

UNITED STATES GOVERNMENT
M E M O R A N D U M

DATE: January 20, 1995

REPLY TO

ATTN OF: Acting Inspector General

SUBJECT: Special Review of the Regional Narrowband PCS Auction

TO: Chairman
Commissioners
Managing Director
Chief, Wireless Telecommunications Bureau

This office has recently completed a special review of the Commission's auction of Regional Narrowband Personal Communication Services (PCS) licenses which was conducted beginning the week of October 26, 1994. I have attached a copy of our report documenting the results of that review.

Due to the pace with which the Commission is pursuing the distribution of licenses through auctions, we determined that the best approach to reviewing the process was through a special review. A special review is meant to be a quick study of a process in order to provide a timely report to management.

During this review we examined upfront payment processing, bidder participation, and long-form application processing. In general, our review indicates that the auction was conducted in an efficient and effective manner. The success of the auction speaks highly of the enthusiasm and professional manner of those Commission staff who participated in the auction planning and conduct. However, two areas were identified where improvements in the auction process can be made. These areas are (1) reporting of bidder eligibility during the auction and (2) instructions to winning bidders regarding long-form application preparation. We discussed both of these issues with representatives from the Wireless Telecommunications Bureau (WTB) during the course of our review. In both cases we were informed that WTB agrees with the auditors and has taken steps to address the respective conditions. The WTB response is enclosed as an appendix to the attached report.

This is the second special review report documenting our examination of the Commission's license auctioning process. Our first special review report, dated September 22, 1994, addressed short-form application processing as part of the Nationwide Narrowband PCS and Interactive Video Data Service (IVDS) license auctions. The Office of Inspector General intends to review other aspects of the process in future auctions.

H. Walker Feaster III

Attachment

CC: Special Counsel to the Commission
For Reinventing Government

Chief, Office of Plans and Policy

FEDERAL COMMUNICATIONS COMMISSION

OFFICE OF INSPECTOR GENERAL

SPECIAL REVIEW REPORT
95-A-1

REPORT ON THE SPECIAL REVIEW
OF THE REGIONAL NARROWBAND PERSONAL
COMMUNICATIONS SERVICES (PCS) LICENSE AUCTION

January 20, 1995

DIRECTOR OF AUDITS

AUDITOR

ACTING INSPECTOR GENERAL

REPORT ON THE SPECIAL REVIEW OF THE
REGIONAL NARROWBAND PERSONAL COMMUNICATION
SERVICES (PCS) LICENSE AUCTION

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REVIEW OBJECTIVE

The objective of this special review was to evaluate the internal controls associated with (1) upfront payment calculation and processing, (2) activity rule enforcement, and (3) FCC Form 401 ("long-form application") processing for those businesses participating in the regional narrowband PCS auctions conducted in October 1994. To accomplish our objective, we: (1) interviewed representatives from the auction task force and Wireless Telecommunications Bureau; (2) reviewed Public Notices, News Releases, and Reports and Orders associated with the auction; (3) analyzed round by round auction data; (4) evaluated census data used to develop upfront payment requirements; and (5) examined documentation filed by businesses participating in the auction.

REVIEW SCOPE

We have conducted a special review of specific aspects of the spectrum license auction process. A special review is meant to be a quick study of a process and, as such, was not conducted in accordance with all professional auditing standards. A special review was conducted because we believe that, in this case, management would benefit from expeditious reporting of those areas of the auction process where improvement is needed. We believe that this is particularly important given the pace with which the Commission is pursuing the distribution of additional licenses through auction.

The scope of this review was limited to (1) upfront payment processing, (2) bidder participation, and (3) long form application processing as part of the regional narrowband PCS license auction conducted in October 1994.

Review fieldwork was performed within the Wireless Telecommunications Bureau during October through December 1994. Primary attention was focused on those representatives participating on the Commission's auction task force, now organizationally defined as the Auctions Division of the Wireless Telecommunications Bureau, and those involved in application processing.

