal Communications' Emergency Request for Oral Argument 15-25 (July 29, 1994).

applications" for "initial" licenses). Thus, even if a license meets the third condition (it involves a use of the spectrum described in § 309(j)(2)), it cannot be issued by competitive bidding if it is not subject to mutually exclusive applications (such as a pioneer's license) or is not an initial license or construction permit (e.g., a renewal license). Pacific Bell and Bell Atlantic do not really take issue with this; indeed they expressly concede that "Section 309(j) does not permit a license to be sold at auction unless there are mutually exclusive applications." Joint Response 2 (emphasis in original).

Nevertheless, Pacific Bell and Bell Atlantic argue that the Commission gains authority to charge for licenses that are not subject to competitive bidding (e.g., those not subject to mutually exclusive applications and renewal licenses) from, of all places, Sections 309(j)(3) and (j)(4). That argument is bizarre, as even a cursory reading of Section 309(j) shows. Section 309(j)(3) authorizes the Commission to issue regulations governing the design of "competitive bidding methodolog[ies]," and Section 309(j)(4) specifies certain rules the Commission is to follow in "prescribing regulations pursuant to [§ 309(j)(3)]." The obvious, and correct, interpretation of Sections 309(j)(3) and (j)(4) is that these provisions are entirely subordinate to the Commission's authority under § 309(j)(1) and thus have no application to licenses -- such as renewal licenses and licenses not subject

to mutually exclusive applications -- that cannot be issued through competitive bidding.

The indications from the structure of § 309(j) are confirmed by the very language of § 309(j)(3) on which Pacific Bell and Bell Atlantic rely. They argue:

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

Joint Response 2-3 (emphasis in original). In highlighting the word "classes," Pacific Bell and Bell Atlantic ignore the words that follow -- "of licenses and permits to be issued by competitive bidding." Under § 309(j)(1), licenses not subject to mutually exclusive applications and renewal licenses cannot be "issued by competitive bidding" and therefore are not, and cannot be, part of the "classes of licenses" referred to in § 309(j)(3).[5/]

[5/] Contrary to Pacific Bell and Bell Atlantic's assertions, the Commission has not "designated" all PCS licenses to be part of a class of licenses to be issued by competitive bidding. Rather the Commission determined that PCS service satisfies the "principle use" of spectrum criteria set forth in § 309(j)(2), see 8 FCC Rcd at 7654, ¶ 116; 9 FCC Rcd at 2358, ¶ 58, but that determination is only one of three conditions that must be satisfied before a license may be issued by competitive bidding. See 8 FCC Rcd at 7636, ¶ 11.

Though resort to the legislative history is unnecessary because the text and structure of § 309(j) are unambiguous, it also provides no support for Pacific Bell and Bell Atlantic's cause. Nowhere in legislative history did the Congress suggest that § 309(j)(3) or (j)(4) had any application to licenses that were not subject to competitive bidding. Indeed, the reports that discuss § 309(j)(3) and (j)(4) confirm that the purpose of those sections was to provide guidance to the Commission in structuring the bidding process for the licenses that would be auctioned. See H.R. Rep. No. 111, 103d Cong., 1st Sess. 254-56 (1993); H.R. Conf. Rep. No. 213, 103d Cong., 1st Sess. 482-84 (1993).[6]

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[6] Pacific Bell and Bell Atlantic also distort beyond recognition § 309(j)(3)(B) in claiming that section is a simple command for Commission to "promot[e] . . . competition." Joint Response 3. Section 309(j)(3)(B) actually directs the Commission to consider the objective of:

> promoting economic opportunity and competition and ensuring that new and innovative technologies are readily accessible to the American public by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women.

Thus, § 309(j)(3)(B) provides no support for the premise underlying Pacific Bell and Bell Atlantic's position -- that "[t]he best way to ensure competition is to . . . sell all of the licenses at auction," Joint Response 8, and that "the new FCC policy should be to 'let the market decide.'" Hausman Aff. ¶ 11. To the contrary, that section reflects a certain distrust of unbridled market allocation of licenses; it directs the Commission to promote competition "by" two

(continued...)

