

What happened in the 700MHz C-block?

February 4, 2008. Note: this analysis was compiled solely based on review of the bids published on the FCC's auction website and without any access to confidential information or contact with the auction bidders.

Since it was announced on Thursday, January 31 that the 700MHz C-block had reached its \$4.6B reserve price, thereby triggering the FCC's open access conditions, there has been uncertainty about who holds the provisionally winning bid (PWB). It now looks like Verizon has emerged as the winning bidder (at the end of bidding on February 4), despite Google having had a nervous weekend holding the PWB since Round 17.

Initial speculation was that Verizon Wireless won the C-block in Round 17¹, since it was perceived as unlikely to wish to concede this spectrum to Google, even if it is forced to accept open access conditions. However, we believe that Google must have held the winning bid after Round 17, and that Verizon Wireless dropped out of the package bidding at a much earlier stage (concentrating instead on pushing up the price paid by AT&T Wireless in the A and B blocks). Why do we believe this? For the simple reason that no bidder other than Google had the motivation to raise its own winning bids in order to force the introduction of open access. If you accept the hypothesis that no other bidder would raise its own winning bid, then Google must be have held the PWB in the C-block after Round 17.

There are two possibilities for the bidding sequence leading up to the provisionally winning bid in Round 17: either two players (or conceivably more) were in contention, or only one player was still bidding and it raised its own PWB to \$4.7B. If there was only one bidder then by definition that bidder would have been Google (since we have assumed that Verizon would not have raised its own PWB²). If there were two bidders, then there are two possibilities: either the holder of the PWB from Round 13 was Verizon, and it was overbid by Google, or the holder of the PWB from Round 13 was Google and it was overbid by Verizon. In the first case, then of course the winner is Google (though in practice this outcome is unlikely, for reasons we explain below). In the second case (which is what has been assumed by Blair Levin and others), then we can simply trace back the bid history to

¹ See for example http://www.businessweek.com/technology/content/jan2008/tc20080131_154134.htm and <http://www.wirelessstrategy.com/auction.html>

² Not to mention the fact that it seems inconceivable that Google would have dropped out of the auction before open access had been assured

determine that Verizon must have raised its own winning bid (which we have hypothesized would not have occurred). PWBs for the C-block were placed in Rounds 8, 10, 12, 13 and 17 (as well as in earlier rounds). However, new bids were not placed in Rounds 9, 11, 14, 15 and 16. If two players were still in contention then the company not holding the PWB must have used a waiver in these rounds³. If Google held the PWB from Round 13, then Verizon must have used a waiver in Rounds 14, 15 and 16⁴. Since each company has only three waivers, then Google must have been the company using the waivers in Rounds 9 and 11. Thus Verizon must have held the PWB in Rounds 8, 10 and 12. It would have had to overbid its own PWB in these rounds (not to mention pausing one round, and then bidding again, in competition with Google, and still coming out the winner), which we hypothesized would not happen (and in any case represents a very implausible bidding sequence). As a result we conclude that Verizon could not have made the PWB on the C-block in Round 17.

We have therefore shown that (assuming no other player would have raised its own PWB) then Google must have held the PWB in the C-block auction after Round 17. Returning to what scenario might have actually taken place, it appears unlikely that Verizon was the winning bidder in Round 13, and was overbid by Google in Round 17. This would have required Google to use its waivers in Rounds 14, 15 and 16, and Verizon to have used waivers in Rounds 9 and 11, but to have bid unsuccessfully against Google in Rounds 10 and 12. We would have expected Verizon to have simply alternated PWBs with Google and not used any of its waivers if it had intended to remain in contention. Instead it appears that Verizon either never entered the C-block bidding at all, or (if it did) dropped out no later than Round 8. Google must then have raised its own PWB from just under \$3B at the end of Round 8 to reach the reserve price in Round 17. The bidding sequence from Round 9 onwards is exactly what one would expect of a single bidder seeking to reach the open access threshold: as holder of a PWB, Google would not have bid in Round 9, but upon seeing no other bids (although perhaps a waiver might have been used by its opponent) it would have raised its bid again in Round 10. In Round 11, Google would have again waited to see if its opponent had been using waivers, but by Round 12 it became clear this was not the case, causing Google to raise its bid twice in succession to reach a point just below the reserve. Then we assume the bid team would have needed to seek authorization from senior management to pass the reserve threshold, knowing that this

³ There could not have been three players or more players still participating in the C-block bidding by Round 17, since a third player would have needed more than three waivers to stay in contention until that point

⁴ One reason for doing this is that the bidding increments decrease from round to round, so the winning bid in Round 17 was some \$152M lower than it would have had to have been in Round 14

might result in Google winning the spectrum, which explains the reason for an overnight delay prior to raising the bid in Round 17.

What has changed now? Verizon has been steadily bidding on individual C-block licenses, which have now come back into contention in Round 30, as the overall price exceeded Google's \$4.7B package bid. By doing this, Verizon did not need to preserve the eligibility needed to bid on a national license, and instead could force up the price for AT&T Wireless in the A and B blocks. AT&T Wireless is left holding very expensive B block licenses, which are needed to complement its Aloha purchase. Verizon instead gets to pick up the C-block, albeit with open access constraints, at a much lower price of \$5B.

Our first reaction is hats off to Verizon for what looks to be a very smart bidding strategy, and presumably there will be relief for Google at having achieved open access without the prospect of having to build out its own network. The loser in all this may be AT&T: while it got the Aloha spectrum at a discount before the auction, this signaled its bidding intentions openly and allowed Verizon to force it to pay a huge premium for the B-block. However, watch this space: AT&T may now try to take its revenge on Verizon, by bidding up the price of individual C-block licenses, in an attempt to make it much more expensive for Verizon to achieve a national footprint⁵. Verizon could end up paying for its cleverness, and spending far more than the \$4.7B it would have cost to win the national C-block license. Depending on how much eligibility Verizon retains, it could even be knocked out of one of the individual C-block licenses (where it holds a winning bid from an earlier round) and be unable to bid again on that license in subsequent rounds (since even though these bids have come back into contention, they do not increase Verizon's overall eligibility). Verizon would then have bought another set of non-national licenses again, just as it did in the AWS auction in 2006.

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⁵ Though building out the C-block would also expose AT&T to open access conditions, these licenses could either be resold or swapped with another wireless operator at a profit, or simply resold to Verizon later at a premium. Verizon is particularly vulnerable in the West and Central licenses, since these are the regions where it has gaps in its AWS spectrum holdings

