

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)
)
Updating Part 1 Competitive Bidding Rules) WT Docket No. 14-170
)
)

**Comments of
Americans for Tax Reform
Center for Individual Freedom
National Taxpayers Union
Taxpayers Protection Alliance**

The recent actions of Dish Network in the AWS-3 auction raise serious concerns about the structure and continued efficacy of the Federal Communications Commission’s (FCC) “designated entity” (“DE”) program. In particular, Dish’s close coordination with several “very small businesses” during the bidding process to save \$3.3 billion at the expense of taxpayers suggests that the media conglomerate may have engaged in activity that the FCC should closely examine as part of the instant inquiry. As discussed in more detail in these comments, the Commission should, at a minimum, seize the opportunity to reform its DE rules by:

- Strengthening Leasing Guidelines for DEs;
- Implementing Real Limits on Bidding by DEs; and
- Eliminating Joint Bidding Agreements Between DEs and Non-DEs.

Absent elimination of the DE carve-out, which is an option for the legislative branch to consider, these reforms will help the program achieve its original objectives, prevent the kind of abuses that occurred in the AWS-3 auction and ensure that the DE program is no longer susceptible to gaming or other malicious activities that undermine it.

I. INTRODUCTION

When Congress granted the FCC authority to auction off blocks of electromagnetic spectrum in 1993, it had in mind two major goals.¹ First, Congress sought to bolster the “development and rapid deployment of new technologies, products, and services for the benefit of the public, including those residing in rural areas, without administrative or judicial delays.”² Previously, wireless licenses for mobile telephony were assigned via lottery, an approach that left to chance the efficient allocation of a precious natural resource for an emerging communications platform.³ Second, recognizing that demand for this finite resource was growing exponentially, Congress authorized the FCC to sell access to spectrum so that it could “recover[] for the public...a portion of the value of the public spectrum resource.”⁴ Indeed, a primary selling point of this authorization, which was part of a larger omnibus budget bill, was that auction revenues generated by a competitive bidding process, estimated to be in the billions of dollars over the long term, would create a new revenue stream for the government that could help reduce the deficit.⁵

¹ See *Omnibus Budget Reconciliation Act of 1993*, Pub. L. No. 103-66, § 6002(b), 107 Stat. 312.

² 47 U.S.C. § 309 (j)(3)(A)

³ See, e.g., Edmund L. Andrews, *Airwaves Auction Bill Advances*, N.Y. Times, May 12, 1993 (“*Airwaves Auction Bill*”).

⁴ 47 U.S.C. § 309 (j)(3)(C).

⁵ See *supra*, *Airwaves Auction Bill*.

Though compelling, the move to an auction system was motivated by more than just a desire to maximize revenues. Among other things, the new delegation of authority to the FCC required the Commission to balance the financial aspects of spectrum allocation with Congressionally-directed goals around inclusion and equality of opportunity for firms of all kinds to participate in the nascent wireless sector. In particular, the new law mandated that the FCC design regulations that would promote “economic opportunity for a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women.”⁶ To do so, Congress recommended that the FCC “consider the use of tax certificates, bidding preferences, and other procedures.”⁷ Thus started a 20 year process of creating the DE program at issue in the instant proceeding.⁸

The DE program that eventually emerged has long been susceptible to gaming.⁹ This has resulted from the Commission’s many struggles to balance the seemingly contradictory goals of maximizing spectrum revenues via auctions on the one hand and providing discounts and other inducements to smaller firms on the other without promoting the “unjust enrichment of ineligible entities,” all while working to hasten the deployment of wireless services that are in much demand among consumers.¹⁰ The result has been a confused system of rules and incentives that has done little to achieve the stated Congressional goal of promoting the participation of a diverse array of entities in the wireless market.

⁶ 47 U.S.C. § 309 (j)(4)(C)(ii).

⁷ 47 U.S.C. § 309 (j)(4)(D).

⁸ *In the Matter of Updating Part 1 Competitive Bidding Rules*, Notice of Proposed Rulemaking, WT Docket No. 14-170, FCC 14-146 (rel. Oct. 10, 2014) (“*NPRM*”).

