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July 30, 2015

EX PARTE VIA ECFS

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: ***Ex Parte Letter***
Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions, GN Docket No. 12-268; Comment Sought on Competitive Bidding Procedures for Broadcast Incentive Auction 1000, Including Auctions 1001 and 1002, AU Docket No. 14-252

Dear Ms. Dortch:

The spectrum reserve is the only competitive safeguard to prevent the nation's dominant carriers from foreclosing competition in the upcoming 600 MHz incentive auction. T-Mobile USA, Inc. ("T-Mobile")¹ therefore urges the Commission to implement a robust spectrum reserve early enough in the auction to promote competition, rather than allowing the largest carriers to game the system and raise prices to foreclosure levels before the reserve is triggered. The Commission's current proposal to link the spectrum reserve trigger to the Final Stage Rule ("FSR") creates an unacceptable risk that AT&T and Verizon will leverage their dominant market positions to cut off competition at the expense of investment, innovation, and consumer choice.

Under the currently proposed rules, Verizon and AT&T can delay creation of the spectrum reserve until they are able to raise prices above fair market value.² Verizon and AT&T are profit-maximizing companies with a fiduciary duty to their investors. Presented with an opportunity to raise their rivals' costs and foreclose competitive entry into the broadband market, they will use it. The question is thus not whether the two dominant carriers will attempt to use the Commission's current auction

¹ T-Mobile USA, Inc. is a wholly owned subsidiary of T-Mobile US, Inc., a publicly traded company.

² See *Ex Parte* Letter of Sprint Corporation and T-Mobile USA, Inc., AU Docket No. 14-252, GN Docket No. 12-268 (July 16, 2015) (showing in great detail how AT&T and/or Verizon could selectively focus their bidding on critical markets to foreclose competition before the spectrum reserve is triggered); see also *Ex Parte* Submission of the United States Department of Justice, WT Docket No. 12-269, at 10-11 (Apr. 11, 2013) ("*DOJ 2013 Letter*") (explaining that well-capitalized incumbents will be willing to pay a premium "foreclosure value" for spectrum licenses to prevent rivals from acquiring a critical competitive input and improving their services).

rules for anti-competitive purposes, but rather to what degree they will succeed in exploiting the potential for an excessively delayed spectrum-reserve trigger.³

The risk is entirely avoidable if the Commission makes a straightforward change to the proposed spectrum-reserve trigger. T-Mobile has proposed that the Commission implement the spectrum reserve when forward auction revenues reach either (1) an average of \$2.00 per MHz-POP in the Top 40 PEAs; or (2) the price for satisfying all broadcaster reimbursement and repacking costs as well as auction administrative costs, whichever occurs first.⁴ This “safety valve” reserve trigger will mitigate the risk of foreclosure tactics from the dominant carriers without sacrificing any of the Commission’s goals in the incentive auction.⁵ Other parties have advanced other solutions that could work equally well.⁶

As shown in the attached white paper, T-Mobile’s proposed accelerated trigger does not require a new construct for the incentive auction. On the contrary, the Commission can readily incorporate the proposal into its existing framework by extending the approach to reserve licenses. For example, the Commission currently plans to allocate extended round revenue requirements among Category 1 licenses in the Top 40 PEAs, and an accelerated trigger should not disturb that proposal.⁷ Similarly, the Commission will already have to address the potential for newly created excess supply of licenses as it transitions to subsequent stages with lower clearing targets.⁸ Creating the spectrum reserve before the FSR is satisfied will not change that fact. Indeed, T-Mobile’s proposed trigger presents no new issues that the Commission would not already have to resolve under the currently proposed rules or that it could not address within the current auction framework.

³ The United States Department of Justice has warned the Commission on three separate occasions of the foreclosure risk in the 600 MHz incentive auction presented by AT&T and Verizon. See *DOJ 2013 Letter*; Letter from William J. Baer, Assistant Attorney General, U.S. Department of Justice to Marlene H. Dortch, Secretary, FCC, WT Docket No. 12-269 at 2 (May 14, 2014); Letter from William J. Baer, Assistant Attorney General, U.S. Department of Justice to Marlene H. Dortch, Secretary, Federal Communications Commission, WT Docket No. 12-269 (June 24, 2015).

⁴ Letter of Trey Hanbury, Counsel to T-Mobile, USA, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, at 3 (June 30, 2015).

⁵ Triggering the spectrum reserve earlier in the auction process will not threaten to reduce the amount of reallocated spectrum or forward auction revenues. Indeed, T-Mobile expects bidding for reserve spectrum will be extremely competitive.

