

# RECOMMENDATIONS TO THE FCC INCENTIVE AUCTION TASK FORCE TO MODIFY THE NON-COLLUSION RULES LIMITING THE NUMBER OF BIDDERS THAT MANAGEMENT CONSULTANTS CAN ADVISE IN THE REVERSE AUCTION

## Introduction

Petitioner Terence P. Dunn<sup>1</sup> hereby makes the following recommendations to the Incentive Auction Task Force at the Federal Communications Commission to make the rare, costly-to-develop auction advisory services of management consulting firms widely available to public television stations, as well as commercial stations, which will: (A) increase the participation of public television stations in the 2016 incentive auction, (B) enable public stations to participate independently in the auction instead of giving up control of their bidding to private equity firms (*by sheer default for lack of any available and affordable sources of expert auction advisory*), (C) lower the Commission's cost of acquiring public stations' spectrum at auction because the less non-commercial spectrum contained in private equity portfolios of stations means the lower the cost of acquisition<sup>2</sup>; and (D) curtail the three-year long acquisition frenzy on the part of private equity firms vying to gain controlling interest in noncommercial broadcast spectrum.

## I. Recommendation: Modify the Incentive Auction's Blackout Period<sup>3</sup> to permit Management Consultants to Advise Multiple Public Station Clients Before and During the Reverse Auction.

The following recommendations create exceptions and refinements to the present "black-out" rule prohibiting communications between bidders after registration for the auction, as stated on page 4 of the May 15, 2014 Report and Order:

Between the short-form application filing deadline and the announcement of the results of the reverse auction and the repacking process, all full power and Class A licensees will be prohibited from communicating directly or indirectly any reverse or forward auction applicant's bids or bidding strategies to any other full power or Class A licensee or forward auction applicant.

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<sup>1</sup> Petitioner Terence Dunn is a management consultant providing auction advisory to both public and commercial television broadcasters. Since February 2014 he has become a behind-the-scenes advocate for the continued existence of public television stations in the face of what he considers highly disadvantageous "subsidy" deals offered by private firms building portfolios of stations to speculate on 600Mhz spectrum. After degrees from Yale College (B.S. 1976) and Harvard Business School (MBA, 1980), from 1980 to 1992, Dunn worked in management consulting as a valuation expert and had as clients the largest investment banks, money center banks, brokerage firms, private equity firms, and Fortune 400 companies. Dunn has been a successful content producer in the entertainment industry from 1992 to the present. In 2013, he became active again in investment banking providing financial advisory to mid-cap companies in the financial services, healthcare, telecommunications, energy, real estate, hotel and hospitality, agribusiness, and new media sectors. In 2013, Dunn became aware of the strange plight and dilemma of public tv stations becoming acquisition targets of private equity players after the announcement of the incentive auction. In 2014, Dunn founded Mercury Direct Consultants to provide auction advisory services to primarily public television stations.

<sup>2</sup> Private equity firms are intent on controlling large blocks of spectrum in every major market as a matter of course. That non-commercial spectrum is increasingly becoming part of blocks of spectra in major markets controlled by private investment firms—because public tv stations have virtually no other sources of competent auction advisory available to them (because no consulting firm can have more than one bidder as a client and therefore cannot capitalize on their high fixed cost to create a slate of sophisticated auction advisory services even if they are able to break-even on it with the one client)--should come as no surprise to the FCC. This trend of public spectrum being consolidated with commercial spectrum in private equity portfolios will naturally make this spectrum more expensive for the Commission to acquire through the reverse auction, will narrow its margin between its cost of acquiring spectrum overall (not just public tv spectrum) in the reverse auction and the revenues paid by wireless providers in the forward auction. Higher spectrum acquisition costs in the reverse auction may be of no concern to the Commission if it supported the Congressional legislation that let private equity firms like Blackstone, MSD Capital, and NRJ TV loose in the henhouse of insecure and unsophisticated public tv station general managers and boards of directors, allowing them to acquire a large stake in a public station's prospective auction proceeds in exchange for a short-term bridge loan and taking over bidding in the reverse auction. Every 6 Mhz of non-commercial spectrum added to a private equity firms' portfolio in any major market increases its leverage to command a higher price for that entire portfolio.

<sup>3</sup> --as stipulated in the May 15, 2014 Report and Order on Page 4.

