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Letter to FCC Chairman Powell Concerning Auction 35

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The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20054

Dear Chairman Powell:

As scholars on auctions and telecommunications regulation, we urge the Commission to cancel bids made in, or permit winning bidders to opt out of, the reauction of the NextWave licenses in Auction 35. Some of us consult to wireless companies, others do not. But we all agree that the costs of the Commission's current policy concerning Auction 35 outweigh the benefits. Our conclusion rests solely on considerations of economic efficiency, and not on the merits of any legal arguments made by the Commission or private parties.

The facts giving rise to the NextWave dilemma are well known. While NextWave's licenses were still in bankruptcy, the FCC reaucted them in Auction 35, which ended in January 2001. In June 2001, before the Commission delivered the licenses to the winning bidders, the U.S. Court of Appeals for the D.C. Circuit ruled that bankruptcy law precluded the FCC's reauction and subsequently denied the Commission's motion for a stay of the mandate, which sent the spectrum back to NextWave.¹ The FCC has refused to cancel the reauction results, even though it remains unable to deliver the licenses to the reauction winners. The Supreme Court will hear the NextWave bankruptcy case in October 2002. A decision is not likely until 2003, but even then it may be years (if ever) before additional litigation retrieves the licenses from NextWave.

For auctions to function efficiently, buyers and sellers must follow basic rules, including the rule that a seller deliver in a timely manner what the winning bidder has purchased. This rule has not been applied in Auction 35. The Commission auctioned something that it did not have—immediate access to the spectrum for the winning bidders. Thus, if the Commission forces the winning bidders to pay, they will sue the agency for forcing them to pay for something that they did not receive. Alternatively,

1. NextWave Personal Communications, Inc. v. FCC, 254 F.3d 130 (D.C. Cir. 2001).

their shareholders will sue the companies. Meanwhile, wireless carriers have invested in less efficient technologies to meet capacity needs.

The FCC's policy toward Auction 35 exacerbates the financial problems facing the wireless industry. Since the conclusion of Auction 35, wireless service providers and equipment manufacturers have laid off tens of thousands of workers and lost tens, if not hundreds, of billions of dollars of market capitalization. Even if the Commission were to prevail in the NextWave case in the Supreme Court, and in further litigation over the Commission's failure to deliver the licenses, it is unlikely that the Treasury could collect the winning bids until at least 2005. In the intervening years, the wireless service providers that participated in Auction 35 would be left in limbo, without access to the radio spectrum that they sought to make productive when bidding on the PCS C Block licenses. In short, the FCC's current policy toward Auction 35 is a negative stimulus package for a wireless industry desperately in need of a recovery.

The winning bidders from Auction 35 must treat their obligations as contingent liabilities without deriving any benefit from the underlying asset. Those contingent liabilities have raised the carriers' costs of capital, impaired credit ratings, and prompted investment bankers to conclude that Auction 35 has increased uncertainty in the wireless industry. These developments are of particular concern at a time when, as you noted to Congress late last month, "capital markets are retrenching and telecommunication companies in need of financing to support their capital-intensive enterprises are suffering."² If the Auction 35 contingent liabilities were removed from their books, the wireless carriers could acquire more wireless licenses, thus increasing the Treasury's proceeds in future auctions. The carriers would then invest in equipment to deploy the newly acquired licenses.

A continuation of the Commission's current policy on Auction 35 also would retard the deployment of advanced wireless services. Additional spectrum is required to deploy these services, but under current policy the NextWave spectrum will remain unavailable until at least 2005 for the reasons noted above. Carriers could use the upper 700 MHz spectrum to deploy these services, but they will reduce their demands for spectrum access unless they can opt out of their Auction 35 obligations or the Auction 35 bids are cancelled. The Commission's current policy is thus likely to allocate the upper 700 MHz spectrum licenses inefficiently and further delay the introduction of advanced services. The forgone consumer welfare from the delayed introduction of these services could be substantial.

The Commission has said that its current policy toward Auction 35 seeks to "protect the integrity" of the spectrum auction process.³ We, however, believe that the

2. Written Statement of Michael K. Powell on "Financial Turmoil in the Telecommunications Marketplace: Maintaining the Operations of Essential Communications," Before the Senate Comm. on Commerce, Science, and Transportation, July 30, 2002, at 11.

3. Requests for Refunds of Down Payments Made in Auction No. 35, 17 F.C.C. Rcd. 6283, 6290 ¶ 12 (2002).

opposite is already occurring. The Commission increases uncertainty in the wireless market if it holds carriers accountable for winning bids for licenses that the agency cannot deliver. Bidders will discount their future bids accordingly, and auction revenues will fall. We cannot see how that outcome benefits consumers, taxpayers, workers, or shareholders.

Nothing in this letter should cast doubt on our continued belief in the efficiency of auctions as a means to allocate licenses to use radio spectrum. But the use of auctions as an efficient means to allocate spectrum licenses is defeated if the seller prevents the bidders' use and instead forces them to resort to inefficient backup plans.

For these reasons, we respectfully urge the Commission to cancel bids made in, or permit winning bidders to opt out of, Auction 35.⁴

Sincerely,

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4. We provide our affiliations for informational purposes only.