

MORRISON FOERSTER

Unofficial transcript for users of mofo.com

Speaker (00:05):

[Inaudible]

John Cooney (00:46):

May it please the court. John Cooney for Petitioner Star Wireless. The FCC has punished Star Wireless for a willful violation of its anti-collusion rule for having had a six-minute conversation with another entity, Northeast Communications, concerning an FCC spectrum auction. Now, the conversation occurred after Northeast had been disqualified from participation in the auction by operation of an FCC rule for failure to make a required upfront payment. Further, the conversation occurred after the FCC had twice issued public notices, informing the world that Northeast had in fact been the disqualified from the auction for not making the upfront payment. The conversation was preceded by a message left by Star for Northeast saying that Star wished to speak to Northeast, if as Star understood to be the case, Northeast was not participating in the auction. And then the conversation itself took six minutes. And in, in the course of that conversation, there was no agreement or understanding reached between the two entities. Star did not intend to violate the anti-collusion rule. Star was acting under what it believed was a reasonable interpretation of the FCC notices and the FCC rule that north—the common sense proposition that since Northeast had been disqualified from participating in the auction, it could no longer affect the results of that auction.

Judge Henderson (02:08):

And why did you and Northeast self-report?

John Cooney (02:10):

There was self-reporting after the fact, Your Honor, out of an excess of caution. Counsel advised that it was possible that the FCC rules could be interpreted in that manner. Did not believe that that was the, the better interpretation of the rule, but to make certain that the FCC knew that this occurred to inform the FCC of that fact. So both Northeast and Star self-reported after the fact. And we think that that's further indication of the fact that they were not willfully violating an FCC rule because they went out of their way to notwithstanding their misgivings about the interpretation that the FCC argues in this court today. They thought that that was not the proper interpretation, but they brought that to the commission's attention so that there was nothing hidden from the commission.

Judge Henderson (02:58):

They weren't getting ready to give these licenses or—to the Wisconsin licenses to Northeast?

John Cooney (03:04):

No, there was still some time remaining before the actual award—other steps that had to be followed. The notice was within, I think, believe the required five business days of when the conversation occurred, and it occurred in the middle of the auction. These are multiple step auctions where there's bidding on the internet in increments, and then they occur in stages until there are no further bids issued. Now, as I say, Star does not believe that there was any prohibition on communicating with a party that had been

disqualified. We believe that the FCC's interpretation of the anti-collusion rule might make sense in other circumstances, or a conversation occurred among two entities while—that were both bidding while the bidding was going on or before the fact while people were still considering whether to make bids. Under those circumstances, there could be a risk of harm here.

John Cooney (03:54):

It could be that the two entities would get together and agree that only one would bid and divide the market. And that, that might produce a lower price for the government and the auction, but that's not what occurred here. There had been a fundamental change. Northeast had made a decision that it couldn't afford to submit an upfront payment, and it did not. And at that point, the FCC issued a notice informing the world that it was out of the auction. And it's only at that point that it occurred. And we regard the disqualification by operation of rule and the notice to the world as something that means the anti-collusion rule as the commission has interpreted; it should not apply in these circumstances. Now, the first issue we present is an ascertainable notice argument that the FCC had not properly informed the regulated community of its understanding that the term applicant meant that you were considered a prohibited source for a conversation from the day you submitted your short form notice until the final stage of the award of the licenses. And I'd like to quote from the commission's own order here to frame the issue on ascertainable notice. The commission says in paragraph 18 of its order on page 14 of the joint appendix that the anti-collusion rule "is narrowly drawn to prohibit competing applicants from discussing or collaborating during the auction regarding bids, bidding strategies, and settlement related to the licenses for which both parties wish to bid." That in a nutshell is the problem with case and the problem with the FCC's interpretation. They use the word competing applicants in their own order and describing what was prohibited here.