The standing prohibition against any direct or *indirect* communications between bidders bars communications potentially mediated by a common consultant and therefore prevents any management consulting firm from providing auction advisory services to more than one bidder throughout the blackout period and during the incentive auction.<sup>4</sup> This prohibition will continue to have a profoundly dampening effect on the interest of public tv broadcasters to participate in the reverse auction because they will continue to be deprived of affordable expert auction advisory to guide them through the extremely complex rules of competitive bidding. When the incentive auction was first announced, the majority of general managers and boards of directors of public stations in the 25 largest markets were intimidated by the auction and stunned by the magnitude of the potential proceeds from the sale of their spectrum.<sup>5</sup> Nearly three years later, most of these public trustees—except for those that had entered into “subsidy” deals with private equity firms and are trusting them to sell their spectrum at auction-- are ***more in the dark and confused than ever about how to sell their spectrum at auction*** and highly apprehensive about the auction because of:

(a) the unavailability of that most rare form of expert knowledge, the wherewithal to develop a successful bidding strategy in a reverse auction, and

(b) the unaffordable high cost to public stations of hiring such expert auction advisory services<sup>6</sup>—due to consultancies’ high fixed cost of developing sophisticated software that creates superior bidding strategies in a reverse auction<sup>7</sup> that they can attempt to recoup through only one client (--let alone turn into a profit center). Public stations are most in need of competent auction advisory but it is not available to them because of the blackout rule extended to management consultants. If consultants were able to offer auction advisory services to multiple bidders, they could naturally charge lower, more affordable consulting fees due to the economies of scale).

**Petitioner Terence Dunn therefore proposes that the Task Force modify the rules governing the blackout period before and during the reverse auction as established in the May 2014 Report and Order so as to:**

A. Allow any management consulting firm to provide auction advisory services to any number of public television stations across the United States--but limited to no more than one client within any designated market area (DMA)—except if the second and additional public station clients are party to channel-sharing agreements, and with no limitation as to timeframe. (If a consulting firm has any clients bidding in the reverse auction, it is strictly prohibited from having any clients participating in the forward auction.)

B. Allow any management consulting firm to provide its auction advisory services to one commercial television station or to one multiple-station owner in any one market (DMA). (If a consulting firm has any commercial station clients bidding in the reverse auction, it is prohibited from having any clients that are participating in the forward auction.)

C. In facilitation of measures (A) and (B) above, establish an “anti-collusion protocol” for auction consultants and their public station clients that require:

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<sup>4</sup> As explained to Petitioner Dunn by Auction Task Force legal counsel Mary Margaret Jackson.

<sup>5</sup> Some managers were literally terrified to the point of paralysis.

<sup>6</sup> “sophisticated auction advisory services” is defined here as a slate of four services: (1) the determination of a minimum bid price through sophisticated valuation, (2) the creation of bidding strategies, (3) the testing of bidding strategies using auction simulation software, and (4) real-time advice on bidding strategy during the reverse auction stages.

<sup>7</sup> Based on discussions with his colleagues and with other consulting firms such as Arlington Economics, Petitioner Dunn estimates that the cost of developing software that creates customized bidding strategies for spectrum sellers and tests strategies through auction simulations, and then can be used to provide real-time auction advisory throughout the reverse auction to be in the range of \$600,000 to \$1 million.

- (1) consulting firms to design effective and verifiable insulation between each and every client bidding in the reverse auction. Such insulation would prevent any communications between a consultancy's clients and prevent any communications between the consulting firm and its multiple clients during the auction. An example of such fully insulated advisory would be (a) customized auction simulation software and (b) bidding strategy creation software given to the client along with a dedicated on-site software instructor who would work only for that client throughout the auction and have no communications with other bidders or the home office of the consultancy.
- (2) consulting firms with more than one client bidding in the reverse auction to agree to install (at their expense) an FCC observer/monitor at their place of business throughout the entire auction, giving the monitors access to all telephonic and electronic communications between the consultancy and all its auction clients and to the records of such communications. Each of the consulting firm's client stations will also agree to allow an FCC observer/monitor to be embedded at the office of the senior executive or General Manager who will be directly executing the station's bidding strategy via the auction software.

### **Rationale for I-A: Permitting Consultants to advise multiple public station bidders**

The following are compelling reasons why the blackout period prohibiting communication between bidders after the registration date<sup>8</sup>—extended to include intermediaries such as management consultants providing auction advisory services—should be modified to allow consultants to advise more than one public television station bidder if all are in different markets:

1. The blackout rule's limitation of any consulting firm's number of spectrum-selling clients to one (1) deprives the universe of potential bidders--both public and commercial broadcasters--of a very rare expert knowledge that public tv broadcasters cannot possibly develop for themselves: the ability to develop successful bidding strategies to sell spectrum in a particular market in a reverse auction. ***Removing the limit of one spectrum-selling client for every consulting firm will make available to all potential spectrum sellers a rare and valuable expertise that they otherwise could never afford. Making affordable consulting services available to public broadcasters would certainly encourage more of them to participate in the auction as independent bidders and aver from the predatory subsidy deals offered by private equity. (The latter default option, of course, translates into much higher spectrum acquisition costs in the reverse auction.)***

The number of consultants specializing in FCC auction advisory is miniscule compared to the hundreds of television broadcasters that the Commission hopes will participate in the reverse auction. Many of the consultants offering auction advisory services are lawyers with experience in previous FCC forward auctions. By and large, the managers of public stations are seeking auction advice from either their in-house lawyers or outside law firms who are putting on a consultant's hat. These lawyers, if they are smart, are in turn getting their knowledge in reverse auction bidding strategy from a few consultants with high-level mathematics backgrounds—specifically, Ph.D.'s in non-cooperative game theory—and perhaps with some remote experience in reverse auctions.

