

Comments on AT&T's No Excess Supply White Paper

Introduction

The Commission has proposed not allowing bidders in the forward auction to reduce expressed demand to a point where aggregate demand in a market would fall below aggregate supply.¹ This “No Excess Supply” (or “NES”) constraint offers a common-sense limitation on bidding activity that helps ensure bidding satisfies the Final Stage Rule while providing a meaningful safeguard against anticompetitive or predatory auction behavior.² Allowing bidders the unrestricted ability to withdraw bids would encourage disingenuous bidding, impede price discovery in the auction, create the opportunity to “bid up” other bidders to raise competitors’ prices and threaten the success of the auction.³

AT&T recently submitted a white paper that proposes to eliminate the No Excess Supply rule.⁴ The Commission should reject AT&T’s proposal. AT&T exaggerates the potential exposure risk that bidders face and downplays the much more substantial risk its proposed solutions would introduce. Retaining the NES safeguard will avoid inefficient spectrum allocations and prevent predatory bidding practices that could threaten the incentive auction. At the same time, some of the more narrowly-tailored alternatives AT&T proposes – namely,

¹ *Competitive Bidding Procedures for Broadcast Incentive Auction 1000, Including Auctions 1001 and 1002; Expanding the Economic and Innovative Opportunities of Spectrum Through Incentive Auctions*, Public Notice, 29 FCC Rcd 15750, 15806-07, ¶ 176 (Dec. 17, 2014)

² *See id.* (explaining that the NES rule is intended to combat “significant reductions in aggregate forward auction proceeds from round to round, impeding progress toward satisfying the final stage rule”).

³ *See Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, Second Report and Order, 9 FCC Rcd 2348, 2373-74, ¶¶ 146-153 (1994) (“*Competitive Bidding Second Report and Order*”) (holding that permitting bid withdrawals would encourage insincere and potentially anti-competitive bidding practices).

⁴ Philip A. Haile, *Comments on the FCC’s Proposed “No Excess Supply” Rule For the 600 MHz Spectrum Auction*, attached to Letter of Christopher T. Shenk, Counsel for AT&T to Marlene H. Dortch, Secretary, FCC, GN Docket No. 12-268, AU Docket No. 14-252 (May 15, 2015) (“*AT&T NES Paper*”).

allowing outcome-neutral demand adjustments and permitting a very limited number of bid withdrawals in carefully defined circumstances – could provide bidders with an opportunity to guard against actual or perceived exposure risk while still maintaining protections against insincere or predatory bidding.

AT&T's Proposal

In the *AT&T NES Paper*, Professor Philip Haile discusses perceived shortcomings of the NES constraint.⁵ He asserts that the NES constraint could be detrimental to some bidders because of potential complementarities in valuations among licenses.⁶ If a bidder values one license at x , that bidder may value two licenses at more than $2x$. Such a bidder may face an exposure problem if it finds itself bidding for 2 licenses beyond price x in a market with excess demand for only 1 unit. To address this problem, Professor Haile proposes three solutions:

- 1) Allow bidders reduce demand by 2 units as long as it does not create excess supply of more than one license, at least once the FSR is satisfied and such a reduction would not reverse satisfaction of the FSR;⁷
- 2) Give bidders a limited amount of “tokens” that could be used for such reductions;⁸
- 3) Provide information to bidders during the auction about unprocessed orders to reduce demand by two units (that would lead to a one unit excess supply), so that other bidders can move their demand at current prices to allow such a reduction to be processed.⁹

According to Professor Haile, removing the NES safeguards would have no or minimal negative effects on the auction so long as the FSR is satisfied.¹⁰ While there may be the theoretical

⁵ *Id.* at 3-5 (claiming that the current rules result in exposure risk, inefficient price discovery and inefficient demand reallocation).

⁶ *Id.* at 3-4.

⁷ *Id.* at 8.

⁸ *Id.* at 8-9.

⁹ *Id.* at 9-10.

possibility that the NES constraint could create limited additional exposure, AT&T and Professor Haile simultaneously exaggerate the exposure risk and ignore the corresponding risks that removal of the NES constraint would create.

AT&T Exaggerates the Risk of Bidding Exposure

The complementarity of licenses is easily exaggerated. While sometimes two blocks together will be more valuable than twice the value of a single block, the reverse is often true, too: the first block may well be more valuable than the second block. Complementary valuations (where two blocks together are more valuable than two times a single block) are more common when dealing with “capacity spectrum” such as AWS, where carriers need more than 10 megahertz for the benefits of deployment to outweigh its costs. For “coverage spectrum,” such as the low-band spectrum to be auctioned here, most of the benefits (*i.e.*: greater coverage over long distances and in-building penetration) are recognized with the first block.¹¹ Acquiring at least two blocks of low-band spectrum in a market is important to providing a consistent end-user experience, particularly in areas that cannot be reached using mid- or high-band spectrum; however, acquiring the first block is particularly critical for carriers without access to low-band spectrum and will thus tend to be valued higher than subsequent blocks by bidders that lack low-band holdings.¹² The exposure risk of securing only one license rather than two or more are,

¹⁰ *Id.* at 5.