⁹ See, e.g., Senator Kelly Ayotte and Commissioner Ajit Pai, *Ending Welfare for Telecom Giants*, Wall St. Journal, Feb. 4, 2015 (“To nobody’s surprise, the biggest competitors [in the wireless market] have figured out a way to game the [DE] system.”) (“*Ending Welfare*”).

¹⁰ See *supra*, *NPRM* at ¶ 5.

As discussed below, the FCC must act to update the DE program in a manner that allows the Commission to fulfill its Congressionally-mandated duties without jeopardizing the deployment of the country's world-leading mobile broadband infrastructure. Contrary to the arguments of those who see salvation in further liberalization of DE rules,¹¹ reform efforts should focus first and foremost on making sure that any taxpayer-funded discounts on spectrum are enjoyed only by actual small businesses, not shell corporations that serve as a pass-through to conglomerates. Tying up these and other loose ends will create a much fairer auction system, one that will dissuade, rather than encourage, entities from seeking to manipulate the structure.

II. HIGHLIGHTING THE NEED FOR ACTION: THE AWS-3 AUCTION FIASCO

The recent AWS-3 wireless spectrum auction had mixed results.¹² When measured in terms of revenues generated, it was by far the most lucrative auction in FCC history, eliciting gross bids in excess of \$44 billion¹³ (the previous record was \$19 billion in gross bids during the 2008 auction of spectrum in the 700 MHz band¹⁴). From the standpoint of supporting further deployment of wireless services, the auction was also a theoretical success, bringing to market a large bloc of much-needed spectrum assets that were meant to help speed the build out of next-generation mobile broadband networks.¹⁵ Indeed, the AWS-3 auction was the first major auction

¹¹ See, e.g., S. Jenell Trigg & Jeneba Jalloh Ghatt, *Digital Déjà Vu: A Road Map for Promoting Minority Ownership in the Wireless Industry*, MMTc (Feb. 25, 2014), http://mmtconline.org/wp-content/uploads/2014/02/Web-Unembargo-MMTC-WHITE-PAPER_WIRELESS-OWNERSHIP_2.24.14_FINAL-2.pdf (“MMTC Paper”).

¹² See FCC, Auction 97: Advanced Wireless Services (AWS-3), http://wireless.fcc.gov/auctions/default.htm?job=auction_summary&id=97.

¹³ *Id.*

¹⁴ See FCC, Auction 73: 700 MHz Band, http://wireless.fcc.gov/auctions/default.htm?job=auction_summary&id=73.

¹⁵ See *In the Matter of Amendment of the Commission's Rules with Regard to Commercial Operations in the 1695-1710 MHz, 1755-1780 MHz, and 2155-2180 MHz Bands*, Report and Order, ¶¶ 1-3, GN Docket No. 13-185, FCC 14-31 (rel. March 31, 2014).

of broadband-ready spectrum in six years.¹⁶ It was framed as a key means of meeting some of the demand for spectrum and serving as a bridge to the highly anticipated incentive auction of broadband spectrum, which is scheduled to take place next year.

By other measures, though, the AWS-3 ended up being among the least successful and most notorious auctions in history. It was (and remains) shrouded in controversy because it became a forum in which putative small businesses flouted the FCC's DE rules. As a result, one company – Dish Network – a large amount of prime spectrum at a significant discount. These events highlight the need for immediate reforms of the DE program.