The 2016 incentive auction will be the first reverse auction in the history of the FCC and television broadcast industry. The only other previous reverse auction on a large scale in American industry took place in the auto industry in the year 2000. No public broadcaster would ever think to retain on its own account an economist to research previous reverse auctions and apply whatever relevant

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<sup>8</sup> --as stipulated in the May 15, 2014 Report and Order and the February 17, 2015 Public Notice seeking feedback on the preliminary "Competitive Bidding Procedures".

knowledge might be gleaned from them to optimizing a bidding strategy in the coming incentive auction—let alone develop a bidding strategy that rises above guesswork.<sup>9</sup>

The investment of capital and talent to create computer software that develops successful bidding strategies in a reverse auction is not specific to any particular TV station. For once the bidding strategy creation program is developed, the market-specific variables such as population size, historical prices in paid for licenses, the number of competing sellers, engineering data, the Commission's opening bid prices, estimated demand by forward auction bidders, etc. are inputs to the software program. The fixed development cost of software that creates reverse auction bidding strategies and tests them through simulations should be incurred only once, from the standpoint of any consultant. With hundreds (if not thousands) of TV stations potentially interested in selling their spectrum at auction, this fixed cost would have to be expended hundreds of times, if broadcasters are to participate in the numbers that the Commission is hoping for. Aside from the largest commercial broadcasters that own scores of stations, the majority of commercial broadcasters—and certainly all the public broadcasters--do not have the resources or confidence to develop reverse auction bidding strategies themselves. Thus the unavailability of auction expertise from consultants caused by the blackout period is a significant economic deadweight loss—one that leaves potential bidders perplexed and paralyzed and directly suppresses their participation in the reverse auction.

As Commissioner Ajit Pai complained in his dissenting statement attached to the end of the February 2015 Public Notice, the proposed rules of competitive bidding are so complex and difficult to decipher that they discourage broadcasters from participating in the reverse auction. Management consultants offering auction advisory services cannot make a dent in this sea of confused and intimidated public station trustees if they cannot advise more than one client throughout the reverse auction.

Such a complicated auction design in both the reverse and forward auction would normally be a management consultant's dream. However, the limitation of one bidder per consulting firm makes paying the high fixed cost of developing a slate of auction advisory services a waste of money, time and brainpower. Consultants have no incentive to develop superior auction advisory services because they must drop all but one of their other clients at the date of auction registration. Hence neither Dunn's firm nor his colleagues at Arlington Economics in Washington, D.C., whom he respects as the "best in class" when it comes to FCC auctions, have not taken the first step in developing auction advisory services on spec for tv broadcasters--although they have discussed it over the past year.

- 2. Expert know-how to sell an asset at a reverse auction is very costly for a consulting firm to develop—especially given the complex design of the 2016 incentive auction--and the black out period makes it practically impossible for any consultancy to recoup this fixed cost and to capitalize upon it . Allowing consulting firms to advise more than one bidder (each one in different markets) will make top-tier auction advisory widely available to public and commercial broadcasters and make such services affordable to public stations (that need it the most) due to the economies of scale.**

Understanding the legal and economic framework of the incentive auction and its extremely complex procedural workings<sup>10</sup> and then developing a bidding strategy to successfully sell spectrum requires rare and high-priced talent. For understanding just the basic workings of the reverse auction

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<sup>9</sup> --e.g., praying that their stab at a minimum bid price (based on some weighted average of a valuation of its license and the Commission's opening bid price) will be far below what the Commission offers during the auction.

<sup>10</sup> --as proposed thus far in the May 15, 2014 Report & Order and the February 17, 2015 Public Notice FCC 14-191 seeking feedback on the preliminary Competitive Bidding Procedures.

integrated with the forward auction in several stages, all the implications of dynamic reserve pricing, and the two conditions by which the final stage rule is satisfied--strains the comprehension of the average general manager of a public tv station. The ability to understand the more complicated procedural rules of the reverse auction proposed in February (FCC 14-191) and to develop a successful bidding strategy within a particular market is totally beyond the expertise of the management teams of virtually all public tv broadcasters--and that of the CEO's and CFO's of most commercial broadcast companies as well. For this rare capability requires the expertise of a Ph.D. in mathematics (specifically, in non-competitive game theory)—plus experience in other reverse auctions.