Finally, if the Pacific Bell and Bell Atlantic were correct in arguing that all licenses for a particular service should be considered part of a class of licenses "to be issued by competitive bidding" merely because the service satisfies the § 309(j)(2) criteria, and that the Commission can somehow require payment for such licenses under § 309(j)(3), then not only could the Commission charge for licenses that are not subject to mutually exclusive application, it could also charge for renewal licenses. In other words, the Commission could charge for cellular renewal licenses, as the Commission has held that cellular licenses are subject to competitive bidding. See 9 FCC Rcd at 2358-59, ¶¶ 60-61. That should be a sobering thought for Bell Atlantic, which received and still holds an enormously valuable free set-aside of cellular licenses. There could be no reason for the Commission to "play Santa Claus" with extremely valuable cellular renewal licenses. Of course, the short answer is that § 309(j)(3) has no application to renewal licenses, just as it has no application to licenses not subject to mutually exclusive

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[6] (...continued)
methods: "avoiding excessive concentration of licenses," and "disseminating licenses among a wide variety of applicants."

applications, nor to any other licenses that cannot "be issued by competitive bidding."[7/]

Respectfully submitted,

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7/ If renewal licenses were subject to payments under § 309(j)(3), parties would be willing to bid far less for initial licenses. Adopting the argument of Pacific Bell and Bell Atlantic thus would radically reduce the revenues from the impending auctions.

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JOINT REPLY AFFIDAVIT OF JOHN P. GOULD AND GUSTAVO E. BAMBERGER

STATE OF ILLINOIS	)	
	:	ss:
COUNTY OF COOK	)	

I. INTRODUCTION

1. We have been asked by counsel for American Personal Communications ("APC") to review the Joint Response of Pacific Bell and Bell Atlantic Personal Communications to American Personal Communications' Post-Remand Filings ("Joint Response"), including the attached affidavits of Professors Paul R. Milgrom, Jerry A. Hausman, and Barry J. Nalebuff. Our qualifications are described in our joint affidavit which was submitted as an attachment to APC's Supplemental Comments on Remand.

2. Nothing in the comments of Professors Milgrom, Hausman, and Nalebuff has changed the views that we expressed in our prior affidavit. In our prior testimony, we addressed the economic issue that was raised by Pacific Bell and Bell Atlantic Personal Communications ("Pac Bell and Bell Atlantic") in their previous filing. We conclude that our original analysis is

correct -- awarding APC and the other pioneer preference recipients broadband Personal Communications Services ("PCS") licenses at no charge instead of charging them a substantial fee will have no effect on competition in the PCS industry.

3. The three professors' criticisms of our analysis are based on a mischaracterization of our prior testimony. Instead of responding to our analysis, they raise new questions and claim that our analysis answered these new questions incorrectly. In effect, they criticize us for answering the question that Pac Bell and Bell Atlantic raised in their prior pleadings rather than the different question they have chosen to address in their affidavits.

4. Pac Bell and Bell Atlantic appear to have abandoned completely their original argument on the "competitive effect" of awarding pioneer preference licenses at no charge and have now adopted a diametrically opposed position. They first argued that awarding the licenses at no charge would harm competition by giving the awardees an "unfair cost advantage." They now argue that giving the awardees licenses at no charge would harm competition because, they claim, the awardees likely would be forced to use inefficient technology -- that is, the awardees would be at a cost disadvantage to their rivals.

