



**McCaw Cellular
Communications, Inc.**

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January 11, 1994

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Mail Stop Code 1170
Washington, D.C. 20544

RE: Ex Parte Presentation
Gen. Docket 93-252

Dear Mr. Caton:

Pursuant to the requirements of Sections 1.1200 et seq. of the Commission's Rules, you are hereby notified that on behalf of McCaw Cellular Communications, Inc. ("McCaw") I provided Judith D. Argentieri and Nancy Booker of the Common Carrier Bureau with copies of the attached Order Instituting Investigation, I.93-12-007, filed by the California Public Utilities Commission on December 17, 1993, for their consideration in the above-referenced docket.

Should there be any questions regarding this matter, please contact the undersigned.

Sincerely,

Cathleen Massey
Cathleen A. Massey

cc: Judith D. Argentieri
Nancy Booker

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's)	FILED
Own Motion into Mobile Telephone)	PUBLIC UTILITIES COMMISSION
Service and Wireless Communications.)	DECEMBER 17, 1993
<hr/>		SAN FRANCISCO OFFICE
		I.93-12-007

ORDER INSTITUTING INVESTIGATION

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ORDER INSTITUTING INVESTIGATION

Summary

This investigation proposes a regulatory program which encompasses ALL forms of mobile telephone service provided to the public within California. For this purpose, the term "mobile telephone service" means any service which permits a user to initiate or receive calls and engage in two-way voice communications while moving freely about within a broad serving area. Generally speaking, mobile telephone services employ various forms of wireless communications technology to provide mobile capability.

This order initiates a review of the Commission's historic policies governing cellular telephone service. It is prompted by further experience with the industry; market and technological developments which include the imminent entry of alternative providers of mobile telephone service; and changes in federal law. The existing regulatory framework which is specific to cellular radio telephone utilities will be subsumed within this comprehensive framework for mobile services once the new framework becomes effective.

While any new framework we adopt will, by definition, be broader in scope with the addition of non-cellular services, we expect its overall impact to be dramatically less burdensome for most service providers and more responsive to consumer interests. Our guiding strategy is to gauge the power over consumers or suppliers held by the different types of firms in the mobile market, and to measure our regulatory response accordingly. We envision that in the not too distant future that the market forces of competition will police the mobile market and allow for an orderly withdrawal of government oversight. We propose today a framework for regulation of the mobile telephone market to carry out this strategy.

In the near term, the proposed framework assures streamlined regulatory treatment for new providers of mobile service as well as most cellular service "resellers." Additionally, it focuses closer regulatory attention on the radio bottlenecks held by cellular duopolists. Further, the framework classifies cellular duopolists as dominant carriers and establishes a clear vehicle for an orderly phasing down of regulation when effective competition infiltrates the mobile market.

I. background

This investigation into the overall intrastate mobile telephone market follows nearly a decade of market evolution and regulatory experience with cellular radiotelephone services.

In 1983, the Commission articulated its original regulatory program for cellular services in Decision (D.) 84-04-014 and subsequent decisions.¹ At the outset the Commission recognized the severe limitations on direct facilities-based competition inherent in the Federal Communications Commission's duopoly scheme for cellular licensing. Accordingly, this Commission's first efforts to oversee the industry focused on assuring interconnection and encouraging an active resale market.

From its adoption in 1984 and continuing through its last major modification in 1992, the Commission's regulatory framework has relied on a complex two-tiered "wholesale/retail" market structure to preserve a competitive retail market and to bring some

¹ The Commission also continues to regulate mobile telephone services which pre-dated the introduction of cellular technology. These services fall under the radiotelephone utility (RTU) regulatory framework currently articulated in R.88-02-015. See the discussion in Section III below regarding the treatment of such services under these new rules.

indirect pressure on the cellular wholesale market.² As a result, the Commission has devoted substantial resources over the years to develop and maintain a resale market, including mechanisms for separate "wholesale" and "retail" tariffs for duopoly carriers, and setting of wholesale/retail margins.

In 1988, the Commission commenced an investigation into possible revisions intended to increase competition in the industry, Order Instituting Investigation (OII) 88-11-040. In D.90-06-025, the decision issued after Phase I and Phase II of I.88-11-040, the Commission elected to "monitor" pricing and investment behavior of duopolists for the purpose of detecting any "failure to compete" at the wholesale level. The Commission chose this path on the grounds that cellular service was "discretionary" and that rapid technological change made industry oversight difficult.

