**Reply Comments on the FCC Wireless Bureau's Proposed**
**COMPETITIVE BIDDING PROCEDURES FOR AUCTION 73**
(DA 07-3415, August 17, 2007; AU Docket No. 07-157)


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We have reviewed all of the comments submitted in response to the FCC's notice. None of them raise any issues with our original submission other than some wishing for less vigilant anonymity provisions. We will not reiterate our initial filing other than to emphasize the critical need for the Commission to reduce the reserve prices. This filing simply addresses a few issues raised by other comments.

## 1. *Package bidding is readily managed*

Contrary to the view of MetroPCS and US Cellular, package bidding is not too complex or risky. The enhancements to the auction system to accommodate the proposed package bidding are easily managed. The FCC has substantial expertise to make the enhancements. Likewise bidders can easily handle the proposed package auction format. There are, however, some auction-related issues that need clarification, which we discuss below.

## 2. *Bid increments for the large licenses should be reduced*

We are concerned about the absolute level of bid increments, especially on the C Block package. For example, the bid increments could be $300 million per round in 14 rounds or less. With multiple rounds per day, the price could go up by more than $1 billion in a day.

A smaller percentage increment and/or an absolute cap of increments of $150 million per license per round would not delay the auction significantly. A more measured pace for large licenses is especially important for a new entrant, who likely requires some analysis and review before daily increments on the order of $1 billion can be approved. Wrege and Hoffman propose using 5%-10% as the limits instead of 10%-20%. It would alleviate some of the pressure early in the auction, but we also support the Bureau's proposal to include absolute caps on bid increments.

Smaller percentage increments for the large licenses are not likely to slow the pace of the auction significantly. In fact, in AWS, none of the large licenses were bid on after the 16th round. Given the structure of this auction, we expect a similar scenario where the largest licenses will reach their final prices relatively rapidly.

## 3. *Withdrawn bids should count toward meeting the reserve prices*

Bid withdrawal penalties should be counted toward meeting the reserve price, since the government will receive the money, and the money is auction revenue. More importantly, payment of the penalty is important to avoid gaming behavior. One of the most basic

principles of any auction design is assuring that the bids are binding commitments. For this reason, it is essential that withdrawals not be allowed to be used without penalty to reduce the revenue on a block from above the reserve to below the reserve.

## 4. *Stage 1 Activity should start at 60%*

We agree with US Cellular that starting with a lower required activity level in Stage 1 makes sense. A lower activity level gives more flexibility and may make blocking harder. If the eligibility level is low, the Commission can move the auction to Stage 2 with a higher activity (80%) and then add a third stage with 95% activity.

## 5. *C Block REAG bids should have the same withdrawal rules as the rest of the SMR auction*

Several comments point out that the proposed rules for C Block bids create an exposure problem for bidders interested in individual REAGs and hence discourage their activity on those licenses. The typical exposure problem is caused by complementarities between licenses: a bidder faces the risk of winning only a license without winning a complementary one. The package bid on the C Block mitigates this problem.

However, the proposed rules create a different exposure problem, this time caused by substitutability of some licenses. A bidder faces the risk that if it bids on a C Block REAG, the package bid goes higher than the sum of the REAGs, and it moves on to other licenses that are substitutes, it can later become a provisionally winning bidder on the REAG (without increasing its own bid, because other REAGs received higher bids).

We appreciate that the Bureau tried to resolve the threshold problem. The tradeoff between the two exposure risks and solving the threshold problem is delicate. In response to the filed comments, to help alleviate the risks without making the threshold problem worse, we propose the following:

a) A bidder who has a bid on a C Block REAG that is topped by another bidder on the same REAG should NOT be committed to its bid should the higher bidder subsequently "drop" or "withdraw" its C Block REAG bid. Instead, the license would revert to the "FCC" with a minimum acceptable bid equal to the second high bid price.

In this way, as soon as a bidder is topped on a REAG, it will no longer face the exposure risk from that license. To solve the threshold problem only the currently highest bid on any given REAG matters, especially if, as we propose, the bids on REAGs face the same withdrawal rules as other licenses:

b) Replace the "dropped bid" rules with standard (i.e., the same as used on other blocks) "bid withdrawal" rules for the highest REAG bids on the C block.

Using the same bid withdrawal penalty as for the rest of the auction would also mean that a withdrawal would not have any impact on the bidders for the other REAGs, a concern

for the Bureau.[1]  Under our proposal, for purposes of comparing the sum of the REAG bids to the package bid, the REAG license should be valued at the level of the withdrawn bid.  Ultimately, the bidder withdrawing would be responsible for the difference between the withdrawn bid and the amount it sells for, so the total revenue for that block would implicitly include the amount of the withdrawn bid.  To completely protect bidders on other REAGs from any impact due to a withdrawn bid on a specific REAG, the "shortfall" calculation should also incorporate the level of the withdrawn bid.