A. The DE Rules for the AWS-3 Auction

In July 2014, the FCC set forth the rules and procedures for the AWS-3 auction.¹⁷ Among these were the requirements for entities participating in the auction via the DE program.¹⁸ Per the rules, entities seeking to benefit from bidding discounts had to certify that they were, in fact, small businesses; the level of discounts extended to these firms hinged on annual revenues. In particular, “a bidder with attributed average annual gross revenues that do not exceed \$40 million for the preceding three years will receive a 15 percent discount on its winning bid,” while “a bidder with attributed average annual gross revenues that do not exceed \$15 million for the preceding three years will receive a 25 percent discount on its winning bid.”¹⁹

In addition, and in keeping with past practice, the FCC also set forth a series of rules to prevent the use of DEs as mere conduits for delivering discounted spectrum to larger

¹⁶ *Id.*

¹⁷ See *Auction of Advanced Wireless Services (AWS-3) Licenses Scheduled for November 13, 2014, Notice and Filing Requirements, Reserve Prices, Minimum Opening Bids, Upfront Payments, and Other Procedures for Auction 97*, Public Notice, AU Docket No. 14-78 (rel. July 23, 2014), https://apps.fcc.gov/edocs_public/attachmatch/DA-14-1018A1.pdf.

¹⁸ *Id.* at ¶¶ 79-93.

¹⁹ *Id.* at ¶ 82.

corporations. For example, the FCC articulated rules regarding the extent to which a DE could be controlled by another, non-DE entity²⁰ and whether a DE has a relationship with a partner or affiliate that will result in the lease or resale of more than a quarter of the spectrum won by that entity.²¹ The latter provision, dubbed the “attributable material relationship” (“AMR”) rule, was put in place to protect against the unjust enrichment of firms seeking to exploit the DE program.²²

Some have argued that the DE rules – both in general and in the specific context of the AWS-3 auction – are too rigid and result in sub-optimal outcomes for the entities that they seek to empower.²³ Others, however, have called for an overhaul of the DE program, in particular the AMR rule, arguing that, as currently structured and applied by the FCC, the rules do little to actually prevent unjust enrichment.

B. Dish’s Actions in the AWS-3 Auction: Openly Flouting the DE Rules

The answer to the questions of whether and to what extent the DE program may or may not be in need of reform, and which path reform should take, should be obvious in the aftermath of the AWS-3 auction.

The actions of one company in particular – Dish Network – require the Commission’s careful examination. It appears Dish worked assiduously to garner every benefit that could be gained via the DE program. Described in the press as a “coup,” Dish succeeded in harvesting about half of all the licenses up for bid by partnering with two small businesses – Northstar

²⁰ *Id.* at ¶¶ 85-86.

²¹ *Id.* at ¶¶ 88-89.

²² *Id.* at ¶ 88.

²³ *See, e.g., supra, MMTC Paper* at pp. 13-16.

Wireless and SNR Wireless – in its pursuit of additional spectrum holdings.²⁴ Under the DE rules, such partnerships are generally permitted so long as they don't run afoul of limitations on the extent to which the larger partner might exert any influence over the smaller companies. The actions taken by Dish took these partnerships to an extreme.

There is significant evidence to suggest that Northstar and SNR were created only to serve as bidding “vehicles” for Dish.²⁵ Public data, including information in the FCC record, shows that Dish “owns an 85% financial interest” in each company, both of which are backed by additional private investors.²⁶ In an effort to extract the largest benefit possible, both Northstar and SNR reported annual revenues of less than \$15 million, triggering the 25% bidding credit.²⁷ However, the relationships were structured such that Dish, at least on paper, does not exercise a “controlling interest” in either firm, a dynamic that technically satisfies the DE rules.²⁸

Via these companies and another entity – AWS-3 Wireless I LLC – Dish was effectively able to bid at a competitive advantage over other companies and fuel demand for many licenses.²⁹ Indeed, according to post-auction press reports, “Dish’s entities ultimately accounted for 27% of all bids placed in the auction, more than AT&T and Verizon combined.”³⁰ The result was the accumulation of hundreds of licenses by Northstar and SNR at a cumulative net price –

²⁴ See Shalini Ramachandran, Kate Linebaugh and Ryan Knutson, *Behind Dish Wireless Coup, Ties to Alaskan Native Groups*, Wall St. Journal, Feb. 3, 2015.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ See Phil Goldstein, *Dish's Road to \$3.33B in AWS-3 Discounts Included a Complex Web of Investments*, Fierce Wireless, Feb. 4, 2015, <http://www.fiercewireless.com/story/dishs-road-333b-aws-3-discounts-wove-through-complex-web-investments/2015-02-04>.