Based on discussions with his colleagues and with other consulting firms such as Arlington Economics, Petitioner Dunn estimates that the cost of developing software that creates customized bidding strategies for spectrum sellers and tests strategies through auction simulations, and then can be used to provide real-time auction advisory throughout the reverse auction to be in the range of \$600,000 to \$1 million.

If consulting firms are allowed to spread their fixed software development costs across several clients participating in the reverse auction, they can naturally charge a lower consulting fee due to the economies of scale. Once the methodology to develop and optimize bidding strategies is created on computer software, the strategy can be easily customized to cater to an individual TV station's market specifications and dedicated software instructors/coaches can be trained to execute the strategy during the auction.

If consulting firms are permitted to advise more than one public station bidder throughout the reverse auction, this much-needed auction advisory will enable more public stations to participate in the reverse auction independently and obviate their reliance on the rapaciously priced subsidy deals pushed by private equity firms that promise their best efforts to sell the stations' spectrum for greatest gain in exchange for a 40% or greater share of a licensee's auction proceeds.

- 3. Permitting consulting firms to advise more than one bidder in the reverse auction will curtail the spectrum-acquisition frenzy of private equity firms by offering competing and comparable --if not superior--auction advisory to the tv broadcast industry, but at much lower and affordable fees.** As stated above in Paragraph 2, understanding the extremely complex procedural workings of the incentive auction<sup>11</sup> and then developing a bidding strategy to successfully sell spectrum in a particular market in the reverse auction requires high-priced intellectual assets that only a consulting firm with an adequate client base (i.e., multiple bidders as clients) or a large private equity firm (with a portfolio of commercial stations with a speculatively rich upside) can justify investing in. Because high-priced, competent auction consultants are unavailable to all but a tiny handful of public stations (those with the biggest budgets from income generation and/or superior fund-raising programs), public tv stations interested in participating in the auction over the past three years have had nowhere to turn for high-quality auction advisory except towards the subsidy deals pushed by private equity firms.<sup>12</sup> The strategy of all the private equity firms<sup>13</sup> actively speculating on

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<sup>11</sup> --as described thus far in May 15, 2014 Report & Order and the February 17, 2015 Public Notice seeking feedback on the preliminary Competitive Bidding Procedures)

<sup>12</sup> Some of the subsidy deals closed by private equity firms over the past two years have been: (a) The Connecticut Public Broadcasting Network (CPBN) selling interest in two of its stations to LocusPoint (Blackstone) in 2013. (b) In February of 2013, the board of directors of KCSM in San Mateo, (a station that Petitioner Dunn coincidentally had worked with in originating content starting in 2008), accepted a subsidy deal with LocusPoint and will be going dark after the incentive auction. (c) In November 2014, the board of a public station in northern Indiana overlapping the high-valued Chicago market that Petitioner Terence Dunn was advising pro bono for nine months, despite his best advice to the general manager to hold-off, signed a subsidy deal with undisclosed terms.

broadcast spectrum is of course to control largest blocks of TV spectrum in every major market so that it can negotiate larger and more profitable carve-outs with the Commission during the reverse auction.

**The FCC's cost of acquiring noncommercial spectrum controlled by private equity firms will of course be much higher than acquiring it from public tv stations participating independently and bidding according to their own devices.** Private equity firms that are strategically speculating on non-commercial TV broadcast spectrum are adding this spectrum to their existing portfolios of commercial TV stations in the major markets (and secondary markets as well). Thus, the **Congressional bill authorizing private equity firms to acquire (through "subsidies") a stake in the liquidated value of noncommercial broadcast spectrum and complete control over a public station's auction bidding has created a legal but far more costly form of economic collusion than the type of collusion historically discouraged by the blackout period.**

Private equity firms have had nearly three years to run wild through the henhouse of once-paralyzed public broadcasters with no competition whatsoever in the way of auction advisory services. As the General Manager of one Chicago area station described to Terence Dunn in the spring of 2014 in an out-of-breath manner, his station's front door---along with those of all others in his market---have been "revolving nonstop at high speed" every week Monday through Friday with private equity executives going in to make their solicitations.

A typical private equity "subsidy deal" offered to a public tv station is modeled below in Exhibit A, titled "Sample West Coast Auction Alternatives for Subsidized Public TV Station." The spreadsheet was prepared by the general manager of a west coast public tv station (here given the fictitious call letters "KOOL") and models the range of outcomes of a subsidy deal proposed to him by one of the three private equity firm most active in investing in broadcast spectrum--which he ultimately declined. The basic structure of this deal is that the station, in return a \$5 million bridge loan from the investment company (bearing 8% simple interest; exit at the reverse auction with the sale of the license), turns over control of its auction bidding strategy to it, along with 40% of the auction proceeds when the station's license is sold.