John Cooney (05:38):

And our point is simply once a regulatory disqualification has gone into play. Northeast is no longer a competing applicant, or certainly to be more precise that the regulated community would not be aware of the government's interpretation that competing applicant continues to apply in what we think is not the common sense reading. That the common sense reading would be upon your disqualification for your own voluntary action, you're no longer a competitor. Now, over the course of time, the commission has tried through a series of notices and rules to describe the effect of the anti-collusion rule. And, as we set out in our brief, the problem there is that the commission uses its nomenclature inconsistently. It sometimes it says "applicant," it sometimes it says "bitter." Sometimes it says "competing applicant." Throughout its statements, there are many indications to the community at large, that it's the ability of an entity to be in the competition that's the critical factor for the application of the anti-collusion rule. And the commission disagrees with that and says that it tried to put in a place notices that clearly informed the world of its intent. The two that it relies on most directly are both issued right at the end of auction 44. The first is a statement on August 7th, 2002, just before it was going to start the bidding process. And in this notice it also listed Northeast as a disqualified bidder, and there on August 7th, the FCC said "all parties that submitted short form applications to participate in the auction, including, but not limited to qualified bidders are reminded that they remain subject to the commission's anti-collusion rule until the post auction down payment deadline." So it's that phrase, "including, but not limited to qualified bidders" that has to do the heavy lifting for the FCC and say, that is the notice to the community at large that the anti-collusion rule remains in place until the very end.

John Cooney (07:43):

But the very next sentence in that notice says, "bidders are reminded that Section 1.2105(c) of the anti-collusion rule prohibits applicants from." And so in the very rule that it relies on most heavily, the FCC has replicated the problem. It states the proposition on the one hand, and then immediately changes nomenclature and goes back to bidders, a term that would tell the world at large, that you had to be in the competition in order to be covered. The other main notice the FCC relies on was on June 26th, which is

substantially similar to the August 7th statement. The notice says that all parties that submitted short-form applications to participate “including but not limited qualified bidders are reminded that the anti-collusion rule applies until the end of the auction.”

Judge Rogers (08:30):

What about this March 26th notice?

John Cooney (08:34):

Um, see, I didn't.

Judge Rogers (08:37):

That's the one referencing the *Pettit* letter.

John Cooney (08:40):

Oh, the *Pettit* letter, Your Honor, is one of several staff interpretations issued at a lower level in the commission that the government relies on.

John Cooney (08:49):

Several of those interpretations refer to participants in the auction or entities that are active bidders, and we regard that as being correct. That's how the rule should apply. If somebody is in the auction, is a participant, or still retains the right to participate that's when the anti-collusion rule was properly applied. *Pettit* is the other place where the commission came closest to stating the rule. And that's my comment on *Pettit*. As we said in our brief, it was at a low level in the commission, and there were later conflicting statements at a higher level on the commission. But if you look at *Pettit*, the principle issue in *Pettit* appears to be whether a party that is the controlling, the parent entity, of somebody who put a bid in is itself covered by a preclusion that would apply to the subsidiary.

John Cooney (09:35):

And in the course of that letter, Your Honor, is correct. They do refer to the application of the anti-collusion rule in a way that would suggest that an entity is covered by the anti-collusion rule until the end of the process. But that is one of many conflicting things, and it's buried within *Pettit* itself. And there are many other statements at higher levels of the organization later that go the other way. And so that's why we think that this is a confusing jumble for the regulated community.

Judge Henderson (10:07):

So let me go back to you—to the May 24th public notice and June 6th public notice. Bidders are reminded that the anti-collusion rule prohibit applicants. I mean, it's addressed to bidders, but it's saying bidders, don't forget that all those applicants who didn't do their upfront payment on you can't talk to them.

John Cooney (10:27):

Your honor, this is my point exactly. It doesn't provide sufficient notice to the community. Yes, the wood applicant is in there. Bidders are reminded that, but the focus many places on is on the bid, the eligibility to participate, the actual competition. And what I would draw Your Honor's attention to is in the June 26th letter. If I could jump ahead in that where the commission most explicitly states its position that everybody remains subject. The sentence that precedes that, and it's not something that I appreciated the significance of until preparing for oral argument, but the sentence before that, and the commission's notice states that that there has been a statute passed the Auction Reform Act of 2002, and that the only persons who are eligible to participate in auction 44, the auction we have here, are people who are listed by the commission is being eligible an earlier June 7th statement.

