

Amnesty Re-Auction is Superior to Revoke Re-Auction in Meeting Commission Goals

Commission Goals

Integrity of Commission (Rules Are The Rules)

- Licenses reclaimed
- Downpayment retained
- Penalties imposed

Fairness

- Dropouts
- Other licensees

Speed to Market

- Control over licenses
- Time to recover licenses

Acceptable Proceeds

- Auction competition
- License prices

Amnesty Re-Auction

Voluntary Return
"Store Credit"
Deferred & Collectible

Revoke Re-Auction

Bankruptcy
Forfeit
Not Collectible

← Participate in Both Cases Indirectly Revalued →

FCC
Voluntary & Immediate

Courts/FCC ?
Delay/Piecemeal Recovery

Most \$ and Participants
Highest Prices

Fewest \$ and Participants
Lowest Prices

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ACCEL PARTNERS

PRINCETON SAN FRANCISCO

August 6, 1997

Commissioner Susan Ness
Federal Communication Commission
1919 M Street, N.W.
Room 832
Washington, DC 20554

Dear Commissioner Ness:

I appreciated the opportunity to meet with you and David Siddall in the company of Roger Linquist and Jay Birnbaum. Several points which were raised in our meeting I wanted to address more clearly to you in writing as follows:

"The integrity of the auction rules must be maintained." "Fair is Fair." The FCC is a policy development and implementation institution. Unlike Christies, the FCC's auction rules are just a technique to achieve a policy goal. FCC rules have always been changed to implement basic policy objectives when the initial rules yielded unintended results. The FCC faced a difficult challenge following Congress's mandate to raise revenues by using auctions to allocate new frequency while at the same time fostering competition from new entrants without the resources of established carriers. The FCC's experimental delayed payment mechanism rules were a creative solution designed to allow small businesses to enter and compete despite the upfront high capital costs "purchasing" licenses entailed. Since these payment rules to date have greatly constrained any new competitors from operating in markets representing over 80% of the total population, these rules clearly need to be adjusted if the FCC's basic policy is still to introduce entrepreneurial competitors with new business models.

"Fairness for small DE's constructing and following the rules to the letter": It is important to be fair to the small DE's who have not been dependent on public financing. The ones I am aware of in this category have avoided this dependency by sticking to small markets and acting as "fill-in franchisees" to the majors on whose credit they generally rely. The uncertainties of C-Block license values have certainly damaged these DEs too. However, this uncertainty has come not from FCC inaction but from the collapse of prices in the D, E and F auctions and the prospect of years of bankruptcies and re-auctions. A single re-auction will reduce the uncertainty. If the capital of the existing DE's is removed from this re-auction (to penalize high bidding) then not only will prices be still lower but a single re-auction will not be possible because many of the existing DEs will be in bankruptcy.

"DEs must be punished in any restructuring or re-auction." Public and private investors currently view the existing DEs as already severely punished by their several years of operating losses, late market entry costs, years of work, and lost opportunity costs on the capital. However, overemphasis on rules and punishment loses sight of the reasons the rules that created the DEs were drawn-up in the first place. To implement its policy of competition, the FCC attracted entrepreneurs to buy licenses through the experimental inducement of a payment mechanism which allowed the licenses to be paid for out of the

One Palmer Square • Princeton, New Jersey 08542 • 609-683-4500 • FAX 609-683-0384
One Embarcadero Center • San Francisco, California 94111 • 415-989-5656 • FAX 415-989-5554

future cash flow of the business. (Previously, this policy was implemented by simply granting free licenses to new entrants). The DE program was tremendously successful for the FCC in winnowing the license owners to those most capable of the arduous process of raising capital by developing and defending innovative business plans designed to compete with the 4 to 6 large, well financed companies already operating in the local markets. The C-Block auction mechanism (including eligibility and bidding rules) caused the winning bids to be tightly tied to the then "comparable" market pricing of public PCS companies - most notably Omnipoint, which (although also able to qualify as a DE under the rules) had already raised substantial capital based on its Pioneer Preference license for New York City. The investment bankers advising the major new DEs all advised that this was the benchmark against which they could raise IPO equity. Unfortunately, whether by intention or not, the C-Block mechanism forced the DEs to assume the market risk of a protracted delay during which shifts in public market sentiment toward DEs and PCS could occur. Since no independent DE competitors have been able to finance in the public debt and equity markets, it seems reasonable to conclude that the architecture of the FCC's C-Block program itself had elements which have frustrated the pro competition policy objective. The failure of some market participants is essential to demonstrate a market discipline is operable. However, if the rules yield no independent DE competitors, surely the rules themselves need adjustment to achieve the policy objective. Did the FCC itself appreciate the market risk its rules and delays were causing the DEs to assume? Was this the intention of the rules or a perverse result?