BACKGROUND

On August 10, 1993, the Omnibus Budget Reconciliation Act of 1993 added section 309(j) to the Communications Act of 1934, as amended. Section 309(j) gave the Federal Communications Commission (FCC) express authority to employ competitive bidding procedures to choose from among mutually exclusive applications for initial licenses. Under Section 309(j) the Commission must determine that the use of a system of competitive bidding will promote:

othe 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;

oeconomic opportunity and competition and ensure that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women;

orecovery for the public of a portion of the value of the public spectrum made available for commercial use and avoidance of unjust enrichment through the methods employed to award uses of that resource; and

oefficient and intensive use of the electromagnetic spectrum.

On March 8, 1994, the Commission adopted a Second Report and Order in the matter of implementation of the competitive bidding component of Section 309(j). The Commission's purpose in the Second Report and Order was to "promulgate competitive bidding rules that, in conjunction with (their) spectrum allocation rules, promote the public policy objectives set forth in Congress." The Report and Order addressed rules governing (1) principles for determining whether licenses may be auctioned, (2) competitive bidding design, (3) procedural payment and penalty issues, (4) regulatory safeguards, and (5) treatment of designated entities. In addition, the Commission reported that "specific rules within the scope of general rules will be adopted in a Report and Order for each service subject to competitive bidding."

On April 20, 1994, the Commission adopted a Third Report and Order in the matter of implementation of the competitive bidding component of Section 309(j). The Commission's purpose in the Third Report and Order was to adopt "service-specific rules for competitive bidding on licenses to be awarded for Personal Communications Services in the 900 MHz band ("narrowband PCS")."

On August 26, 1994 the Commission announced, via Public Notice, an auction of thirty regional licenses for narrowband PCS to begin on October 26, 1994. The auction was subsequently held and the thirty licenses were auctioned for a total winning bid value of \$490,901,787.

Issue No. 1 - Bidder Eligibility Reporting

The Commission did not publish information on activity rule waiver use by bidders during the auction. Absence of this information may have prevented bidders from analyzing competitor bidding strategies in an accurate and timely fashion. Although there are no indications that this condition adversely impacted the regional narrowband PCS license auction results, we believe that publishing activity rule waiver information would be consistent with the conclusions the Commission reached in its Second Report and Order regarding auction design and information availability during simultaneous multiple round auctions.

In its Second Report and Order, the Commission evaluated competitive bidding designs intending to select that design(s) which best fit policy objectives. In the Order, the Commission adopted simultaneous multiple round auctions as the primary auction methodology. The Commission concluded that "multiple round auctions, by providing bidders with information regarding other bidders' valuations of licenses, generally will yield higher revenues and more efficient allocations of licenses." In addition, the Commission concluded that providing bidders with most information about license values during the course of the auction will "provide bidders with the most flexibility to pursue backup strategies." When a bidder is analyzing a competitors actions during an auction, a significant component of license valuation in upcoming rounds is indicated by maximum eligibility. Maximum eligibility, in turn, is directly affected by activity rule waiver use as discussed in detail below. Therefore, information regarding activity rule waiver use is necessary for an accurate and timely analysis of a competitors valuation of licenses during the auction.

In its Third Report and Order, adopted April 20, 1994, the Commission established competitive bidding rules for the auction of narrowband PCS licenses. As part of these rules, the Commission promulgated "activity rules" establishing minimum requirements for bidder activity at each stage ("phase") of the auction. These requirements are intended to ensure that a simultaneous auction with simultaneous stopping rules closes within a reasonable period of time by preventing bidders from waiting until the end of the auction before participating. The activity rule governs the maximum eligibility of each bidder based upon auction participation by reducing eligibility if participation falls below minimum requirements. Waivers may be entered by bidders ("proactive waiver") or entered by the Commission on behalf of a bidder ("automatic waiver"). Bidders may override the automatic waiver mechanism when they place a bid below the required participation level, however, the bidders eligibility will be permanently reduced. During the regional

narrowband PCS license auction, each bidder was allowed one waiver from the activity rule during each of the three auction phases. Participants were informed of activity rule waiver and eligibility requirements in the bidder information package and in several Public Notices explaining the auction.