John Cooney (11:19):

And it was in the June 7th statement that Northeast was first mentioned as being ineligible to bid. So, we have an unusual situation here where the FCC refers directly to a statute that itself makes Northeast ineligible to bid in this situation. And I believe that that's significant for several reasons among them, when we raise with of the FCC, our position, that our interpretation is reasonable. The commission says, "no, there's only one reasonable interpretation in here. And it's the one that applicant applies to your status all the way through." And we say, "well, what about the fact that you gave public notice? What about the fact that your rule says, if you don't make the upfront payment, you will be ineligible and your application will be dismissed?" To which the commission says, "well, that indicates that there will be future activity taken on our part."

John Cooney (12:06):

And so it's not self-effectuating. More needs to be done. And so you should have understood that you were still subject to the ban. But let's look at the language. The phrase "will be ineligible" has immediate effect. You cannot bid in this auction unless the FCC lists you as eligible and then gives you the security codes that will allow you to access the internet website. The FCC is not going to give you that. Their disqualify—your inability is immediate. And they're not going to give you the conditions precedent to bidding. Also, they say, "well, we will dismiss this." And that means we'll dismiss it at a later date. The commission didn't actually do that in this case. It never issued an order that disqualified these people. Its practice was different from its theory as set out in its interpretation. And finally, again, specifically for auction 44, there was a statute that automatically made Northeast ineligible for participation here.

John Cooney (12:58):

So there was no need for further commission action in this particular auction. Northeast was out by operation of law. And so for those reason, we think Star's interpretation that it was reasonable, that it was permitted to communicate with Northeast is a reasonable one. Certainly reasonable within the meaning of *GE* and *Satellite Broadcasting* and the other cases that speak to the ascertainable certain doctrine. Now in the time that's remaining, I'd like to turn very briefly to the other argument we have in the case, the other principle argument, which is even if the FCC is right, it's conclusion is irrational here. And for that, we point to the basic economic principles and the case laws under the antitrust merger guidelines, looking at horizontal competitors. And the lessons you draw from that is if an entity is not in a market or is not on the fringes and able to enter the market, then it can't affect the price that is obtained from the auction in that market.

John Cooney (13:56):

And the two classic cases, the antitrust merger guidelines itself state that explicitly. That you're not considered part of the market unless you're in it, or you can enter it if there's a change in price. And the two principle cases in the antitrust law in this point are the *General Dynamics* case and the *Philadelphia National Bank* case. The *General Dynamic* case saying "if you don't have the ability to compete, compete in the market in the future there are no antitrust considerations, no threatening to reduce competition if you're taken over by somebody who is in that market, because you can't affect future prices in that market, because you can't compete in it." And the *Philadelphia National Bank* case states explicitly that where there is a government established barrier to entry, as there is here, when Northeast was disqualified. Where there's a government barrier to entry, then we don't consider it to be a potential into the market. And so we don't consider your potential influence on the price in that market. And the harms that the FCC has pointed to here are very similar to the antitrust harms. Their concerns stated in their rules and in their order are that two parties could get together and collude collaborate to divide up the market. And that can't happen here because Northeast no longer had that potential to. There could not be one fewer bid. Northeast was going to be out.

Judge Henderson (15:18):

But I mean there, but also they're saying it's prophylactic. I mean, to me, it's a per se rule they don't want get into. We've got to hear these conversations or decide whether or not they're going to bid. We're just going to stop it all together.

John Cooney (15:31):

That's correct, Your Honor, but look at the nature of the prophylactic rule. That would make perfect sense in other circumstances where the biddings going on and people might be talking to each other there, it might be very difficult. There'd be a risk of collusion. It would be hard to detect. This is not that situation because the commission has decided itself absolutely by rule and announced to the world that Northeast is not eligible. They've made the case by case determination already, not on a ground on conversations, but on the fact that they didn't put up money, and they don't give Star or them—sorry, they didn't give Northeast the bidding codes to allow it to access. They've already made that determination on a case by case basis. So our conclusion is the prophylactic rule itself is irrational in a situation like this, where the agency will make that specific decision and will act on it by withholding the bidding codes. Thank you. I'll reserve the remainder of my time.