¹¹ Those bidders that already hold low-band spectrum in a given area will incorporate the 600 MHz spectrum into their existing coverage layer. The limited marginal value of incorporating additional coverage spectrum into networks already awash in coverage spectrum does not take into account the foreclosure value that the dominant carriers may attribute to the low-band spectrum being auctioned. *See Ex Parte* Submission of the United States Department of Justice, WT Docket No. 12-269 at 11 (April 11, 2013) (“In highly concentrated industry with large margins between the price and incremental cost of existing wireless broadband service, the value of keeping spectrum out of competitors’ hands could be very high.”).

¹² AT&T and Verizon are reserve eligible in those markets in which they do not already hold more than one-third of the available low-band spectrum. On a nationwide average basis, AT&T and Verizon already hold 73 percent of

therefore, counterbalanced if not entirely offset by the higher value of securing at least one license by those bidders that have little or no access to alternative licenses with similar characteristics.

The Risk of Predatory Bidding is Significant and Outweighs Limited Potential Exposure Risk

The threat of predatory auction practices from abandoning the NES rule heavily outweighs whatever marginal benefit these proposals might achieve against the ostensible exposure concerns. While Professor Haile focuses on the problems that the NES constraint could potentially cause, his paper ignores another (and more important) problem that is present in any dynamic multi-unit auction: if bidders can withdraw their bids, they have little incentive to express truthful demand. Instead, bidders can increase the prices that other bidders pay, while maintaining the option to reduce demand in later rounds. The NES constraint serves the important purpose of making such predatory behavior more costly. Specifically, to increase others' prices, a bidder would need to increase the price of its own licenses. But removing the NES constraint would create the option to raise competitor prices with no cost to the predatory bidder. Such tactics could prove attractive to a bidder that already has significant low-band spectrum holdings, has extensive financial resources, and stands to benefit from foreclosing competition or raising rivals' costs.

If the NES constraint is not in place to prevent predatory auction behavior, competitive bidders worried about having prices "bid up" may reduce their demand earlier than they otherwise would have, which would lead to inefficient allocations of spectrum and lower revenues in the incentive auction. If bids are not firm commitments to purchase licenses at the

low-band spectrum and the two dominant providers hold even more low-band spectrum in the most densely populated markets.

current prices, bidders have an incentive to misrepresent their demand. The Commission first explained this principle more than twenty years ago:

Allowing bidders to withdraw bids without ever paying a penalty would encourage insincere bidding. Insincere bidding, whether purely frivolous or strategic, distorts the price information generated by the auction process and reduces its efficiency. Strategic bidding is likely to be the most damaging. For example, a strategic bidder might attempt to deter a rival from acquiring a regional collection of licenses (or from entering altogether) by bidding up the price of key licenses and then withdrawing.¹³

Concerns regarding these sorts of anticompetitive bidding practices have led to the use of activity rules and the definition of “provisional winners” in simultaneous multiple round auctions that have been used by the Commission in countless spectrum auctions and that are close cousins of the clock auction design proposed for the 600 MHz Auction.¹⁴ The commitment aspect of the Commission’s auction rules has proven an indispensable safeguard against anticompetitive behavior in prior auctions and should not be eliminated.¹⁵

¹³ *Competitive Bidding Second Report and Order*, ¶ 147. See also *Amendment of Part 1 of the Commission’s Rules—Competitive Bidding Procedures*, Third Report and Order and Second Further Notice of Proposed Rule Making, 13 FCC Rcd 374, 459-60 ¶ 150 (1997) (explaining that “bidders may, in some instances, seek to remove bids for improper purposes”); Peter Cramton and Jesse A. Schwartz, *Collusive Bidding: Lessons from the FCC Spectrum Auctions*, JOURNAL OF REGULATORY ECONOMICS, May 2000, at 19 (“Cramton/Schwartz”) (explaining that bid withdrawals had been used in FCC auctions to facilitate parking strategies, retaliations, lateral handoffs, and penalty reductions).

¹⁴ See *Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions*, Report and Order, 29 FCC Rcd 6567, 6776, ¶ 507 (2014) (“Like the SMR auction format the Commission typically has used, the ascending clock auction format will proceed in a series of rounds, with bidding being conducted simultaneously for all licenses available in the auction As in SMR auctions, bidders will be subject to activity and eligibility rules that govern the pace at which they participate in the auction.”).