⁶ See, e.g., Letter from Lawrence R. Krevor, *et al.* of Sprint Corporation to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, GN Docket No. 12-268, at note 6 (July 9, 2015) (proposing to limit forward auction participants to bidding on three spectrum blocks per market); Letter from Angie Kronenberg, Chief Advocate and General Counsel, COMPTTEL to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, GN Docket No. 12-268, at 2 (July 16, 2015) (proposing a variation of Sprint’s proposal which would impose a 40 percent cap on bidding within in a given market).

⁷ See *Comment Sought on Competitive Bidding Procedures for Broadcast Incentive Auction 1000, Including Auctions 1001 and 1002*, Public Notice, 29 FCC Rcd 15750, 15893-94 (2014) (“*Comment Public Notice*”).

⁸ It is possible that a particular PEA may have more licenses available at a lower clearing target (if, for example, a license were so impaired under the previous clearing target that it was not offered for auction), and it may also have more Category 1 (or Category 2) licenses available at a lower clearing target, even if the total supply goes down.

If the bidding strategies that would result in foreclosure are as unlikely to occur as some parties claim them to be, then T-Mobile's "safety valve" reserve trigger will never come into play. But if the dominant carriers implement the bidding strategies that they have every incentive to pursue, then T-Mobile's proposed reserve trigger – or any one of the number of alternatives that a wide variety of carriers, trade associations, and public interest advocates have proposed – will prove essential in helping to prevent an immensely grave harm. Ignoring the possibility that the Commission may have guessed wrong about the capacity and ability of the dominant carriers to implement a foreclosure strategy within the current auction construct requires assuming an intolerable level of risk for an agency as deeply committed to the protection of consumers and the advancement of more competitive markets as this one.

Pursuant to Section 1.1206(b)(2) of the Commission's rules, an electronic copy of this letter is being filed in the above-referenced dockets. Please direct any questions regarding this filing to me.

Respectfully submitted,

/s/ Steve Sharkey

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T-Mobile USA, Inc.

Attachment

Mechanics of the Spectrum-Reserve Trigger and its Fix

Numerous parties have expressed concern that the “trigger” necessary to activate the pro-competitive spectrum reserve may not occur early enough in the auction to limit the risk of anti-competitive foreclosure by the two dominant providers. We review the operating mechanics of the current staff proposal for the spectrum-reserve trigger and show how T-Mobile’s proposed modification of the trigger could be readily incorporated into the current staff proposal without creating any significant new hurdles.¹

Staff Proposal

The currently proposed trigger for the spectrum-reserve is tied to the Final Stage Rule (FSR), which is a reserve price with two components.² The FSR, and thus the spectrum-reserve trigger, requires that forward auction proceeds meet both a minimum revenue component (\$1.25/MHz pop average in the top 40 PEAs), which is not at issue, and a spectrum clearing cost component, which has raised anti-competitive concerns.

Under the current model, the Commission would start with a high clearing target and use up to two price clocks per Partial Economic Area (PEA) to account for Category 1 and Category 2 spectrum blocks. The Commission would initially treat all spectrum in the forward auction as “unreserved.”

If the bidding does not satisfy the FSR, the Commission will use an extended round to try to meet the FSR.³ If the bidding still does not satisfy the FSR, the Commission will move to a subsequent stage with a lower spectrum-clearing target.⁴ At the new spectrum-clearing target, any given PEA may have more or fewer licenses in each category than at the prior spectrum-clearing target.

¹ Other proposals to address the unacceptable risk created by the flawed reserve trigger would be equally straightforward, but this white paper is primarily focused on T-Mobile’s proposed modification and the ease with which it could be integrated into the Commission’s currently proposed auction framework. *See, e.g.*, Letter from Lawrence R. Krevor, *et al.* of Sprint Corporation to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, GN Docket No. 12-268, at note 6 (July 9, 2015) (proposing to limit bidding to three spectrum blocks per market); Letter from Angie Kronenberg, Chief Advocate and General Counsel, COMPTEL to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, GN Docket No. 12-268, at 2 (July 16, 2015) (proposing to place a 40 percent cap on bidding within in a given market).

² *See Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions*, Report & Order, 29 FCC Rcd 6567, 6712-15 ¶¶ 338-346 (2014) (“*Incentive Auction Order*”); *Comment Sought on Competitive Bidding Procedures for Broadcast Incentive Auction 1000, Including Auctions 1001 and 1002*, Public Notice, 29 FCC Rcd 15750, 15769-74 ¶¶ 46-63 (2014) (“*Comment Public Notice*”)

³ *Comment Public Notice*, 29 FCC Rcd at 15810-12 ¶¶ 189-194. The Commission could also hold multiple extended rounds during a single stage of the auction in an effort to satisfy the FSR at a particular clearing target, but for the purposes of this submission, we assume a single extended round per stage of the forward auction, consistent with the Commission’s currently-proposed rules.

⁴ *Id.* at 15775 ¶69.