Judge Henderson (16:26):

Mr. Palmore.

Joseph Palmore (16:33):

Thank you, Your Honors. Joseph Palmore here on behalf of the FCC. The FCC's anti-collusion rule safeguards the integrity and competitiveness of spectrum auctions. Under the explicit terms of that rule, those who apply to participate in an FCC auction may not communicate about bidding strategy with other applicants from quote, "the short form application filing deadline" to quote "the down payment deadline after the auction." That's 1.2105(c)(1). Stars' claims notwithstanding. The commission has repeatedly made clear that the anti-collusion rule applies to all applicants up to the down payment deadline. Even those applicants that are disqualified from participation in the auction at some point before them. For example, on August 7th, 2002, Mr. Cooney referred to this public notice, this was just three weeks before the communication that took place here. This was after Northeast had been listed as a disqualified applicant. The commission issued a public notice reminding auction applicants, including but not limited to qualified bidders that they remain subject to the commission's anti collusion rule until the post auction payment deadline.

Joseph Palmore (17:40):

Now, Mr. Cooney referred to subsequent language, which is addressed only to bidders. But a further reminder to a subset of people subject to a rule does not serve to narrow that rule, especially in light of the clear language that came above that made abundantly clear that the anti-collusion rule continued to apply even to applicants that had been disqualified. On March 20th, 2002, the commission, likewise, reminded applicants that the anti-collusion rule kicked in at the short form application deadline, and ended at the down payment deadline. In that same order, the commission provided a list of past decisions on the anti-collusion rule, among them the letter to *Robert Pettit* that Judge Rogers referred to, and we discussed it in our brief. That letter ruling, which was explicitly brought to the party's attention just before this auction began, is listed in appendix G of that March 20th order, that letter ruling addressed the exact question presented here, does the anti-collusion rule cover communications with a party that has failed to make the upfront payment?

Joseph Palmore (18:40):

The answer in that letter was yes, that the same answer that commission has consistently provided. So the notice in this case was more than adequate. Mr. Cooney talked about the use of the phrase competing

applicants, and somehow suggested that that added some confusion to this question. Competing applicants is a settled term of art in the commission's rules and in auction practice. And it means applicants who applied in their short form application to bid on the same licenses. That makes them competing applicants. The anti-collusion rule applies to them. Northeast and Star were competing applicants, but because they had listed the same licenses that they were interested in bidding on.

Joseph Palmore (19:21):

And again, to under the kind of ascertainable certainty standard as explained for instance, by this court, in the SBC case that we cited in our brief, it's not enough for a party to kind of go on the scavenger hunt and try to manufacture ambiguity. There might be a problem of due process notice if there were some decisions going one way and some decisions going another way. If counsel could point to a decision from the commission saying, "you know what the anti-collusion rule does not apply to one who makes who fails to make an upfront payment," he might have an argument under the ascertainable certainty standard. There is no such decision in contrast to all the public notices. The *Robert Pettit* letter were uniform in reminding parties that the anti-collusion will apply to all applicants up until the down payment deadline. Star also argues that it is entitled to, in a sense, write its own exception into the anti-collusion rule, exempting its communications with Northeast because, in its view, the rule's purpose was not served by enforcement on these facts. As Judge Henderson noted, the anti-collusion rule is a prophylactic rule designed to prohibit certain communications, especially likely to lead to abuse of the auction process. Enforcement of the plain terms of a prophylactic rule cannot be arbitrary, whether or not the abuses actually materialize in a given case.