There are two ways in which a withdrawing bidder on a C Block REAG license would not pay any withdrawal penalty – if the REAG sells for the same or more, or if a package bid is greater than the sum of the REAGs (including the full amount of the withdrawn bid). We have provided an example of how C Block bid withdrawals calculations would work below.

Several comments pointed out that the proposed "dropped bid" rules create a complex problem for the bidders: once a bidder moves its bidding activity to a different license, it faces a difficult decision whether to keep its bid on the C-Block REAG or to drop it. Dropping bids is costly if it is non-reversible because it removes valuable options for future bidding. On the other hand, not dropping the bid creates the risk of winning this license even if the bidder no longer desires it.  Giving the bidders the option to withdraw bids would make the decision to keep the bid on a REAG less costly. As a result it should also mitigate the threshold problem.

Admittedly, some exposure risk remains under the "bid withdrawal" rules as the following scenario illustrates. Bidder X bids on REAG-1 but is outbid by a package bid. He moves on to a different block and becomes a winning bidder on some substitutable licenses. As a result, his valuation for the REAG can drop. If other bidders increase their bids on the other REAGs that help overtake the package bid, bidder X would become a provisional winner on REAG-1. At worst, however, he would be liable for the withdrawal penalty, while under the proposed rules, if he did not drop his REAG-1 bid before, he would be liable for the full price.[2]

If for that reason the Bureau decides that even with our proposed changes the exposure risk is too large for the C Block bidders, the withdrawal penalty could be reduced by some predetermined percentage in case a bidder withdraws a bid that is *not* provisionally winning.[3]

Package bidding on the C Block and a nationwide license for the D Block minimizes the exposure risk for those bids so we do not think that withdrawals should be allowed for the D Block or for C Block package bids.

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[1] See  ¶83 of the Notice.
[2] On the plus side, under the currently proposed rules he would have the option to avoid any liability by dropping the REAG-1 bid early.
[3] A different possibility is to follow the Wrege and Hoffman proposal of allowing bidders to drop their non-provisionally winning bids once with the option to reinstate them later. Finally, the Bureau could allow both dropping and withdrawing bids on the *C* Block, but that could complicate the rules.

### 6. *Do not release each bidder's eligibility before the start of the auction*

To keep the auction anonymous and facilitate true competition, we think it makes sense not to reveal bidder eligibility. If it were revealed, it might enable more accommodative strategies in the auction and reduce auction revenues. It also might create scenarios where incumbents could use the information to facilitate blocking strategies.

### 7. *Random resolution of ties is better than the use of the time stamp*

Pekec proposes using a time stamp to resolve ties. We think that using the time stamp of a bid to resolve ties is a poor approach, which the FCC has wisely rejected. The use of time stamps induce bidders to engage in costly activities to increase the speed with which their bids can be placed or to slow down the placing of the bids of others. These activities serve no positive economic purpose and may cause mistakes in bid submission. Moreover, the use of time stamps punishes those bidders that need to engage in analysis and review before submitting bids. Analysis and review should be encouraged; indeed, these are the main reasons for conducting a dynamic auction.

Random resolution of ties is a simple and accepted approach.

### 8. *Related bidders do not get an advantage from multiple waivers*

Manti Telephone argues that related companies get multiple waivers and that gives them an unfair advantage. The argument is simply wrong – two related companies would indeed have six waivers between them, but they would use them twice as fast as a single bidder in rounds in which they were not bidding. Thus they get no strategic advantage and the rules do not need to be changed.

**Bid Withdrawal Example:**

Consider the bid history in the table below. With such bids the provisionally winning bids are the individual REAG bids. If the high bidder on REAG-1 withdraws its bid, the sum of the REAG bids would still be computed as equal to 800 and higher than the package bid of 795. The REAG-1 license would be held by the FCC and offered again at 90. The minimum bid on the package would be reduced to 800.

If the final sum of R-2 – R-8 plus 100 were greater than the package bid, the REAGs would win and the bidder who withdrew would be responsible for the withdrawal penalty (100 minus what the REAG ultimately sold for in that auction or a subsequent auction).

If instead, there were a subsequent package bid of 800 (or more) and no more REAG bids, then the package bidder would be awarded the C Block licenses and there would be no withdrawal payment. Also, if R-1 were part of a winning set of REAG bids with a new bidder at 105, again there would be no withdrawal penalty.

|      | R-1 | R-2 | R-3 | R-4 | R-5 | R-6 | R-7 | R-8 | Package |
|------|-----|-----|-----|-----|-----|-----|-----|-----|---------|
| High | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 795     |
| 2nd  | 90  |     |     |     |     |     |     |     |         |

The same withdrawal calculations would be done if the package bid at the time of the REAG-1 withdrawal had been 805 and the REAGs were not provisionally winning at the time – if the REAGs ended up as winning bids, then the withdrawal payment calculation would be done as 100 minus the ultimate selling price of the license.