However, the Commission did express concern about the potential for anticompetitive cross-subsidy of affiliated retail operations by duopoly wholesale operations. In response, the Commission directed the development of a cost allocation methodology between wholesale and retail operations of duopoly carriers. The Commission also attempted to provide additional pricing flexibility for facilities-based carriers and streamline the regulatory treatment of independent resellers.

In addition, in D.90-06-025, the Commission stated that it would keep the investigation open to address the resellers proposal to perform switching functions currently provided by the cellular carriers and the unbundling of the wholesale tariff rate element.

In D.92-10-025, the decision in Phase III of I.88-11-040, the Commission rejected the monitoring program of cellular

² See D.90-06-025, 36 CPUC 2d 491, 504 (1990).

capacity; amended the facilities-based carriers' Uniform Systems of Accounts (USOAs) to include a cost allocation to segregate wholesale and retail activities and cellular and noncellular activities; allowed the resellers to file petitions to modify their certificates of public convenience and necessity (CPCNs) to perform switching functions; and required the facilities-based carriers to unbundle their wholesale tariffs. However, in D.93-05-069, the Commission granted rehearing on the issues of the reseller switch, the unbundling of the wholesale tariff, and the capacity monitoring program, and rescinded adoption of the USOA modifications. The Commission indicated in D.93-05-069 that all of these issues would be addressed in this OII.

II. Recent Developments

A number of recent developments further prompt the initiation of this investigation to develop a comprehensive strategy for the mobile telecommunications market and, consequently, to reexamine the regulatory framework for cellular services adopted by the Commission in 1984 and revised in 1990.

A. The Impending Entry of Alternative Service Providers

The introduction of alternatives to cellular service will redefine the market for mobile telephone services over the next several years. Although limited mobile telephone services existed before the introduction of cellular technology in the 1980s, cellular service has overshadowed the entire mobile market over the past several years. While the deployment of cellular systems represented a landmark step in mobile telephony, society stands now on the verge of yet another series of critical advances as new technologies and new providers come to market.

In I.88-11-040, the Commission did not consider the prospect of direct competition in the facilities portion of the mobile telephone market. Instead, the Commission focused on

indirect methods of encouraging competition through the promotion of a resale market. With these policies, California has developed into one of the largest and most vibrant cellular markets in the world.

It appears that competitive alternatives to current cellular service may develop in the next few years. The development of this competition should diminish the need for vigorous regulation of this market. While it may take some time to develop a fully competitive wireless telecommunications market, we are hopeful that such a market will develop.

A primary purpose in examining a new strategy for regulation of cellular is to place such regulation in the context of a rapidly broadening mobile telecommunications market. Specific opportunities exist for new entrants into the mobile communications market. At least three types of wireless telecommunication services in addition to cellular are expected to begin providing mobile telephone services in California over the next several years.

First, radio carriers licensed by the FCC as "specialized mobile radio" (SMR) carriers will soon be operating as telephone corporations within the definition of the Public Utilities Code. Mobile telephone services provided to the public by SMR carriers will also fall within the scope of our proposed regulatory framework.³

³ Consistent with federal law, the Commission will not apply these proposed rules to radio dispatch services offered by a firm pursuant to a FCC specialized mobile radio license. A radio dispatch service is defined for these purposes as a radio service which provides a customer with a private communications network linking a closed and "regularly interacting" group of stations, i.e., one or more central dispatch points and specified individual users "in the field". See 47 U.S.C. Section 153(gg).

(Footnote continues on next page)

Second, the FCC plans to auction additional radio spectrum this spring for a new class of services termed "personal communications services" (PCS). The Commission considers competition involving PCS to be less imminent, as licenses have yet to be acquired and the necessary infrastructure built to allow PCS providers to fully compete with existing providers of similar services.

Rather than a specific technology or service, PCS represents an array of mobile voice and data services that will make use of advanced radio and switching technologies. The framework provided in this OII encompasses services that use PCS spectrum and meet the Commission's mobile telephone service definition.

A popular concept of PCS envisions that in the future mobile phones will be ubiquitous and will replace landline telephones as the primary vehicle for basic telecommunications. In this case, the "personal" in PCS would allow every person to carry one phone which the public telephone network could "find" no matter where the user roams.