Joseph Palmore (20:42):

In this case, however, those abuses did, in fact, materialize. And enforcement of the anti-collusion rule was therefore plainly appropriate. Because Star contacted Northeast, it obtained critical information about post auction demand for several licenses in Wisconsin, which had it then proceeded to bid on and obtain. This information was not disclosed in Northeast short form application. And I think the facts of the administrative process here unfolded are important, the way the auction process unfolded here is important. When Northeast filed its short form application, it listed 734 licenses of interest. That was all the individual licenses in the auction. At page 92 of the joint appendix, Northeast explained why it did that. It said it didn't, and it was perfectly appropriate for it to do that, to list all the licenses—said, it didn't want to narrow the subset to show what it was really interested in because it didn't want to put its cards on the table and notify competitors about which auctions it was actually going to bid on. So it listed all 734. By contacting—

Judge Henderson (21:41):

Can I just understand what happens?

Joseph Palmore (21:42):

Sure.

Judge Henderson (21:42):

If everybody does that and everybody bids on everything, then what happens?

Joseph Palmore (21:47):

Well, some parties will list everything. That doesn't obligate them to bid on everything. It just preserves their ability to—

Judge Henderson (21:52):

So once they have to put the upfront payment down, that's where they signal what they're interested in?

Joseph Palmore (21:58):

Not necessarily. It's when the bidding actually starts. That's when they'll start bidding on actual individual licenses that—

Judge Henderson (22:07):

And there's small a bidding window?

Joseph Palmore (22:10):

It's a multiround auction. And it lasts basically as long as there are bids for any individual license. But the important point to keep in mind here is that that Northeast in the publicly filed short form application—

Judge Henderson (22:20):

I understand your point. I just was trying to understand how this actually works.

Joseph Palmore (22:24):

Right. It's quite complicated, Your Honor. But this fact is not complicated.

Judge Henderson (22:29):

So, just so I'm clear. If I want to enter this auction and I want to hold my cards close to my chest, my initial application just says, "I want a bid on all the licenses."

Joseph Palmore (22:43):

You could do that, yes.

Judge Henderson (22:44):

Then when I have to put down my first payment, what is that payment covering precisely? It's like a deposit just to show off—in good faith?

Joseph Palmore (22:54):

It's a deposit of good faith to show that entity's actually seriously interested in bidding.

Judge Henderson (22:59):

And it's calculated as to the number of licenses I've indicated I'm interested in?

Joseph Palmore (23:04):

I don't believe it is, Your Honor. I don't know. The record here doesn't discuss that. That's not an issue—

Judge Henderson (23:08):

So then I put my payment down?

Joseph Palmore (23:11):

Right.

Judge Henderson (23:12):

And then the bidding opens up?

Joseph Palmore (23:14):

Correct.

Judge Henderson (23:16):

And at that point I say, "I don't know, I want a bid \$2 million on license 453." And that's how it goes?

Joseph Palmore (23:25):

That's correct. And you'll put in a bid, other parties will put in a bid. And then there are multiple rounds, and the auction continues until no one else is bidding. So here, what Star did—Star also listed many, many licenses in its application and it began bidding just on licenses in, I believe California and Florida. Then on when Mr. Behenna of Star picked up the phone and called Northeast, and the call was returned the next day. And he was able to find out despite the fact that Northeast listed 734 licenses on its short form application, before five licenses that Northeast really wanted. That was secret information that Star obtained that was not available to any other party, no other party would've dreamed of picking up the phone and making that phone call to Northeast. And then within literally within 30 minutes of that conversation, I think those parties take the anti-collusion rule pretty seriously, Your Honor.

Judge Henderson (24:22):

All right.

Joseph Palmore (24:22):

With literally within—

Judge Henderson (24:23):

Very broadly stated. And your point is that the notices here even in a future auction would not be any clearer?

Joseph Palmore (24:34):

Well, I suppose things can always be stated more clearly, but that's not the standard here. The—

Judge Henderson (24:38):

No, but I just.

Joseph Palmore (24:39):

The question is—

Judge Henderson (24:40):

The argument is it was clear on its face. If you read these notices, if you read the rule, end of discussion.

Joseph Palmore (24:45):

I think that is the case. I think the *Robert Pettit* letter, the August public notice the June public notice all—

Judge Henderson (24:55):

The only reason I'm putting it that way, as opposed to the *Pettit* letter is, you know, when you refer to attachments, it's sort of hiding things. It's distinct from just saying upfront, what you mean.