"DEs should have had their financing in place before bidding." The established practice for financing wireless networks has been to rely on significant vendor financing and high yield debt on top of some equity. In the case of General Wireless this was \$300 million in supplier credit, \$220 million in high yield debt, and \$165 million in public equity on top of the \$115 million in private debt and equity raised prior to the auction. This plan did not change materially from July of 1995 when General Wireless initially engaged Bear Stearns (the leading banker in PCS financing) to February, 1997 when the company intended to update its IPO filing after license grant on January 27, 1997. The reality of wireless systems is you must invest an enormous amount of capital upfront, building out the network before you are in business. Only the public markets in the United States are a well established alternative for raising equity in the amounts needed for such a competitive business. Since the DEs could only raise IPO money after they had a certainty of a license grant (e.g. Omnipoint - NYC) then by definition no financing could be in place prior to the auction. Investment bankers advised on what they could do but all promises by the bankers had to be contingent on a public market.

Omnipoint, although technically a DE, is not representative of the FCC's DE program. During the early stages of the auction, Omnipoint raised public money based on the hugely valuable NYC license and had tied up large amounts of both vendor credit and high yield debt. This head start over the other DEs is hard to describe as fair. Today the gap is far greater as Omnipoint has licenses for about 98 million PCS pops and greatly increased financial resources. Because of Omnipoint's head start it can afford to pay higher prices in a new C-Block re-auction than other C-Block DEs, since it does not face the hurdle of the IPO process and it simply has far more cash resources. Indeed, to date Omnipoint is the major beneficiary of the whole DE mechanism.

One fact which Omnipoint's current financial success demonstrates is that the prices paid by Omnipoint in the C-Block auction have not been a major deterrent. Indeed, in the published reports on Omnipoint analysts never negatively mention the C-Block license costs (e.g. Philadelphia at \$54/pop). This goes a long way to demonstrating that investors do believe that the licensed properties will generate enough revenue and profits to service the debt of these licenses despite the price. This fact and the success of DEs in arranging vendor financing - subject to the IPO equity and high yield debt financing - strongly argues that the obstacle of the "high license price bids" related entirely to the market risk of the IPO comparables to other PCS companies (i.e. Omnipoint), and not to doubts about the businesses' ability to ultimately repay the debt out of operations. (Cook Inlet with its cash reserves and affiliation with Western Wireless is also a unique case).

“Can Entrepreneurial new companies really make a Difference to PCS/ Cellular?”: Entrepreneurs seldom take over an industry, and there is certainly not that possibility in the wireless industry. However, their effect on the overall behavior and efficiency of whole industries has been profound. This catalytic role is achieved because these businesses innovate in their business model. They identify and exploit the inefficiencies of the established player with a new specialized business model which focuses on exploiting the inefficiencies. The large companies gradually react and consumers get better services and products for less. Roger Linquist, General Wireless's CEO, caused the entire paging industry to adjust many of its business practices through his successful development of PageMart. Similarly, General Wireless has a radically different competitive business model for the cellular/ PCS market based on what Roger learned from being President of PacTel Personal Communication (Air Touch) prior to starting PageMart in 1989 with Accel Partners. Many DEs will fail and many less sophisticated ones will become “franchisees” to the larger players rather than introduce new competitive business models. However, other DEs, if allowed to start, will succeed against the established players despite their apparent overwhelming disadvantages by introducing new competitive business models which will stimulate the evolution of the industry over time.

The FCC Self Interest: Since introduction of DE competition remains a core policy objective of the FCC, the successful launching independent DEs continues to be in the FCC's self interest. The initial set of rules, of course, failed to anticipate fully all the circumstances created by their novel approach. In particular, I doubt the FCC fully recognized the amount of market risk the long license approval process would impose on the very DEs the FCC sought to encourage. However, entrepreneurs capable of raising \$1 Billion in deposits were successfully attracted to the program. This was quite an accomplishment given the competitors they face in their BTA's. Why begin again with a completely new set of entrepreneurs after these DEs have proven themselves through 4 years of competition to be especially capable and tenacious? Adding more competitors, rather than subtracting them at this time seems in the FCC's interest.

Thank you again for your consideration and hearing us out.

Sincerely,



Arthur C. Patterson
Managing Partner

ACP/jvm
Enclosures

cc: Blair Levin
David Siddall