Third, mobile satellite services which will use space-based facilities to provide global coverage are another category of

(Footnote continued from previous page)

Firms that hold SMR licenses but are also engaged in the provision of exchange or interexchange telephone services to mobile consumers and thereby are providers of public switched network services shall be considered telephone corporations subject to Commission regulation with respect to such services. Nothing in these rules is intended to transform SMR licensees into common carriers and subject them to state regulation with respect to radio dispatch services, regardless of whether such dispatch services are offered indiscriminately or for compensation. See 47 U.S.C. Section 332(c)(1).

services that will become available over the next several years. Such services may provide some opportunities for substitution for terrestrial mobile services. Satellite services may be used to provide complementary geographic coverage in areas where terrestrial services are not available. Mobile satellite services will not fall with the scope of this OII but will offer competition to cellular services.

Thus, this proceeding deliberately covers the market for "mobile telephone services," and not just cellular services. We propose an integrated strategy for all telephone utilities that provide mobile capability, and recognizes that cellular technology is but one method for delivering mobile services. However, we will consider the extent to which different technologies provide competitive substitutes to each other and whether symmetrical or asymmetrical regulatory treatment should apply.

B. Demand for Mobile Services

In D.90-06-025, the Commission characterized cellular service as a "discretionary" service which complemented basic landline service." Today, however, a blanket characterization of mobile telephone service as discretionary belies its importance to California. While residential consumers do not use mobile telephone service for routine communication, many people do subscribe for the sense of safety convenience and accessibility it provides when traveling. Mobile service has become an integral part of the telecommunications services relied upon by many businesses and institutions in the State. Entrepreneurs who are sole proprietors and in the past had to rely on answering machines or answering services are now, with mobile communication capability, instantly accessible. Further, many public safety and community institutions rely on mobile telephony to improve their emergency response capability. Clearly, this growing dependence on mobile communications is an additional factor driving the Commission's new examination of mobile service regulation.

In less than two years cellular service exceeded the five percent penetration that we indicated in D.90-06-025 would take five years to reach.⁴ Cellular systems in California now serve well over one million subscribers, nearly triple the 400,000 subscribers noted in the record cited in the 1990 decision.⁵ More remarkable, the volume of new cellular customers now approaches or exceeds the volume of new residential access lines.⁶ We note now as we did in 1990 that mobile telephone services could become "competitive with landline basic service in the coming decade."⁷

While mobile services may not yet enjoy a place as the typical mode of communications for most Californians, it may have already become a service whose availability can critically affect the welfare of all residents of the State. This changing role of mobile telephone services must be acknowledged in a new regulatory framework for the mobile market.

4 D.90-06-025, 36 CPUC 2d at p. 474 (1990).

5 Undoubtedly a significant portion of the growth discrepancy reflected the rapid rate at which any industry snapshot becomes obsolete in this exploding market, tied with the normal lag between the submission of evidence and the issuance of the Commission's decision.

6 The Wall Street Journal of August 5, 1992 cites a statement that nationally more cellular phones were put into service in 1991 (2.5 million) than landline residential phone lines (1.9 million). Recent cellular subscribership growth and landline access line growth figures in California show that the numbers of additions are comparable.

While strictly speaking this type of comparison may indicate more about the relative maturities of the two services than anything else, it clearly illustrates the significance of the evolution in mobile market demand as well.

7 D.90-06-025, 36 CPUC 2d at p. 472 (1990).

We note that this Commission, and indeed the industry itself, has often underestimated the market demand for cellular telecommunications and other wireless services. Therefore, we need not predicate our regulation upon a specific view of the demand for such mobile telecommunications. We believe that mobile telecommunications certainly has the potential to be a substitute to traditional landline access and seek comment what type of regulation, if any, spurs the development of such competition.

Since the capacity monitoring program proposed in the Phase II decision to measure anti-competitive pricing behavior is no simpler than the cost of service examination, the Commission still must develop a method to measure whether rates are competitive and whether cellular markets are competitive. The need for an appropriate test still exists. The strategy for regulating cellular prices depends upon accurate information on and measurement of the competitive nature of cellular prices. We solicit comments on what measurements are appropriate for evaluating cellular market behavior. In the interim, because of the critical need for this information, we may pursue a plan to either audit or sample the industry for information relevant to the status of competition through subsequent rulings in this docket.

C. Experience With Implementing the Monitoring Approach

In establishing regulatory frameworks, as repeatedly expressed, our first preference is to encourage and rely upon effective competition to assure just and reasonable rates for mobile telephone service.⁸ Where it is possible to enhance competition and avoid the imposition of economic regulation or relax such regulation and still provide just, reasonable and fair service to consumers, we will do so.