If the new, lower spectrum-clearing target creates more Category 2 licenses and fewer Category 1 licenses (or vice versa), the new spectrum-clearing target may result in excess supply in that category. Once the bidding satisfies the FSR, the Commission will implement the spectrum-reserve, which requires up to one additional clock for as many as three reserve license blocks in any given PEA.⁵ This transition will not create any excess supply because the reserve will only occur to meet demand. In other words, if reserve-eligible bidders are demanding fewer reserve blocks than could be created based on the initial clearing target, the auction creates only the number of reserve blocks that reserve-eligible bidders are actually demanding in that PEA during the round in which the reserve is created.

\$2 Reserve Addition

T-Mobile has proposed a modification of the spectrum-reserve trigger. Under T-Mobile's proposal, the reserve trigger would be either (a) when prices satisfy the FSR, or (b) when prices in the Top 40 PEAs reach an average of \$2.00 per MHz-POP, whichever occurs first.⁶

Here too, the Commission would start with a high clearing target and use up to two price clocks per PEA to account for Category 1 and Category 2 spectrum blocks. Again, the Commission would initially treat all spectrum as "unreserved."

If forward auction bidding satisfies the FSR cost component before satisfying the proposed average price of \$2.00 per MHz-POP in the Top 40 PEAs, then the spectrum-reserve would be created as described above.⁷ In other words, there would be no change: the reserve would kick in using up to one additional clock for possibly multiple licenses in the spectrum reserve, and the transition would not create any excess supply because the reserve will only occur to meet demand.

If the bidding satisfies the proposed average price of \$2.00 per MHz-POP in the Top 40 PEAs before satisfying the FSR cost component, the auction process would operate in much the same way. The reserve would be created and, as before, up to one additional clock would exist to account for the possibility of multiple licenses in the reserve. Once again, the transition would not create any excess supply because the reserve would exist only to the extent that reserve-eligible bidders express demand for reserve licenses.

If the cost component of the FSR is satisfied after the creation of the reserve at the same spectrum-clearing target, then there should be no issues or complications. If the FSR is not

⁵ *Id.* at 15799-15802 ¶¶149-158.

⁶ Letter of Trey Hanbury, Counsel to T-Mobile, USA, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission, AU Docket No. 14-252, at 3 (June 30, 2015).

⁷ Under this scenario, the Commission could retain the requirement that average prices in the Top 40 PEAs reach \$1.25 per MHz-POP, thereby assuring that prices for licenses reflect competitive values.

satisfied during the stage when the reserve is created, then the Commission would continue into an extended round. If the FSR is satisfied in that extended round, then the auction would move to the assignment stage and, again, no special complications or concerns should arise.

If after the extended round forward auction proceeds still fail to satisfy the cost requirements of the FSR, the Commission would reduce the spectrum-clearing target as in the earlier model. Because the new spectrum-clearing target would incorporate reserve licenses in addition to unreserved Category 1 and Category 2 licenses, we understand three questions have been raised about the detailed technical rules to govern the auction process. The questions are as follows: (1) how to handle offering three items during the extended rounds; (2) how to resume forward-round bidding following the reduction of the spectrum-clearing target; and (3) how to address any issues of possible excess supply.

Question 1: Extended Rounds

One question that has been raised is how to run the extended round in a situation where the spectrum-reserve has already been triggered. Under the current proposal, the Commission will run an extended round in which it increases the prices of all Category 1 blocks in the “high-demand” PEAs without excess supply by a set increment.⁸ That increment, after being applied to the applicable licenses, would raise auction revenues to some amount over the two FSR thresholds.⁹ It would be a relatively straightforward solution for the Commission to extend its current extended round proposal to situations where the reserve has already been triggered. Since the current plan is to increase the price of all Category 1 blocks in the “high-demand” PEAs by the same incremental percentage, we would propose that the extended round clock price for reserved spectrum licenses increase by the same percentage as all other Category 1 licenses in “high-demand” markets.¹⁰

An extended round will end when either the FSR is satisfied or at least one bidder reduces demand.¹¹ With the reserve triggered, the extended round can be stopped by a demand reduction of a firm bidding for the reserve, naturally extending the currently proposed rule to circumstances where the reserve has already been triggered.

Question 2: Resumption of Forward Auction Bidding

If the FSR is still not satisfied after an extended round, the Commission will move to a subsequent stage and reduce the spectrum-clearing target. But upon reducing the

⁸ *Comment Public Notice*, 29 FCC Rcd at 15810 ¶¶ 189-191.

⁹ *Id.* at 15810 ¶ 190.

¹⁰ To the extent that the Commission has proposed using only Category 1 licenses to create the reserve, this proposal will ensure that reserve eligible bidders pay their share of extended round revenues.

¹¹ *Comment Public Notice*, 29 FCC Rcd at 15810 ¶¶ 189, 192.

spectrum-clearing target, there will typically be at least one fewer license available in each PEA. If so, should this license be drawn from the non-reserved or reserved spectrum blocks?

