

Ben to push down auction revenue¹

The Hague is counting on 20 billion gulden when auctioning mobile phone frequencies. British and Dutch auction experts, however, point to the fact that the design of the auction will lead to much lower revenues.

By Stephane Alonso

The Hague – June 30th. Paul Klemperer, Professor at the University of Oxford, believes that revenues from the Dutch auction of UMTS frequencies (for third generation mobile phones) will not reach the same dazzling heights as in the UK. The fact that one of the bidders in the Netherlands, Ben, is now backed by Deutsche Telekom – with whom it has established an intense co-operation – has further reduced the chances of an efficient auction, says the British game theorist during a phone conversation.

Klemperer would know. The British auction was his brainchild. The British government set him two tasks: design a fair and transparent auction, but make the design such that we get the best possible price for our frequencies. Which is exactly what happened. The British auction lasted for 6 weeks and earned the British government more than 80 billion gulden.

An auction can be badly designed because of three reasons, argues Klemperer. The auction can be designed such that bidders will collude, keeping prices low in the process. Or it can lead to companies overbidding. In this case, after the auction the highest bidder finds out that too much has been paid. Finally, an auction can be set up in such a way that new entrants are deterred from participating.

The British market has 4 national mobile phone suppliers: Vodafone, Orange, BT and One-2-One. According to current auction theory, “homeplayers” are very keen to remain “homeplayers”. They will continue to bid aggressively. To avoid the 4 UK homeplayers dividing the cake amongst themselves, Klemperer created a fifth licence to attract new entrants.

Klemperer’s auction was well designed. Colluding was difficult as there were a total of 13 parties bidding for 5 UMTS licences. What’s more, one of these licences was reserved for a new entrant. Hence, for parties just entering the market, it remained interesting to bid in even the later stages of the auction. As there was still a probability of being successful.

Some people have argued that UK bidders actually did overbid. But the jury is still out on that as we can only say something with some degree of authority if one of the bidders goes bankrupt as a consequence of the UMTS-auction.

For the Dutch auction there are 5 licences to be auctioned, whilst there are also 5 existing mobile phone suppliers: KPN, Libertel, Dutchtone, Telfort and Ben. This situation can deter new entrants and according to Klemperer it looks like this effect

¹ Everywhere where I translate “Dutch auction”, it actually means literally that, i.e. the auction that was held in the Netherlands (i.e. NOT the standard Dutch auction from auction theory).

has already materialized. A year ago, the Ministry of Transport and Waterways was counting on some 12 participants to the auction, but, as was revealed yesterday now there are only 8, including the homeplayers. This means there are only 3 new entrants, compared to 9 in the British situation.

In itself, the number of participants is not that important, argues Eric van Damme, game theorist and professor of Economics at the University of Tilburg. More important is whether new entrants are strong enough. "And it looks like they are", says Van Damme, who is also a consultant for one of the Dutch bidders. Amongst the new entrants are Hutchison – the Hong Kong conglomerate – and Nogenta, part of the telecom-company NTL which was also bidding in the UK auction, where it only gave up in the later stages.

Until yesterday, Klemperer did give the Dutch design some (not large) chance of being successful. This had to do with the position of Ben, the smallest and most vulnerable supplier of mobile phones in the Netherlands. Ben's weak position would have been good for the newcomers who could have kept Ben out of the UMTS-market with a higher bid. The fifth licence could then play the same role as the fifth licence in the UK. The auction would have been more efficient.

Klemperer argues that now that Ben has the backing of Deutsche Telekom, a different situation has been created. The Germans can throw a lot of money into the auction, which will deter entrants. It thus seems that the auction will be short and will not be very successful in raising substantial revenues. As such, both Klemperer and Van Damme argue that the 20 billion gulden in revenue (=old Dutch money, 1 euro is more or less equal to 2 gulden) policymakers in The Hague are hoping for, will definitely not materialize.

Telecom-company Versatel – one of the entrants in the Dutch auction – has complained to the European Commission about the auction design. For Versatel, the auction is "a closed shop", says Mark van der Heijden, a legal representative of the telecom-company. "We can only enter the market by kicking another party off its chair", says Van der Heijden. "And that is going to cost an awful lot of extra money."

Klemperer wonders whether it wouldn't have been better to create a sixth licence – as a guarantee for entrants. But according to Van Damme that was not possible. In the Netherlands there is at the moment too little frequency-space for a sixth licence. "The problem is that we have exactly 5 national players."