⁸ See D.90-06-025, 36 CPUC 2d at p. 491 (1990)...

However, upon closer scrutiny, the program contemplated in D.90-06-025 appears substantially more difficult to analyze and less effective in evaluating competition than the Commission originally envisioned.

In rejecting more active regulation of duopolists, the Commission in 1990 placed its hopes on being able to conduct meaningful monitoring and evaluation of network utilization and expansion. However, after thoroughly evaluating the record in Phase III of I.88-11-040, it appears that the information that carriers assert they can provide, is insufficient to properly evaluate whether a carrier's conduct comports with economically efficient and competitive decision-making.

In Phase III, the Commission envisioned using information gathered in monitoring reports to evaluate competitiveness. However, such a determination presumes that the Commission knows the characteristics of an ideal cellular network. The exercise of investigating and judging what is economic investment and expansion and what is duopoly conduct is no simpler than the type of cost of service examination the Commission rejected in D.90-06-025.⁹

Moreover, if this is the case, a successful monitoring approach which requires that such an examination be performed on an ongoing basis would result in precisely the approach to regulation,

9 The monitoring approach adopted in D.90-06-025 was dependent on being able to identify two critical warning signs: (1) pricing above "out-of-pocket costs" despite excess capacity, or (2) failure to expand system capacity when expansion was both feasible and economic with respect to current rates. See D.90-06-025, 36 CPUC 2d at p. 495 (1990).

To be successful, monitoring of the first sign requires an ability to determine out-of-pocket costs for wholesale operations. Monitoring of the second warning sign involves an even more challenging task -- being able to evaluate the capabilities and cost of the rapidly-evolving technological frontier.

continuous cost-of-service rate review, that we explicitly abandoned in D.89-10-031 for local exchange carriers.

D. Changes in Federal Law

Finally, recent changes in federal law which have significantly altered the nature and extent of federal authority over mobile services motivate us to re-examine the regulatory framework for mobile services.

On August 10, 1993, the Omnibus Budget Reconciliation Act of 1993 ("Budget Act") was signed. Among other things, the Budget Act amends Section 332 of the Communications Act of 1934 in order to create a new regulatory framework governing the provision of commercial and private mobile services. "Commercial mobile service" is defined as any mobile service that is provided for profit, is available to a substantial portion of the public, and is interconnected with the public switched network. Such service is treated as common carrier service, and subject to the entry, rate and other provisions of Title II of the Communications Act. "Private mobile service" is defined as a "service that is not a commercial mobile service or the functional equivalent of a commercial mobile service." Private mobile service is not subject to federal rate or entry regulation.

Under Section 332(c)(3)(A) of the Communications Act, as amended, Congress has preempted the states from regulating the rates or entry of all commercial mobile services not currently subject to state regulation, and all private mobile services. States, however, are not preempted from prescribing other terms and conditions governing commercial mobile services.

Moreover, under Section 332(c)(3)(B), as amended, Congress has allowed a state to stay the preemptive effect of Section 332(c)(3)(A) with respect to state rate regulation in effect on or before June 1, 1993 governing commercial mobile services. However, a state which wishes to maintain such regulation must formally petition the FCC no later than August 10,

1994 and demonstrate that, absent state rate regulation, market conditions fail to protect subscribers adequately from unjust, unreasonable or discriminatory rates. Alternatively, the state must show that commercial mobile service has substantially replaced landline telephone exchange service, and market conditions fail to protect subscribers adequately from unjust, unreasonable or discriminatory rates.

During the pendency of the state petition before the FCC, and during the reconsideration of an FCC order denying a state petition, federal preemption of existing state rate regulation of commercial mobile services is stayed.

In the event that we determine that continued rate regulation remains necessary for dominant providers of commercial mobile services, we intend to invoke Section 332(c)(3)(B), file a petition with the FCC by August 10, 1994 and make the showing required by that section. Accordingly, in this proceeding, we seek evidence on (1) the degree of competition currently existing in urban, suburban and rural California markets for commercial mobile services; (2) whether, in each market, competitive conditions protect subscribers adequately from unjust and unreasonable rates, or rates that are unjustly or unreasonably discriminatory for commercial mobile services; and (3) where such market conditions exist, whether commercial mobile service is a replacement for landline telephone exchange service for a substantial portion of the telephone landline exchange service within California.