We would address this concern pragmatically consistent with existing rules. If there are enough active reserve bidders, say three active bidders for three available reserve licenses, then the reduction should come from the unreserved license category. This approach is consistent with the current rules that the amount of reserve in every PEA is determined by the initial clearing target.¹²

But what if the reduction of the clearing target causes the number of Category 1 licenses to drop below the number of reserve licenses? Suppose, for example, that the reserve incorporates three licenses at the initial spectrum-clearing target, but there were only two Category 1 licenses available in a given PEA after the reduction of the spectrum target. How is the supply reduction to be addressed among the three different categories of units (Category 1, Category 2 and Reserve)?

As a threshold matter, we do not think this situation will occur frequently because a reduction in the spectrum-clearing target is less likely to reduce the number of Category 1 licenses than reduce the number of Category 2 licenses. Nevertheless, this situation could occur. In such a case, the Commission could adopt the T-Mobile proposal to designate the three least impaired licenses to be in the reserve.¹³ If designating the three least impaired licenses for the reserve is not feasible either because the Commission does not want to allocate any Category 2 licenses to the reserve under any circumstances or because there are no Category 2 licenses to allocate to the reserve, then the Commission could reduce the amount of the reserve spectrum in the given PEA to the currently available supply of Category 1 licenses. This would create excess demand for the reserve and, hence, would not create any new problems for the auction.

But what if the transition from one spectrum-clearing target to a lower clearing target creates excess supply, especially of reserved licenses (for example, because of demand reduction for the reserved licenses in the extended round)? Excess supply at the transition between clearing targets could just as easily occur without the reserve having come into existence. Under the current rules, in other words, it is possible that a particular PEA may have more licenses available at a lower clearing target (if, for example, a license were so impaired under the previous clearing target that it was not offered for auction), and it may also have more Category 1 (or Category 2) licenses available, even if the total supply goes down. Furthermore, the Commission has proposed allowing bidders to reduce demand for Category 2 licenses in the first round of a new stage, even if it would create excess supply.¹⁴

¹² *Policies Regarding Mobile Spectrum Holdings; Expanding the Economic and Innovation Opportunities of Spectrum Through Incentive Auctions*, Report and Order, 29 FCC Rcd 6133, 6208 ¶ 184 (2014).

¹³ See Comments of T-Mobile USA, Inc., AU Docket No. 14-252, GN Docket No. 12-268, at 6-8 (Feb. 20, 2015).

¹⁴ *Comment Public Notice*, 29 FCC Rcd at 15812 ¶ 198.

We propose the Commission follow whatever plan it intends to adopt for this situation under its currently planned auction rules. Whatever the currently planned solution is, the Commission should be able to extend it to the case of three price clocks with the reserve already triggered. The excess-supply scenario seems to be quite unlikely to occur; however, we recognize that the rules have to be specific for all contingences, even unlikely ones. If this contingency happens, it is possible that bidders would move some of their eligibility across PEAs and bring demand to meet supply in at least some of the areas with excess supply. If even by the end of the auction there was excess supply in some area(s), the Commission could re-auction the unsold license(s) as it has done in other auctions. In case the excess supply happens because of the demand reduction in the extended round on a reserved license, the Commission can also consider moving the over-supplied Category 1 license from the reserve to the unreserved Category 1 licenses (which typically would bring the market to no excess supply).

Question 3: Late-Created Excess Supply in the Reserve

One other mathematically possible scenario that may need to be addressed is as follows: (1) at the initial clearing target there are three licenses that would be designated for the reserve; (2) at some lower spectrum-clearing target, a PEA has only two Category 1 licenses when the spectrum-reserve is triggered; but (3) at an even lower spectrum-clearing target, the PEA again has three or more Category 1 licenses. To address the potential for an intervening dip in the supply of the reserve licenses, we suggest that the reserve should stay at the reduced level; any subsequently available Category 1 licenses that would otherwise go into the reserve would be offered as unrestricted licenses at the prices of the current unreserved Category 1 licenses. Again, such variability in the number of available licenses in a given PEA/category is present under the current rules. Therefore, as an alternative to our proposed approach, any existing solutions can be used with the spectrum-reserve trigger that we propose.

Conclusion

T-Mobile's proposed modification of the spectrum-reserve trigger conforms to the operating mechanics of the current staff proposal. The three conditions that could conceivably arise are not unique to the proposed modification, but rather exist under the current staff proposal, too, and presumably have already been addressed. Pragmatic adjustments to the staff proposal could mitigate some of the potential costs to reserve-eligible bidders that might otherwise occur; however, the structure and operating features of the current staff proposal could remain largely unchanged following adoption of the proposed modification of the spectrum-reserve trigger.