²⁹ ²⁹ See Thomas Gryta and Ryan Knutson, *Behind Dish Network's Race for Wireless Spectrum*, Wall St. Journal, Feb. 12, 2015.

³⁰ *Id.*

about \$10 billion after discounts – equal to several hundreds of times each company’s annual revenues: Northstar’s winning bids totaled more than \$5.8 billion, while SNR’s eclipsed \$4.1 billion.³¹ These are significant, if not excessive, commitments of funds by companies with minimal annual revenues.³² Only when viewed in larger context – context that includes Dish Network as a major partner of these companies – do these numbers make more sense since Dish has annual revenues approaching \$14 billion and is worth an estimated \$36 billion.³³

C. The Outcome: A Serious Blow to FCC Credibility and a Major Loss for Taxpayers

Although trumpeted as a success by some, the AWS-3 auction was highly flawed in several significant ways. Dish has been accused of “mak[ing] a mockery” of the DE program, raising significant concerns among a broad range of stakeholders about the continued viability of the program and of the FCC’s ability to conduct successful auctions in furtherance of very specific Congressional mandates vis-à-vis spectrum.³⁴ Coupled with other recent criticism regarding the granting of waivers and other questionable actions under the aegis of bolstering the DE program, some observers have raised serious concerns about the FCC’s credibility in the context of making sure spectrum is put to the best possible uses. This is especially concerning at a time when the Commission is gearing up for what many predict will be the most important – and lucrative – spectrum auction in history: the incentive auction.

³¹ See *FCC AWS-3 Auction: Bidder Payment/Refund*, Attachment B, Jan. 29, 2015, http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0130/DA-15-131A3.pdf (“AWS-3 Auction: Bidder Payment/Refund”).

³² According to regulatory filings, “neither [company] had any gross revenues.” See *supra*, *Ending Welfare*.

³³ See Yahoo! Finance, Dish: Key Statistics, <https://finance.yahoo.com/q/ks?s=DISH+Key+Statistics> (as of Feb. 16, 2015).

³⁴ See *Statement of Commissioner Ajit Pai on Abuse of the Designated Entity Program*, FCC, Feb. 2, 2015, http://transition.fcc.gov/Daily_Releases/Daily_Business/2015/db0202/DOC-331802A1.pdf.

In addition to undermining the spirit of the DE program, the outcome of the AWS-3 auction was also ultimately counterproductive from the vantage of achieving Congressional goals around maximizing revenues and bolstering network deployment. The \$3.3 billion discount that Dish was able to extract via Northstar and SNR is significant and deprives the Treasury – and thus all U.S. taxpayers – of the benefits that those funds would provide.³⁵ FCC policy in this instance effectively provided a taxpayer-backed corporate subsidy instead of promoting the public interest, as it was intended to do.

III. RECOMMENDATIONS FOR UPDATING THE DE PROGRAM

Left unaddressed, or if liberalized per the suggestions of some, the many problems plaguing the DE program – problems that were made clear during the AWS-3 auction – will only worsen. Indeed, if the *status quo*, or some version thereof, continues forward, the very entities that the rules are meant to help will be disadvantaged as their DE status will be unfairly leveraged by larger businesses. Fortunately for the U.S. public – the ultimate owners and beneficiaries of the nation’s wireless spectrum assets – the FCC has a unique opportunity to address these many obvious failings. The following provides some specific recommendations that the FCC should incorporate into the outcome of the instant proceeding.

Strengthen Leasing Guidelines for DEs. The FCC proposes to repeal the AMR rule.³⁶ The rationale offered by the FCC in support of this dramatic move is that a newer, more flexible approach is needed to encourage greater participation in spectrum auctions by small businesses.³⁷

In reality, though, repealing the AMR rule would do little to discourage a DE from acquiring

³⁵ See, e.g., Miriam Gottfried, *Dish Enjoys a Spectrum of Options*, Wall St. Journal, Feb. 3, 2015 (speculating on how Dish might use its AWS-3 spectrum resources and noting that few involve actually building a wireless network).