In light of these developments and the fact that we have now concluded the steps we devised in I.88-11-040 to improve the original cellular regulatory framework, we propose for consideration in this OII alternative forms of regulation for cellular services within the overall mobile telephone market.

III. Regulatory Framework Proposals

A. The Measure of a Successful Regulatory Program

Our objective is to promote an environment in which Californians receive high quality and reasonably-priced mobile telephone services. Such services should meet the individual needs of personal and commercial consumers in the State in a fair and efficient manner. Toward those ends, we encourage innovation which improves the quality and efficiency of service provided in California, and increases the range of choices available to satisfy the diverse needs of its population. We also seek to create an environment which encourages cost effective investment in advanced mobile telecommunications that expand the capability, capacity and coverage of mobile telecommunications in California. We also remain firmly committed to maintaining the requisite amount of oversight to discourage firms from exercising excessive market power or attempting to defraud the public.

One primary concern is to develop a balanced regulatory approach which encourages competitive entry into the mobile market while simultaneously assuring effective oversight of facilities based cellular carriers until such competition develops. Another concern is ensuring adequate consumer protection and education. A basic premise of any effective competitive market is that consumers are informed when making decisions. Thus, the regulatory framework we adopt should recognize the rapid pace of advancements in technological efficiency and capabilities in mobile services and the long term benefits competitive diversity and service innovation may provide. We will strive to preserve and improve incentives which will accelerate competitive entry and innovation, while assuring fair and reasonable delivery of services.

B. Specific Problems to be Resolved

The current cellular regulatory framework resembles a regulatory "crazy quilt" more than a progressive environment for

consumer protection and innovation. In particular, firms are subject to entry and rate regulation as well as an elaborate wholesale/retail regulatory structure. We seek comment on how well our existing regulatory structure has promoted the development of competition and/or reasonable rates.

Eight years of experience leads us to tentatively conclude that the elaborate retail regulatory structure is ineffective in enhancing competition in the cellular market. It is our belief that the explicit margin structure and its associated requirements do little to cure the central problem of limited competition in the existing wholesale cellular market.

It is our belief that limited competition in the mobile market stems from the cellular duopolists' control of the radio transmission bottleneck.¹⁰ It is the placement of control of radio spectrum in the hands of just two facilities based cellular providers per geographic market which constrains the competitive vitality of the market.¹¹ This problem is further magnified by the fact that facilities based carriers in one market are partners in other markets. Such affiliations cause us concern, we believe that such affiliations may impact the vitality of the market with respect to competition. One way to address the problem is to regulate those that control that bottleneck.

C. Overall Proposed Strategy

The Commission proposes to replace the current wholesale/retail regulatory structure with a regulatory framework for all mobile telephone service providers which distinguishes

¹⁰ The Commission has commented on the problematic structure of this industry on many previous occasions. See, for example, D.90-06-025, 36 CPUC 2d at p. 471 (1990).

¹¹ In fact, with the partnership arrangements that prevail in the cellular market, the two competitors in each cellular geographic service area often have common investors.

treatment solely based on whether a provider is classified as dominant or non-dominant. Under the new framework firms would be classified as dominant providers if they have control of important bottlenecks which are essential to providing mobile services to some or all of the public, i.e., they possess significant market power. All other firms which are not affiliated with dominant providers would be classified as non-dominant.¹²

New and innovative mobile service providers are to be encouraged to provide service in California. Accordingly, alternative mobile carriers holding personal communications service and SMR licenses would be classified as "non-dominant" service providers and, to the extent permissible by law, would be subject to minimal or no entry or price regulation.¹³

Similarly, pared down non-dominant regulation would apply to all independent mobile service resellers, even if such resellers operate a switch. However, all non-dominant providers would be subject to an informational "registration" requirement. The registration requirement would include the following elements:

1. Providing information to the Commission on the business' name, primary officers, place of business and point of contact for receiving consumer complaints.
2. Agreeing to be bound by minimum safeguards promulgated by the Commission to prevent and correct fraud or misleading information.

12 The dominant/non-dominant concept was generally recognized in D.90-06-025, 36 CPUC 2d at pp. 502-3 (1990). We propose to expand and substantially restructure its application here.