5. Our previous testimony examined only one economic issue -- whether charging the pioneers for their licenses rather than awarding the licenses at no charge would have an adverse effect on competition. In their replies to our affidavit, Pac Bell's and Bell Atlantic's experts raise two additional issues. First, they claim that awarding APC and the other pioneer preference recipients licenses likely will result in economic inefficiencies. Their analysis of this issue contains a fundamental economic error. Furthermore, Pac Bell's and Bell Atlantic's experts concede that their proposed remedies need not result in the efficient allocation of PCS licenses. As we explain later in this affidavit, if the sole goal of the Federal Communications Commission ("Commission") were to maximize economic efficiency (and we

understand that it is not), it could attain this goal by removing the resale restrictions placed on the pioneer recipients.

6. Second, Pac Bell's and Bell Atlantic's experts claim that awarding the licenses at no charge constitutes "undue enrichment" and is "economically unjustified." The terms "undue enrichment" and "economically unjustified" are never defined by Pac Bell's and Bell Atlantic's experts, but the professors' conclusions appear to be based on a comparison of the value of the three licenses and the pioneer recipients' initial investments. Their analysis of this issue also contains a fundamental economic error.

7. The remainder of our affidavit is organized as follows: Section II reviews our prior testimony on "competitive impact" and shows why the criticisms of Pac Bell's and Bell Atlantic's experts do not apply to our analysis. Section II also describes how Pac Bell and Bell Atlantic have abandoned their previous position on the competitive impact of awarding pioneer licenses at no charge. Section III explains the fundamental economic error contained in Pac Bell's and Bell Atlantic's experts' discussion of economic efficiency. Section III also explains how the Commission could achieve an efficient allocation of PCS licenses. Section IV discusses the fundamental economic error contained in the analyses of "undue enrichment."

II. AWARDING APC AND THE OTHER PIONEERS A LICENSE AT NO CHARGE INSTEAD OF FOR A SUBSTANTIAL FEE WILL HAVE NO IMPACT ON COMPETITION

8. Professors Milgrom, Hausman, and Nalebuff have elected not to address the issue we analyzed in our prior testimony, but instead analyze a <u>different</u> question altogether. Thus, their criticisms of our testimony are misplaced. We address the new questions that they have raised in sections III and IV of this submission. We note here that the question we addressed in our earlier affidavit is important because our analysis of it is directly responsive to

the (incorrect) claims of Pac Bell and Bell Atlantic that if APC obtains a broadband PCS license, its competitive behavior will depend on whether it pays for the license or receives it at no charge. We show in our earlier affidavit that APC's competitive behavior will not be changed and nothing we have read in Pac Bell's and Bell Atlantic's new submission leads to us change our conclusion on this key point.

9. The issue we addressed in our prior testimony is the issue considered by the Commission in its Mtel order (i.e., whether a pioneer recipient should receive its PCS license at no charge or conditioned on the payment of a fee).[1] That is, we assume that APC and the other pioneer recipients will receive and use broadband PCS licenses. Pac Bell's and Bell Atlantic's experts' analysis is based on a <u>different</u> assumption. They take as given that APC may not receive a PCS license and that it could be replaced by a supposedly more efficient firm. For example, Professor Milgrom argues that in certain situations "competition and efficiency would both be significantly enhanced if the license were instead placed in the hands of" a losing bidder at the broadband PCS auctions. Milgrom Aff., para. 8.

10. Although Professor Hausman's analysis is based on the assumption that the pioneers may not receive PCS licenses, he, in effect, concedes that our analysis is correct. He states that "[f]irms have not yet make [sic] their decisions of whether to enter the PCS industry in a particular geographic location. If they do decide to enter and win a license and build a network, at that point their costs would be sunk. However, that entry decision has not yet been made." Hausman Aff., para. 6. But as we made clear in our prior testimony, we understand that APC plans to enter the PCS business even if it is charged for its pioneer license. Thus, APC has decided to enter in a particular geographic location (the Washington, D.C./Baltimore MTA). Its cost of acquiring a license therefore is sunk. Thus, whether APC is

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1. Memorandum Opinion and Order, Application of Nationwide Wireless Network Corp., FCC No. 94-187, File No. 22888-CD-P/L-94.