³⁶ See *supra*, NPRM at ¶ 8.

³⁷ *Id.*

spectrum at a taxpayer-funded discount and flipping it to someone else at full market value. Indeed, repealing it would likely create huge incentives for DEs to engage in this type of behavior, increasing the chances that future auctions would proceed in much the same way as the AWS-3 auction played out. That would be terrible for taxpayers, who would be underwriting corporate welfare, and for consumers, who would not see valuable spectrum put to its most productive uses.

A better approach by the FCC would be to retain, strengthen, and clarify the contours of the AMR rule by, for example, retracting the discount on spectrum if a DE leases a significant portion of its asset to a larger company. This would be in keeping with existing DE rules that theoretically protect against the unjust enrichment of firms via the transfer of certain spectrum assets. These rules should be harmonized so that DEs have real limits on how they can lease and sell their discounted spectrum – if they choose to lease or sell a significant portion of spectrum within the first five years of ownership, then the DE should be required to pay back all or part of the discount.

Implement Real Limits on Bidding by DEs. Under the current DE framework, there are no guidelines regarding what a small business can bid during an auction. In today's marketplace, where spectrum is a highly valuable and scarce resource, this allows – indeed compels – a DE to seek funding from corporate partners with much deeper pockets. The irony is that, while such partnerships are permitted and encouraged under the rules, the DE nevertheless remains a “small business” for the purposes of receiving a discount on spectrum. This yields the perverse outcomes evident in the AWS-3 auction, where “small business” shells with non-existent revenues are able to win licenses worth billions of dollars. To prevent such an outcome from happening again, a worthy goal that the FCC must pursue, entities that want discounted spectrum

should not be able to bid at levels that undercut the purpose of the DE program, which is to ensure that actual small businesses have equal opportunity to participate in the wireless market. One possible remedy is to institute a cap on a DE's bidding, perhaps at 10 times its annual revenues. For small businesses that would amount to a cap of \$400 million; for very small businesses the cap would be \$150 million. In the AWS-3 auction, these caps would not have prevented actual small businesses from winning licenses; among the winners were many companies whose cumulative bids were below these levels.³⁸

Eliminate Joint Bidding Agreements Between DEs and Non-DEs. Current DE rules do not restrict joint bidding agreements between DEs and non-DEs. In practice, this means there are no limits on how a company like Dish can work with bidding vehicles like Northstar, SNR, and American AWS to engage in behavior – coordinating bidding, agreeing not to bid in certain markets, etc. – that is tantamount to collusion. The practical impact of these actions, which were on stark display in the AWS-3 auction, is a perversion of a program that was initially devised to help small businesses gain a foothold in the wireless market. Instead, the rules are being gamed by companies, turning discounts meant for small businesses into taxpayer subsidies for larger companies. To prevent the problems that occurred in AWS-3, protect American taxpayers, and uphold the intent of an otherwise meritorious endeavor, the FCC should bar joint bidding agreements between DEs and non-DEs.

IV. CONCLUSION

The instant proceeding is happening at the optimal time. Many stakeholders have questioned whether the Commission has positioned the best interests of the public and taxpayers

³⁸ See *supra*, *AWS-3 Auction: Bidder Payment/Refund*.

at the forefront of its efforts to design effective and fair spectrum auctions.³⁹ As currently administered, the DE program, a major part of auctions past and present, has allowed large corporate entities to acquire scarce spectrum assets at a discount. If the FCC is serious about enhancing diversity in the wireless marketplace and creating truly competitive auctions, then it must undertake a holistic review of its DE rules and make wholesale changes along the lines proposed above. In short, the FCC must act swiftly and decisively in order to bolster public confidence that the nation's airwaves – and the revenues they generate – are not being squandered.

Respectfully,

Americans for Tax Reform
Center for Individual Freedom
National Taxpayers Union
Taxpayers Protection Alliance

³⁹ See, e.g., *Editorial: Government Handouts at Wireless Auctions*, N.Y. Times, Feb. 3, 2015.