

May 18, 2015

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12th Street, SW  
Washington, DC 20554

**Re: Notice of Ex Parte Communications, Docket Nos. WT 14-170; WT 12-269; GN 12-268; RM-11395; WT 05-211**

Dear Ms. Dortch:

On May 14, 2015, I spoke with Jim Schlichting, Jean Kiddoo, and Sue McNeil of the Wireless Telecommunications Bureau (WTB) with regard to the above captioned proceeding. We discussed the general framework submitted by AT&T and rural wireless carriers on May 11, 2015 (“AT&T DE Proposal”). Although Public Knowledge (PK) disagrees with many of the details of The AT&T DE Proposal, it provides a reasonable framework for moving forward to a workable solution for a problem that the Commission has sought to address for more than 15 years – how to fulfill the statutory mandates of Sections 309(j)(3)(B), 309(j)(4)(C) and 309(j)(4)(D).

**Small business/New Entrant credit justified by changes in wireless market.** Public Knowledge (PK) supports both a credit for new entrants and a credit for small businesses. In 1994, when the FCC first implemented bidding credits, it was plausible that a small business could start with relatively modest resources and gradually expand into regional and national providers. Today, this appears increasingly unlikely. Small businesses (including those owned by women and minorities) are unlikely to expand beyond their immediate footprint without significant financial resources. By contrast, potential new entrants that might offer genuinely new products or business models other than go beyond CMRS voice and data service (e.g., services centered on Internet of Things (IoT)) are dissuaded from entering the market because of the high cost of licenses.

For example, if Apple wanted to offer wireless service over exclusive licensed spectrum with its new “Apple Watch,” or Intel wanted to offer a unique private network for IoT devices, it would need to rely entirely on the networks and spectrum held by others. Acquiring spectrum in the market so that it could configure its own network would require investment of billions of dollars for spectrum rights before spending a single penny on deploying an entirely new network. While

such giant companies might be able to afford such expenditures, it is not rational to expect them to do so – or even plan to do so in the current environment.<sup>1</sup>

This is not to say that the focus on small businesses, particularly rural wireless companies, is misplaced. To the contrary, these providers need an expanded bidding credit so that they may acquire the necessary spectrum to continue to serve their customer base, and to hopefully grow regionally. But this is different from the expectation when the Commission first adopted the DE bidding credit in 1994, when the wireless market was nascent and it was reasonable to assume that a small business with a bidding credit might be able to capture licenses in enough markets to grow into a substantial regional or national CMRS competitor.

The problems of the last 15 years stem in part from the Commission attempting to fulfill 2 goals simultaneously. Because the Commission seeks to limit the credit to small businesses, it cannot realistically hope that these businesses will be able to enter the market for the first time without substantial assistance from existing wireless firms. Accordingly, the Commission has permitted various types of relationships with large existing wireless firms capable of providing needed resources, expertise and market connections to enable the genuine new entrant to compete. This prompts larger wireless carriers to use the DE rules to obtain spectrum at a discount not intended for their use. However, when the Commission has prohibited these “material relationships” and imposed safeguards draconian enough to prevent abuse, they have also prevented the small businesses the Commission hopes to benefit from taking advantage of the DE program.

**Bifurcate the functions of the DE credit.** PK therefore advises that the Commission expressly recognize the changes in the wireless market over the last 30 years and consider the purpose of the DE credit. One credit would go to small businesses with the expectation that these will be primarily existing carriers or local minority and women owned businesses. The other credit would be targeted at genuine new entrants who have never held a Commission license of the kind currently included in the spectrum screen.<sup>2</sup>

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<sup>1</sup> As always, it should be recalled that the value of license distribution by auction derives from the “rational actor” theory. Rational actors assess their ability to extract value from the spectrum license and bid an amount less than their ability to profit. A rational actor will not bid more than it can hope to extract with the license, even if it can easily afford to lose money, because it is not rational to expect private actors to subsidize public goods such as innovative new products or competition generally.

<sup>2</sup> Licenses such as Part 90 licenses and CARS licenses should not preclude an entity offering a novel business plan from being considered a “new entrant.”

In doing so, the Commission should recognize that competition at the national level among existing carriers is better, and primarily, addressed through direct targeted means such as the spectrum reserve in the incentive auction. In keeping with the need to promote competition in the existing CMRS marketplace, the Commission should expand the spectrum reserve to 40 MHz, making it possible for two firms who are not dominant nationally to secure 20 MHz each.