As part of our review, we conducted a detailed analysis of bidder activity during the auction. The purpose of this effort was to determine if the Commission was taking appropriate steps to enforce established activity rules. The analysis was conducted using publicly available information sources (e.g., public notices, internet, etc.) and the explanation of activity rule waivers and eligibility requirements made available to participants prior to the auction. During the analysis we noted that although detailed round by round bidding information was being made available (including information by bidder on high bids, all bids, and bid withdrawals), information about activity rule waiver use was not being provided. Without this information we were, in some cases, unable to accurately calculate maximum bidder eligibility. Following the auction, auction representatives were able to provide a detailed spreadsheet identifying activity rule waiver use by type (proactive or automatic), bidder and round. We used this information to complete our analysis of bidder participation.

We discussed our observations regarding activity rule waiver information release with regional narrowband auction personnel. During those discussions, we were informed that the automated system used to track auction activity was not "programmed... to provide that information as part of the round results data." As a result, information on activity rule waiver use was not released to bidders during the auction.

During our discussions, auction personnel indicated that the Commission intends to make activity rule waiver information available in future auctions. In fact, during analysis of the ongoing Major Trading Area Broadband PCS license auction, which began December 5, 1994, we noted that information about each bidder's maximum eligibility and remaining waivers is being made available along with round by round auction results. In our opinion, release of this information adequately addresses this issue. We recommend that the Commission continue to release this information in future simultaneous multiple round auctions.

Issue No. 2 - Long-Form Application Instructions

Our review indicated some inaccuracies in the instructions provided regarding FCC Form 401 ("long-form application") preparation. The long-form application is the vehicle by which successful bidders apply for a narrowband PCS license. Long-form applications were required within ten business days after high bidders are announced by public notice. Following Commission review of long-form applications and the Petition to Deny process, the Commission decides if there are any reasons the license should not be granted; if there are none, the Commission grants the license. General instructions regarding requirements for long-form applications were provided in the Public Notice, dated August 17, 1994, announcing the auction. Detailed instructions regarding long-form application completion were provided in the Bidder's Information Package.

As part of our review, we requested that the Narrowband Commercial Radio Branch of the Wireless Telecommunications Bureau provide copies of those long-form applications submitted for the thirty regional narrowband PCS licenses that were auctioned. We were informed that the application process was being slightly delayed because several applications were being resubmitted. Further inquiry revealed that several winning bidders (six applicants out of a total of nine) submitted an individual long-form application for multiple licenses. In fact, several applicants submitted single long-form applications for frequencies in each of the five markets. Applicants were notified in writing by the Narrowband Commercial Radio Branch that "further documentation" was required and that a "complete application for each market and frequency block" be submitted. In addition, applicants were reminded that §24.11 of the Commission's Rules states that "an applicant must file an application for an initial authorization in each market and frequency block desired." After applicants had prepared individual long-form applications for each market and frequency block and resubmitted those documents, we were able to obtain copies of all original and resubmitted applications for review.

During our examination of the applications, we reviewed the instructions provided to the applicants in the Public Notice announcing the auction and in the Bidder's Information Package providing detailed instructions on long-form application preparation. We noted during this review that no mention is made in these sources of §24.11 of the Commission Rules, or its requirement for individual applications for "each market and frequency block." In fact, the "sample" long-form application provided in the Bidder's Information Package shows multiple markets and frequency blocks on the same long-form application (please refer to the Attachment).

We discussed this condition with a representative from the Narrowband Commercial Radio Branch and were informed that steps are being taken to alleviate this problem in future auctions. For example, a new bidder information package has been developed which clarifies the requirement for individual applications. In addition, a new form (Form 600) has been developed and includes filing instructions which clearly indicate this requirement. We believe that these steps will adequately address this problem in future auctions.

RESPONSE TO THE DRAFT REPORT

On January 19, 1995, the OIG received a response to the draft report by the Deputy Chief, Wireless Telecommunications Bureau (See Appendix). In his response, the Deputy Chief indicated his agreement with the issues raised in this report. Furthermore, he stated that specific corrective action has, and will, be taken to fully address the issues raised by the OIG.