By entering into such 40%+ deals, a public broadcaster is getting a sizable short-to-medium term loan of \$5 million at simple interest for working capital that it would probably not be able to secure from a commercial bank or a special lender for lack of sufficient free cash-flow and/or assets for collateral. If the private equity firm is 100% confident of its valuation of the station's license and its ability to sell the station's spectrum, then this bridge loan approaches being a no-risk investment. But such bridge loans represent very big carrots to public stations that are universally cash-strapped and are far behind the universe of commercial tv stations in building their digital platforms. Because of the inexperience (with reverse auctions) of a typical public station's general manager and directors and their inability to find affordable expert auction advisory from any quarter (given that consulting firms

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<sup>13</sup> (1) The Blackstone Group LP owns 99 percent of a subsidiary called LocusPoint through its "Blackstone Tactical Opportunities" division. In February of 2014, LocusPoint purchased two public stations from the Connecticut Public Broadcasting Network (CPBN). Then in Feb. 2013, the Board of Directors of KCSM in San Mateo (a station that Petitioner Dunn coincidentally had worked with in originating content starting in 2008), accepted a subsidy deal with LocusPoint and will be going dark.

(2) NRJ TV LLC is a media holding company funded by loans from Fortress Investment Group LLC., a private equity firm with more than \$50 billion in assets under management. According to its S.E.C. filings, NRJ's media acquisitions include the \$22.7 million purchase of WZME in New York in August 2011, the \$30.4 million purchase of WTVE in Philadelphia and the purchase of KNET in Los Angeles for \$4.4 million.

(3) OTA Broadcasting is a division MSD Capital, L.P., a private equity firm that employs the capital of Dell Computer founder Michael Dell and his family. MSD Capital is headquartered in New York City and also has an office in Santa Monica, California in the same building as Dunn's office. Prior to turning to its acquisition sites on non-commercial spectrum, OTA had invested in unprofitable commercial stations in key and outlier markets. OTA's deals include purchases of KAXT in San Francisco for \$10.1 million in January and WEBR in New York for \$6.6 million in 2012.

cannot advise more than one bidder), private equity firms are able to charge a staggering premium for an insurance policy stating that they will make their best efforts to sell the station’s spectrum in the reverse auction. 40% of station KOOL’s auction proceeds under the forecasted “Middle” sale price scenario (based on Mhz-POP of \$3.25) amounts to **\$24,688,640**. If sold at the very top of the range of historical prices paid for spectrum in forward auctions (Mhz-Pop of \$6.10), the investor waterfall is **\$33,138,334**. If the gross price suppression estimated on Line 9 “reverse auction adjustment” (e.g., approximating the effects of proposed opening price methodology and dynamic reserve pricing) is removed, the median waterfall to the investor in that market will be **\$45,771,544** and the high-end waterfall will be **\$83,743,928**.<sup>14</sup>

### Exhibit A – Sample West Coast Auction Alternatives for Subsidized Public TV Station

KOOL Spectrum Auction Alternatives							
	Proceeds Alternatives						
	Low	Near Low	Mid Middle	Middle	High Middle	High	Very High
Spectrum in Auction	100%	100%	100%	100%	100%	100%	100%
Loan from Investor	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
3 Year Interest @8%	1,298,560	1,298,560	1,298,560	1,298,560	1,298,560	1,298,560	1,298,560
<b>Redemption Price</b>	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560
47,212,842 Mhz POPs @	47,212,842	47,212,842	47,212,842	47,212,842	47,212,842	47,212,842	47,212,842
APTS Low Range to High Range	<b>\$0.95</b>	<b>\$1.25</b>	<b>\$2.25</b>	<b>\$3.25</b>	<b>\$4.25</b>	<b>\$5.10</b>	<b>\$6.10</b>
	\$44,852,200	\$59,016,053	\$106,228,895	\$153,441,737	\$200,654,579	\$240,785,494	\$287,998,336
Reverse Auction Adjustment %	35%	35%	45%	55%	55%	60%	65%
Reverse Auction Adjustment	(\$15,698,270)	(\$20,655,618)	(\$47,803,003)	(\$84,392,955)	(\$110,360,018)	(\$144,471,297)	(\$187,198,919)
Auction Proceeds	\$29,153,930	\$38,360,434	\$58,425,892	\$69,048,781	\$90,294,560	\$96,314,198	\$100,799,418
Redemption Price	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560	6,298,560
<b>Net Proceeds</b>	22,855,370	32,061,874	52,127,332	62,750,221	83,996,000	90,015,638	94,500,858
<i>Level 1 Proceeds to \$20 million</i>	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000
Investor Waterfall	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%	40.00%
Investor Proceeds	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000
Sub-total Investor Proceeds (proceeds + interest)	9,298,560	9,298,560	9,298,560	9,298,560	9,298,560	9,298,560	9,298,560
KOOL Waterfall	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%
KOOL Proceeds	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000
<b>Sub-total KMTP Proceeds</b> (Proceeds plus Principal)	17,000,000	17,000,000	17,000,000	17,000,000	17,000,000	17,000,000	17,000,000
<i>Level 2 Proceeds &gt; \$20 million</i>	2,855,370	12,061,874	32,127,332	42,750,221	63,996,000	70,015,638	74,500,858
Investor Waterfall	40.00%	40.00%	36.00%	36.00%	36.00%	32.00%	32.00%
Investor Proceeds	1,142,148	4,824,750	11,565,840	15,390,080	23,038,560	22,405,004	23,840,274
<b>Total Investor Proceeds</b> (proceeds + Interest)	<b>10,440,708</b>	<b>14,123,310</b>	<b>20,864,400</b>	<b>24,688,640</b>	<b>32,337,120</b>	<b>31,703,564</b>	<b>33,138,834</b>
KOOL Waterfall	60.00%	80.00%	64.00%	64.00%	82.00%	68.00%	68.00%
KOOL Proceeds	1,713,222	9,649,499	20,561,492	27,360,142	52,476,720	47,610,634	50,660,583
<b>Total KOOL Proceeds</b>	18,713,222	26,649,499	37,561,492	44,360,142	69,476,720	64,610,634	67,660,583