¹⁵ See, e.g., *Auction of Advanced Wireless Services (AWS-3) Licenses Scheduled for November 13, 2014*, Public Notice, 29 FCC Rcd 8386, 8445-46, ¶¶ 215-219 (2014) (“AWS-3 Auction Procedures PN”); *Auction of 700 MHz Band Licenses Scheduled for January 24, 2008*, Public Notice, 22 FCC Rcd 18141, 18207-08, ¶¶ 250-256 (2007) (“700 MHz Auction Procedures PN”); *Auction of Advanced Wireless Services Licenses Scheduled for June 29, 2006*, Public Notice, 21 FCC Rcd 4562, 4621-22, ¶¶ 230-235 (2006) (“AWS-1 Auction Procedures PN”).

More Targeted Alternative Proposals to Address Perceived Exposure Risk Merit Consideration

While the Commission should reject AT&T's proposal to abandon the NES constraint, Professor Haile's proposals to keep bidders informed of demand reductions and to allow a limited and carefully circumscribed number of bid withdrawals to address complementary valuations merit consideration.

First, the proposal to provide information about unprocessed demand reductions could encourage the efficient allocation of licenses and reduce any exposure risk that may exist, but it may also introduce new risks into the auction.¹⁶ If a demand reduction that leads to excess supply of one unit is likely to encourage others to "pick up" that additional license at a later round and hence not reduce revenues, then signaling the willingness to surrender a license at the current prices should result in the same outcome as the original situation while resolving the exposure risk.¹⁷ Such an outcome would benefit all parties. Bidders could identify markets with the potential for an excess supply of licenses. All bids would be processed. And no party would pay more than it valued for a spectrum license.

Indeed, the Commission could extend the disclosure policy proposed for demand-reduction situations to any situation where bids might otherwise go unprocessed because they would result in excess supply of one unit. Even during a round where supply was equal to demand, the Commission could enhance the auction outcome by permitting bidders to submit an order reducing demand by one unit, but simply not process that demand-reduction request unless some other bidder proved willing to increase its current demand to include that surrendered unit. Allowing one bidder to reduce demand one unit whenever another bidder is willing to increase

¹⁶ *AT&T NES Paper* at 9-10.

¹⁷ *Id.* at 5-6.

demand by one unit could lead to a more efficient allocation of resources and a superior auction outcome. At the same time, however, the Commission would have to carefully weigh the benefits of announcing unprocessed demand reductions against the attendant risks of improper bid signaling.¹⁸ In the context of this first-of-its-kind incentive auction where there are many uncertainties, adopting a process by which demand reductions would be announced may have unintended and unforeseen consequences. Specifically, identifying unprocessed demand reductions could undermine the integrity of the auction process by allowing bidders to coordinate in reaching a low-revenue equilibrium and could be used to deter rivals and suppress expressions of demand. While these risks would not necessarily occur during the auction, the Commission must carefully weigh these risks against the benefits of announcing unprocessed demand reductions.

Second, if the Commission is concerned about the risk of exposure associated with complementary valuations among licenses, the Commission could offer bidders a limited number of “bid withdrawal rights,” as it has in previous auctions.¹⁹ Bidders could use these bid withdrawal rights exactly as Professor Haile suggests in the *AT&T NES Paper*.²⁰ To avoid gaming, however, these withdrawal rights would need to be very limited in number (there should be no more than 1-3 per bidder) and subject to other constraints. Specifically, the Commission should: (1) permit bid withdrawals only for demand reductions that result in excess supply of no

¹⁸ See *Cramton/Schwartz* at 6-8 (discussing bid signaling and retaliation in prior FCC spectrum auctions); *Application of Mercury PCS II, LLC*, Memorandum Opinion and Order, 13 FCC Rcd 23755 (1998) (although the use of “trailing numbers” in bids was detrimental to the auction process and the Commission’s rules were sufficiently broad to prohibit such behavior, the parties had not received adequate notice that their behavior violated the anti-collusion rules).

¹⁹ See, e.g., *AWS-3 Auction Procedures PN*, ¶¶ 215-216; *700 MHz Auction Procedures PN*, ¶ 253; *AWS-1 Auction Procedures PN*, ¶ 234.

²⁰ *AT&T NES Paper* at 8-9.

more than one unit; (2) allow bid withdrawals only after satisfaction of the Final Stage Rule; and (3) prohibit bid withdrawals when a withdrawal would reduce cumulative auction revenues below the Final Stage Rule threshold. In this way, bidders that harbor genuine concerns about the exposure risk associated with placing bids on multiple blocks in a single market would have some ability to guard against that type of risk.

Conclusion

Maintaining the NES safeguards will protect the integrity of the auction. AT&T's proposal to abandon the NES safeguard would eliminate an important protection against insincere and anticompetitive bidding in order to guard against low-probability exposure concerns the practical harm of which is easily overstated. At the same time, allowing outcome-neutral demand adjustments among bidders and permitting bidders to exercise a very limited number of bid withdrawals in carefully defined circumstances could improve auction outcomes. These measures would provide bidders with the ability to protect themselves against actual or perceived exposure concerns while limiting the risk of insincere and predatory bidding the NES safeguards seek to prohibit.