Joseph Palmore (25:07):

Well, the August public notice put it up front.

Judge Henderson (25:10):

Yeah.

Joseph Palmore (25:10):

And I think it's not just a matter of attachments. The March 20th letter said for further guidance on how the anti-collusion rule operates, read these decisions. And the Robert *Pettit* letters is listed as, as one of those.

Judge Henderson (25:22):

Right.

Joseph Palmore (25:22):

Um.

Judge Henderson (25:24):

So what happened within 30 minutes?

Joseph Palmore (25:27):

Within 30 minutes, Star stopped bidding on the licenses that had previously been bidding on in California and Florida, and started bidding on the very licenses that Northeast had identified as those that it was particularly interested in. And then Star actually went on to be the winning bidder for several of those licenses. So Star gained exclusive access to information about possible post auction demand for those licenses. And then it used that information to obtain those, to be the high bidder for those licenses. So again, this is, pardon me?

Judge Henderson (25:59):

Does it have a now stock?

Joseph Palmore (26:00):

The licenses had not issued. At the same time because of the contact, Northeast was effectively able to participate in an auction from which it had been disqualified and possibly gained access to valuable licenses without its competitors in those parts of the country knowing what it was doing. Enforcement of the plain text of the anti-collusion rule was clearly reasonable under these circumstances.

Joseph Palmore (26:22):

Mr. Cooney in his brief, and again, he at argument talked about antitrust cases. But there's—it's not just antitrust principles that are at issue here. The anti-collusion rule serves a very broad purpose to say at it most general, as the commission has, to safeguard the integrity of the auction processes. So here, the integrity of the auction process was subverted because Star obtained this information, which was unavailable to competitors, and then used that information for its benefit. And, in any event, even if you look, if you want to say, as Mr. Cooney does, that you have to look at a party's ability to affect—to enter a market, the commission has reasonably conducted that inquiry at the time of the short form applications. So at that time, Northeast was an applicant for these very licenses that were at issue. And at that time it had an ability to affect the price for those auctions because for those licenses, because it could have made the upfront payment, and it could have continued in and could have obtained them. If the court doesn't have any other questions, I will see the balance of my time. Thank you.

Judge Henderson (27:37):

No time. Right. Why don't you take two minutes.

John Cooney (27:42):

Thank you, Your Honor. I'll comment briefly on two parts of council's presentation. First Star was the highest bidder for four licenses in the auction. In two of those bids, it had no competition. And this is all set forth at joined appendix 51 to 52. And in two of the other licenses, there was only one other bidder and that bidder came in in around 15. Second, I want to come back to the statement of harm that the government just made. It's conflicted on this. In page 31 of its brief, it makes the argument it made here, which is to say the problem here is that Star obtained access to secret information, and it used that secret information. Well, this was an entity that was disqualified from the auction and couldn't have affected the price. It all started as unilateral would call up and find out the information as to whether the people were still interested.

John Cooney (28:34):

At other places in its brief, it says that the harm here is that—actually the harm is because the information that Northeast put out was very public. And because it was very public, it provides an opportunity for many other people to try to cheat on the anti-collusion rule. But all the information that about Star is publicly known—I'm sorry about Northeast. It was known to everybody. They knew the three critical facts about Star. I'm sorry, again, about Northeast. They knew where Northeast existing licenses were. They knew where Northeast had expressed interest in the short form bids. So they could see that Northeast might be interested in things that were contiguous to its existing service area. And they also knew that Star had—that Northeast had withdrawn. It didn't have the money to participate, so it was not participating in the auction. So in trying to find harm, the Commission can't have it both ways. It can't be that the problem is that the information we obtained with secret information, and it can't be that the harm comes because the information we obtained was public information. It seems to me that that conflict shows that there is no rational basis, no consistent theme that the commission is able to seize on for what the harm was for the communication with Northeast. If there are no further questions. Thank you.

Judge Henderson (29:41):

Thank you.

Bailiff (30:20):

All stand please for this honorable court [inaudible]