Instead, the new entrant DE credit would be designed to bring in firms that have genuinely new products and business models entirely different from the existing CMRS marketplace. The ability to capture a national footprint, even of low-band spectrum, is not going to create a new national CMRS carrier. The new entrant credit would rather be explicitly designed to attract “new and innovative technologies”<sup>3</sup> This credit should therefore not be capped, since it is impossible to interest a national provider of any wireless service without the ability to capture licenses in major markets. As a single license in a major market may cost billions of dollars, a cap such as AT&T has proposed would make the new entrant credit essentially useless.

### **Legal Authority For A New Entrant Cap.**

The DE program has been considered a “small business” credit. But the statutory language does not limit itself to small businesses. To the contrary, the statute sets a variety of goals, including specific instruction to facilitate acquisition of licenses by small businesses, rural providers, and women and minority owned businesses.<sup>4</sup> But nothing in the statute precludes the use of bidding credits to larger businesses to achieve the statutory goals.

For example, while Section 309(j)(3)(B) specifically lists small businesses, rural providers, and women and minority owned firms as intended beneficiaries of the auction design, this list is not exclusive as demonstrated by the key word “including” before listing these entities. The core purposes of Section 309(j)(B) are to promote “economic opportunity and competition” and ensure “new and innovative technologies are readily accessible to the American people,” to “avoid an excess concentration of licenses” and to disseminate “licenses among a wide variety of

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<sup>3</sup> 47 U.S.C. §309(j)(3)(B).

<sup>4</sup> Because race-conscious measures must survive strict scrutiny, the Commission has, since 1995, used small businesses as a proxy for businesses owned by women and minorities. The low-level of minority ownership demonstrates the enormous difficulty in designing a bidding credit that will target women and minority owned businesses in light of the legal restriction on race-conscious remedies. Creation of a “new entrant” credit that allows genuine new entrants to participate without restriction based on size could allow larger businesses owned by women and minorities to compete successfully against incumbents.

applicants.” A properly structured new entrant credit can achieve these goals. The continuation of the small business credit would fulfill the statutory mandate to “include” small businesses and rural providers as well.

Similarly, Section 309(j)(4)(C)(ii) requires the Commission to ensure the benefits of wireless services flow to “a wide variety of applicants, *including* small businesses, rural telephone companies, and businesses owned by members of minority groups and women” (emphasis and added). The use of the word “including” is clearly intended to mean “not limited to.” Rather, the primary goal the auction rules must fulfill is to “prescribe area designations and bandwidth assignments” that ensure “a wide variety of applicants.”

Additionally, the inclusion of a bidding credit designed to attract genuinely new entrants is consistent with the directive that the auction system promote “the development, and rapid deployment, of new technologies, products and services for the general public,”<sup>5</sup> as well as the Commission’s broad authority to “generally encourage the broader use of radio in the public interest.”<sup>6</sup> Nor would such a credit confer an “unjust enrichment” to the new entrant or fail to secure to the public adequate return on the spectrum. A “new entrant” DE credit is similar in structure and motivation to a tax credit, it is a relief from an obligation to pay the government for the express purpose of promoting investment or other behavior that confers a public benefit.

For these reasons, Public Knowledge generally supports AT&T’s proposed framework to close the “loopholes” in the DE program that have persisted, despite the best efforts of the Commission, for more than 15 years. With the modifications proposed above, PK believes this approach provides a positive way forward.

### **Bidding Consortia.**

PK expressed general concern with permitting the use of bidding consortia, either for DEs or generally. PK expressed concern that it is impossible to prevent entities bidding separately in a coordinating fashion from using coordination among multiple entities to preserve eligibility and improve their chances to capture licenses in ways that do not reflect the intended efficiencies of the auction. PK recognizes that there are situations when joint bidding consortia could allow smaller entities to successfully challenge larger entities in a pro-competitive manner (as DISH did when challenging AT&T and VZ through its joint bidding arrangement, producing a pro-competitive result by capturing a significant number of licenses). Nevertheless, the advantages of such a system are outweighed by the additional complexity introduced.

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<sup>5</sup> 47 U.S.C. §309(j)(3)(A).

<sup>6</sup> 47 U.S.C. §303(g).

This is particularly true in the aftermath of the AWS-3 auction. Granted, the DISH/SNR/Northstar consortium produced a pro-competitive result, without apparently violating any rules. However, as UK auction expert Paul Klemperer has observed, there are two kinds of spectrum auctions, the first auction and all subsequent auctions. Rules and strategies that work the first time will not necessarily work again, given that bidders learn from the previous auction. Given the success of DISH's bidding consortium with SNR Wireless and Northstar Wireless, it is inevitable – if the rules remain unchanged – that all major bidders will use bidding consortia in upcoming auctions. This will serve no purpose other than to further advantage the largest companies capable of assembling massive “war rooms” for such complex strategies. To the extent joint bidding consortia created efficiencies previously, these potential efficiencies are now far outweighed by the potential cost and complexity that will be added to the auction.

