COMMENT REGARDING COMPETITIVE BIDDING PROCEDURES FOR AUCTION No. 70

DA 06-1810

AU Docket No. 06-170

Before the Federal Communications Commission
445 12th Street SW
Washington, DC 20554

In a Public Notice dated September 21, 2006, the FCC seeks comments regarding competitive bidding procedures for Auction 70. In Section II.D.1 of the aforementioned Public Notice, it is proposed that the interim withdrawal payment for a withdrawn bid be increased to twenty percent. The Commission supports this proposal by "[c]iting experience with Auction 37, among others, [wherein] the Commission has observed a disproportionate number of withdrawals late in our auctions, indicating that some bidders have been placing and withdrawing bids primarily to discourage potential or existing market competitors from seeking to acquire licenses."

1. The Commission's reasoning as to why bidders withdraw bids late in the auction is seriously flawed.

The Commission's reasoning as to why bidders withdraw bids late in the auction is seriously flawed. It is incorrect and misleading for the Commission to assume that such bidders seek to discourage market competition when simple common sense indicates that these bidders are attempting to avoid huge withdrawal penalties. Yet if the Commission fails to comprehend the true reasons for late bid withdrawals, the Commission will continue to experience problems with unsold allotments. Although the problem could be addressed by placing an absolute ban on bid withdrawals, such an approach would have a chilling effect on bidding, significantly reducing auction revenue.

2. A Bidder's Dilemma

The primary reason for bid withdrawals is that the auction activity requirement creates a bidders dilemma. If a bidder confines their bidding solely to a desired permit, the activity requirement mandates placement of yet another bid every time they are displaced as the standing high bidder. In short order, the price of the desired permit may escalate beyond reach. In order for a bidder to maintain eligibility while keeping price increases on a desired permit to a tolerable level, auction rules implicitly encourage bidding on permits having little value to the bidder. This phenomenon, known as "parking", has been discussed at length in a textbook entitled, "Auctioning the Radio Spectrum", Chapter 1 of Auction Theory for Privatization, by P. Milgrom, Cambridge University Press, 1998.

Although the Commission's goal is to achieve as high a price as possible for an allotment, the bidder does not share this objective and will utilize various available options in an attempt to limit their overall expense. In the case of a small businessperson, any loss in bidding eligibility, however minor, may result in permanent loss of the ability to bid on a desired allotment. In order to preserve full eligibility, one may repeatedly bid on an undesired permit so as to cause price increases resulting therefrom to be reflected in the undesired permit, not the desired permit. Later in the auction, the small businessperson hopes to dump the undesired allotment for the desired allotment, predicting that the price of the desired allotment will be lower than if the small businessperson had previously restricted their bidding to the desired allotment only. Does the current bidding credit scheme address such concerns? A majority of Auction 37 and 62 participants qualified for a full (35%) or partial (25%) credit, notwithstanding the fact that many of these participants had access to deep and extensive financial reserves, placing bidders of more modest financial means at a significant disadvantage.

In order to compete against these insurmountable odds, true small business concerns may be motivated to adopt potentially risky auction strategies such as parking. Ideally, as the auction progresses, a small businessperson parking on an undesired license hopes to be outbid on this license in due course, whereupon he will commence bidding on a desired license. However, dire consequences may ensue if such outbidding does not take place before the close of the auction.

3. Bidding Activity decreased abruptly during Auction 37, taking some bidders by surprise. Bidders who thought they were safely parked on undesired allotments remained as standing high bidders, thereby causing bid withdrawals to be submitted late in the auction.

Some bidders committed serious and irreversible errors during Auction 37 because these bidders were familiar with auction rules in theory, but not in practice. These bidders did not have an opportunity to observe the practical effects of these rules until Auction 37 was nearing completion. Without a doubt, the mock auction was useful in terms of identifying computer connectivity problems and software interoperability issues, but woefully inadequate as a vehicle by which bidders could gain practical experience applicable to competitive, real-world bidding situations. Specifically, certain less desirable allotments were repeatedly rotated from bidder to bidder in Auction 37, wherein these allotments effectively constituted a community parking lot for purposes of preserving eligibility. Unfortunately, several naïve and unsuspecting bidders were left “holding the bag” (stuck with these allotments) when auction activity experienced a sudden and marked decrease in the latter rounds. This situation is similar to a game of musical chairs where the music suddenly stops playing and an unfortunate player remains standing.

Although the FCC has engaged in extensive studies of auction gaming theory, an inexperienced bidder may not have the time, resources, or expertise to do so. At the same time, the inexperienced bidder is provided with no warning for avoiding a devastating pitfall that a clinical yet thorough review of the auction rules fails to reveal. This common pitfall occurs when a bidder holds an unwanted allotment beyond mid-auction in an effort to preserve eligibility for subsequent bidding on a desired allotment. As bidding activity decreases in a non-linear manner, the bidder may be subjected to a severe "parking fine" or final withdrawal payment that could very well exceed the amount of a subsequent winning bid.

If the Commission wishes to discourage late auction bid withdrawals, this is best accomplished by adopting a strategy that is fully cognizant of the reasons why such bid withdrawals may occur. Though it may be tempting for the Commission to ascribe sinister motivations to late auction bid withdrawals, the reality is that these withdrawals are primarily attributable to parking. Late auction bid withdrawals can be discouraged or eliminated by replacing the current two-component (interim and permanent) withdrawal payment scheme with a single, permanent payment assessed at the end of each and every auction.

4. The existing concept of Interim and Permanent Withdrawal Payments should be replaced by a flat 10% Permanent Withdrawal Payment that is due and payable at the end of every auction, with no obligation on the part of the Withdrawing Bidder being deferred to any subsequent Auction. The most effective technique for discouraging repeated bid withdrawals in successive auctions is to make each auction a completely independent event.

Under the Commission's rules, if a given allotment remains unsold at the end of an auction due to a bid withdrawal, then until there is a winning bid for a given allotment, there is no basis for determining the final withdrawal payment that is due. Accordingly, it is in the best financial interest of the withdrawing bidder if a long period of time elapses before a winning bidder for a given allotment is declared, because <u>until</u> a winning bidder is declared for the allotment, no 'final payment' needs to be made.

All bidder obligations should be settled at the end of each auction, with no obligation continuing forward that is contingent on the outcome of a successive auction. The current two-step bid withdrawal scheme (interim payment followed by permanent payment) should be scrapped in favor of a fixed-percentage, permanent bid withdrawal penalty at the end of each auction in the amount of 10% of a bidder's withdrawn high standing bid.

By levying a fixed-percentage, final penalty at the end of each auction, bid withdrawals would be discouraged much more effectively than in the case of current procedures where many withdrawing bidders are willing to take a gamble that their withdrawn allotment will experience a price increase in a subsequent auction. This proposal would distribute the cost of bid withdrawals more effectively among withdrawing bidders, avoiding extreme withdrawal payments that may have a chilling effect on bidder participation. This proposal would also eliminate inequitable situations where a withdrawal payment grossly exceeds the amount of another bidder's subsequent winning bid. This is especially important if the bidder is a small business or sole proprietorship where the bidder faces financial ruin or bankruptcy at the hands of a withdrawal payment equivalent to five or ten years of hard-earned income, and far in excess of the fair market value of the permit in question.

Respectfully Submitted this 4th day of October 2006:

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