<sup>14</sup> Calculated by adding Line 9 value to Line 20 value and multiplying by line 21, the investor waterfall percentage.

40%--or even 20%--of a public station's auction proceeds in any major market thus can translate into an astronomical windfall for private investors. With such high stakes attached to non-commercial spectrum, general managers and trustees of uncommitted public tv stations would do well to have the warning, "Borrower beware," tattoo'd on the back of their writing hands.

## **SUMMARY AND CONCLUDING ARGUMENT**

In his introductory email to Task Force head Gary Epstein in July 2015, prior to being asked to file this proceeding, Petitioner Terence Dunn asked him the question:

"What type of public stations does the FCC want participating in the auction: (a) independent bidders guided by competent auction consultants, or (b) public stations with their bidding strategies given over 100% to the strategy groups of private equity firms through the "subsidy deals" that effectively merge their controlling interest in public tv spectrum with their portfolio holdings of commercial spectrum previously acquired in the same markets?

Dunn asks this same question here and respectfully urges the Task Force to carefully and rigorously assess if there is any negative trade-off between the downside risk of possible collusion between public tv stations in different markets (hypothetically instigated or mediated by a common management consultant) and the upside benefits of (a) more public tv stations participating in the reverse auction and (b) those public stations bidding independently --as opposed to having their bidding strategies 100% determined by private equity firms holding portfolios of stations in numerous markets.

Because the probability of collusion between two or more public stations in different markets executed through a common consultant is so very low to begin with<sup>15</sup> and that collusion can be eliminated by implementing a specific anti-collusion protocol, the above decision tree analysis weights strongly and rationally in favor of facilitating (a) public stations bidding independently guided by competent auction consultants.

**Petitioner Dunn thus urges the Task Force to make the proposed refinements to the auction rules governing non-collusion to enable consulting firms to advise multiple public station clients (in different markets) and facilitate this rule-change by establishing new anti-collusion protocols as touched upon in Section I-C.**

**In doing so, there will be no incremental increase in the risk of collusion by the client public stations. Even if collusive bidding in the reverse auction by two public stations in different markets instigated by a common consultant were to occur, the hypothetically higher cost of acquiring their spectrum will not come close in magnitude to the very real and ever-increasing cost of acquiring similar amount of spectrum from a private equity firm with a large portfolio of stations spanning many markets.**

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<sup>15</sup> Such collusion scenarios are most unlikely because (1) The imperative and overriding goal of any public station's management to monetize its spectrum in the reverse auction will make it extremely risk-adverse during the auction and not prone to collude with another bidder in a different market to price-fix and (2) It is not in a consultant's self-interest to orchestrate collusion between public stations during the auction because consultants retained by public stations typically are not compensated in a way that incentivizes risk-taking in this manner--i.e, increasing the risk of not selling the station's spectrum in order to maximize the sale price at auction (through collusive bidding) in order to be earn a higher fee. If a consultant's compensation was front-loaded with a substantial cash retainer in the mid-to-high six figures and featured a very substantial contingency fee based on successful sale of spectrum plus an additional kicker based on selling the spectrum at a price above a threshold valuation, then there would be great motivation for the consultant to maximize the sales price at auction by any means, including engaging in collusion. Propensity to take bigger risks in this case due to having received a substantial cash retainer upfront creates a real threat of collusion because of the *wealth effect*. But none of the 40+ public stations in major markets that Consultant/Petitioner Dunn has conferred with over the past 18 months--except for one New York station--can afford to compensate a consultant in this manner.