Additionally, to the extent there are advantages, parties are free to hold licenses jointly through joint ventures. While the Commission should not permit such joint ventures by the two largest firms, the Commission should permit them by all other firms, including between Sprint and T-Mobile.

Generally, the use of such joint ventures raises significant concerns with regard to collusion and refusal to compete. However, as explained in the Department of Justice Antitrust Division (DoJ) and Federal Trade Commission (FTC) “Antitrust Guidelines for Collaborations Among Competitors,”<sup>7</sup> such combinations can also have pro-competitive benefits. Here, as the Commission has previously identified, the two largest firms have dominant spectrum positions as well as huge market share compared to even the 3<sup>rd</sup> largest and 4<sup>th</sup> largest rival. While Sprint and T-Mobile have incentive to compete against each other, they also have incentive to compete against the largest firms. It is in fact that competition with the two largest firms that already drives the innovation of the two players in the market, as both AT&T and Verizon present a far greater source of potential customers than either T-Mobile or Sprint. As T-Mobile and Sprint each grow larger, however, they represent a source of customers, encouraging each to more aggressively capture customers from each other as well.

Accordingly, allowing Sprint and T-Mobile to engage in limited collaboration around low-band spectrum licenses will enable healthy competition with the two dominant firms without jeopardizing the benefits of 4-firm competition.

### **Spectrum Holdings.**

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<sup>7</sup> available at: [https://www.ftc.gov/sites/default/files/documents/public\\_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf](https://www.ftc.gov/sites/default/files/documents/public_events/joint-venture-hearings-antitrust-guidelines-collaboration-among-competitors/ftcdojguidelines-2.pdf)

PK reiterated its support for expanding the proposed spectrum reserve to 40 MHz. Analysis of the AWS-3 bidding confirms the prediction that AT&T and VZ have far greater capacity to raise money in the capital markets and to outspend competitors. This can only be explained by the power of foreclosure value, which is a key part of spectrum valuation and enhanced in the low-band context.

*Distinguishing foreclosure value from “warehousing.”* The idea of foreclosure value and the concept of “warehousing” spectrum are often confused. Certainly warehousing spectrum can indicate that the primary value of spectrum to the winning bidder was its foreclosure value, given that it is not driven to immediately deploy the spectrum. But foreclosure value and warehousing are entirely separate concepts, and the presence or absence of warehousing is not proof of foreclosure.

Foreclosure value is the value derived from preventing the rival from securing the spectrum, or driving up the cost to the rival beyond the ability of the rival to extract value from the spectrum. Where all parties have equal amounts of spectrum, foreclosure value is minimal. But where one party has a significant advantage over its rivals in spectrum capacity, that party derives further value from keeping the spectrum from its rivals. By contrast, the spectrum constrained party does not derive the same value from depriving its spectrum rich rival of the license, since the spectrum rich rival can still meet its needs even without the target license.

Example: consider a license with a supposed market value of  $X$  based on the ability to carry wireless traffic. Now consider two bidders, one spectrum constrained, the other with sufficient spectrum to meet its needs (“spectrum rich”). The spectrum rich rival will derive value not merely from the spectrum itself, but from the inability of its rival to expand service and challenge it effectively. This additional value is foreclosure value, or  $f$ . The rational spectrum rich bidder will therefore rationally bid  $X+f$ , whereas the rational spectrum constrained bidder should only rationally bid  $X$ . Either the spectrum constrained bidder loses the licenses, or must pay more than it can reasonably hope to extract from the license over time.

If we believe in rational actor theory, this concept should be uncontroversial. Spectrum auctions are not morality plays, and if a rational bidder will enjoy an advantage based on foreclosure we should expect the rational bidder to act accordingly. Coase himself recognized this possibility in his paper *The Federal Communications Commission*, but suggested that a solution could wait until the problem actually emerged. As the problem has now clearly emerged – demonstrated by the enormous premiums paid by AT&T and Verizon over the pre-auction estimates – the Commission should expand the spectrum reserve to make it possible for two rivals to each capture 20 MHz of spectrum.

In accordance with Section 1.1206(b) of the Commission's rules, this letter is being filed with your office. If you have any further questions, please contact me at (202) 861-0020.

Respectfully submitted,

/s/ Harold Feld  
Senior Vice President  
PUBLIC KNOWLEDGE

cc: Jim Schlichting  
Jean Kiddo  
Sue McNeil