Petitioner Dunn's proposal to permit consulting firms to advise more than public station bidding in the reverse auction should be adopted by the Commission Task Force--if not for the sake of furthering the public interest in giving non-commercial spectrum licensees the wherewithal to sell their licenses themselves and thereby keeping their auction proceeds whole to endow their respective public institutions, then for the sake of furthering some of its most basic goals in the incentive auction:

- (1) getting more public stations to participate in the reverse auction, and
- (2) reducing the Commission's costs in acquiring non-commercial spectrum in the reverse auction and thereby increasing the net proceeds after the forward auction.

Commissioner Ajit Pai remarked in his dissenting statement at the end of the February 17, 2015 Public Notice (FCC 14-191) that that document's proposed rules add a layer of complexity on an already very complex auction design. He thus wished "stakeholders that plan to comment on the proposed auction rules the best of luck in trying to decipher what these proposals mean and how they are supposed to work." After careful and extensive review of those proposed rules in the February PN over the past eight weeks, Petitioner Terence Dunn and his colleague Dr. Michael Nowotny<sup>16</sup>, feel that Commissioner Pai's good wishes offer pale shelter and further agree with Mr. Pai that the proposed rules would discourage broadcasters from participating in the reverse auction. Moreover, given the extremely complex rules of competitive bidding proposed thus far, the standing "one bidder per consulting firm" rule, and the fact that special dispensation had to be gotten from Congress for private equity to take positions in non-commercial broadcast spectrum through its subsidy deals, Petitioner Dunn cannot help but wonder if the auction rules have been designed so complexly in part to drive public broadcasters into the arms of private equity firms.

As explained on page 6, private equity firms have enjoyed a free run through the world of public television broadcasters over the past 3 years where they were able to exploit with some success the perennial cashflow problems faced by general managers, their initial ignorance with regards to pre-auction, pre-Greenhill spectrum valuation, lack of sophistication in fully grasping the windfall magnitude of a spectrum sale and its lasting impact, and a lack of confidence based on inexperience and not knowing that an auction is an auction. As we approach within one year of the incentive auction, the managers and directors of public stations are better informed about the special opportunity that the reverse auction represents, have better understanding of the value of their licenses, and will be less susceptible to paying upwards of 40% of their auction proceeds for seller's insurance. The rate of noncommercial spectrum being made available for the forward auction by private equity deals is slowing down and will continue to do so. Therefore, it would be timely regulatory move to now formally allow management consulting firms to advise as many public station clients as they can handle (given the restrictions outlined in Section I), if the Commission wants more public stations participating in the reverse auction.

### **Rationale for I-B: Permitting Consultants to advise one commercial tv station bidders in each market**

- (a) Independent commercial tv broadcasters and smaller commercial broadcast companies—in contrast to the largest broadcasting companies owning scores of stations—do not have the in-house resources to develop bidding strategies for a reverse auction and are in the same boat of confusion that the

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<sup>16</sup> Michael Nowotny is a former professor of finance at Boston University Graduate School of Business's MBA program. He earned a Ph.D. in management with a specialization in finance at UCLA. He earned his bachelor's degree in mathematics at Mannheim University, one of the most rigorous mathematics colleges in Germany. His research focus is in pure rationalist mathematics applied to finance and has no intellectual interest in non-cooperative game theory.

public stations are in.<sup>17</sup> Making affordable auction advisory available to commercial stations will encourage more of them to participate in the auction.

- (b) Collusion between two commercial stations in different markets is not likely unless one or both have special knowledge as to how much spectrum is in demand for their respective markets and how much the commission is willing to pay for both licenses.
- (c) The senior executives at commercial broadcasters are generally more savvy and aggressive than their public station counterparts. If two commercial broadcasters are intent on colluding, it is likely that the collusion will be planned well in advance of the registration for the auction.
- (d) Similarly, two commercial broadcasters intending to collude in bidding are not necessarily going to wait for a management consulting firm to come by to advise them to collude.
- (e) A consulting firm will not be able to orchestrate a collusion between two clients nor direct collusive bidding in real time during the auction –if the measures outlined in (I-C) on page 3 are implemented.

The upside benefits allowing consulting firms to provide services to at least one commercial station in each market is that these commercial stations will have more confidence in their bidding strategies and thus will be more encouraged to participate. They will also benefit from consultants' more sophisticated algorithms for deriving spectrum valuations, which in turn will prevent situations from occurring where a commercial station drops out of the reverse auction because it is operating on a hyper-inflated, above-market valuation.

## **II. RECOMMENDATION: To Schedule the Incentive Auction in 4<sup>th</sup> Quarter 2016**

Petitioner Dunn urges the Task Force to schedule the incentive auction in the last quarter of 2016 to give consultants more time to advise public and private television clients alike in the complexities of the reverse auction and to bring them out of dire confusion.

## **III. RECOMMENDATION: To Conduct a Second Incentive Auction Exclusively for Public TV Broadcasters to Divest Spectrum 6 to 12 Months After the First Auction.**

In addition to recommending the above modifications to the “blackout period” to enable consultants to advise multiple public station clients throughout the incentive auction, Petitioner Dunn also urges the Task Force to segregate all public television broadcasters from the scheduled 2016 Incentive Auction and conduct **a separate incentive auction** six to twelve months later in order to give the 171 public institutions (holding the licenses of 355 public stations<sup>18</sup>) more time to get educated and versed in the reverse auction, and thus participate as sellers in greater numbers.

**Upside:** While segregating public broadcasters from the first incentive auction and conducting a separate and more organized reverse auction for them would interrupt and prolong and the repacking plan, doing so would be tremendously beneficial to public television and to the forward auction

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<sup>17</sup> Only the largest and most profitable commercial broadcasters that own scores of stations have their own financial strategy staffs and the ability to hire top consulting firms staffed-up with Ph.D.'s in applied mathematics with specialization in non-cooperative game theory, and thus would be able to create bidding strategies for a reverse auction with any confidence of success.

<sup>18</sup> 355 public stations of which 342 are part of the PBS network.

bidders and greatly advance the Commission's strategic revenue-generating and spectrum re-allocating goals. Holding second incentive auction would:

1. Naturally enable public tv broadcasters to learn lessons gained from the first auction (primarily through management consultants) and create a great comfort level. This would result in more public stations participating in the auction. Results in greater learning for management consultants developing bidding strategies a simultaneous reverse auction and forward auction.
2. Give the universe of public stations more time to build out their digital platforms and thus enable them to divest their spectrum at the most natural time. Because of public broadcasters' limited budgets and their managements' preoccupation with broadcast operations and fundraising, the vast majority of pubcasters are far, far behind their commercial tv counterparts in building their digital platforms. Once any public tv broadcaster has its digital platform up and running, relinquishment of its spectrum will become and a top priority.
3. Allow for a more orderly auction, where public tv stations will have more time and the opportunity to get educated by a wider selection of competent auction advisors, and to participate in the auction as independent bidders with high confidence and avoid relinquishing their power to sell to private equity firms.
4. Allow public station participants that dropped out of the reverse auction at some point in the bidding to have a second shot at selling their spectra--with the benefit of its experience plus access to the greater auction expertise of consultants developed through learning.
5. Enable the Commission to acquire more 600 Mhz spectrum should demand by the wireless telecommunications industry in the first auction exceed supply.
6. Enable the Task Force to learn from the first auction and to fine-tune the rules for the second one, to specifically address and more constructively address the concerns and idiosyncracies of the management culture of public television stations, with the ultimate result of maximizing seller participation.
7. Enable the Commission to acquire more non-commercial broadcast spectra than in the first auction and to acquire it more cost-effectively.
8. Obviate the need for public stations out of panic and lack of understanding of the competitive bidding rules of the (second) auction to enter by default into subsidy deals that convert a massive bulk of the liquidated value of their spectrum to the benefit of private investors. By giving public stations more time to prepare for a later incentive auction, thus giving them a reprieve from private equity solicitations, this legalized form of conversion of public resources that Professor Ellen Goodman of Rutgers University's Institute For Information Policy and Law has been protesting as "scandalous"<sup>19</sup> for the past two years will be further reined in.

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<sup>19</sup> Two years ago, Congress made the fateful decision to allow noncommercial stations to cash out of their spectrum when it goes up for auction to wireless providers. That means that a university licensee can sell its spectrum and put the proceeds into a gym or a dorm. Or, the licensee can enter into a deal with a commercial entity to split the proceeds in return for subsidizing its operations until that fateful auction day. It's like this: a nonprofit is granted (at no cost) public land to operate as a park, and then allowed to sell the land on the commercial market, splitting the proceeds with a private equity firm. The park is gone, and the public gets nothing other than more commercial real estate." (Excerpt from "Scandalous Privatization of Noncommercial TV Spectrum" by Ellen Goodman about the acquisition of KCSM San Mateo, CA by Blackstone Group's LocusPoint subsidiary in 2013, posted on [www.media-alliance.org](http://www.media-alliance.org))

9. Allow private equity firms more time—and a second bite at the apple—to close subsidy deals with those public stations that are in such financial distress and desperate need of immediate cash infusion that 40% deals like the one modeled in Exhibit A are their best and only solutions.

**Downside risk to public stations:** The downside risk for the public stations to stay out of the first auction and participate in the recommended second auction is that the demand for spectrum by the telecom industry may be fully or substantially met by the first auction, and it may wind up selling its spectrum for less money in the second auction than what it would gotten have from the first auction—or or not be able to sell it at all.

**Downside risk may be offset:** However, the risk that a public station may not sell its spectrum at a price as high as in the first auction may be more than offset by the fact that they will not need to split off 40% of its auction proceeds to a private equity firm!

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