13 While it is theoretically possible that the Commission might identify some significant bottleneck held by an independent provider of alternative mobile services, we consider that possibility remote. Our intention is to grant non-dominant status routinely to all new entrants until a new market power problem is conclusively demonstrated.

The minimum safeguards would include requirements to provide consumers with essential information for making a prudent choice among competing alternatives, to have customer complaint procedures, to cooperate with investigating agencies in resolving consumer complaints, and to refrain from fraudulent behavior. Violations of these minimum safeguards would result in revocation of operating authority and/or other sanctions.

The notion that the Commission must regulate alternative mobile service providers on the same basis as cellular duopolists to assure a "fair and level playing field" is explicitly rejected. It is a red herring in terms of the public interest to suggest that this Commission is somehow obligated to regulate all service providers identically when some have market power or control bottleneck facilities which can be used to extort monopoly prices.

The dominant/non-dominant framework is intended to make a vital distinction between providers who have the ability to control a substantial portion of the mobile market, and those who do not. The fact that different providers of mobile service may all be providing functionally identical services says nothing about who controls market power. The semi-exclusive licensing arrangement in cellular is a distinct cause for ongoing concern.

Prospective competitors to cellular licensees are currently scrambling to find cracks in the regulatory wall to enter the market, much like MCI and Sprint did in the long-distance market of the early 1980s. Such firms lack inherent franchise rights to serve customers and, therefore, must rely on providing innovative service and greater value to attract a customer base.

To facilitate its goals, the Commission may seek legislative flexibility to waive tariffing requirements for non-dominant carriers.

D. Services Included

The term "mobile telephone service" shall mean any service provided to some portion or all of the public which permits

a user to initiate or receive calls and engage in two-way voice communications while moving freely about within a broad serving area.¹⁴ This definition includes pay station mobile services based on radio technology, such as CT2/telepoint services.¹⁵

Providers of pre-cellular mobile telephone technologies such as Improved Mobile Telephone Service (IMTS) who elect to retain radiotelephone utility CPC&Ns may remain under the RTU regulatory framework at this time.¹⁶ Alternatively, any such provider may apply for reclassification as a non-dominant mobile telephone service provider subject to the regulatory framework adopted in this proceeding.

**E. Extent and Duration of Oversight
Necessary Over Cellular Duopolists**

Cellular service should be subject to continuing oversight until the Commission is absolutely convinced that market forces are in place to ensure just and reasonable rates and service to consumers. Although competitive pressure may be achieved in a

14 This definition therefore excludes private communications systems and cordless phones which provide internal communications links for a single end user. We also exclude basic exchange telecommunications radio service (BETRS) which this Commission regulates as a part of the services of local exchange carriers (LECs). Conventional paging is excluded as being principally one-way communications covered by our RTU regulatory framework.

15 In the interests of efficiency, we do not plan to consider at this time whether the regulatory framework developed in this proceeding should be extended to air-to-ground and railphone services. Aside from considering the competitive implications for terrestrial mobile services, we do not plan to include mobile satellite services within the scope of this investigation either.

16 The Commission may elect to mandate a transition of all IMTS providers to the new mobile telephone framework at a future time.

duopoly structure as we discussed in D.90-06-025, it is a condition which is also susceptible to collusive behavior.¹⁷

Duopoly cellular licensees shall be classified as "dominant" until the Commission makes a determination that competition exists to restrain the potential exercise of market power or that cellular licensees lack significant market power. In this investigation, we propose a specific trigger mechanism for lessening regulation (see Appendix B).

Within the overall strategy outlined above, we wish to consider a number of alternatives for regulation of cellular duopolists. We solicit comments on the appropriateness of each of these regulatory alternatives in light of current and anticipated market conditions, and on the relative merits of these alternatives in furthering the Commission's goals and strategic direction.

¹⁷ A survey of federal agencies which have recently developed positions on the competitive status of cellular markets provides an illustration of the significant differences of interpretation that are possible.

The FCC has recently found that "the record is not conclusive as to whether the service market [for cellular] is fully competitive." In the Matter of Bundling of Cellular Customer Premises Equipment and Cellular Service, CC Docket No. 91-34, Report and Order, FCC 92-207, released June 10, 1992, at 11.

The staff of the Bureau of Economics of the Federal Trade Commission, commenting in the FCC's bundling proceeding, draws a number of conclusions suggesting weaknesses in the competitiveness of the cellular service market. Noting a lack of evidence as to substitution from other services, an industry structure that would place cellular in the most-scrutinized "highly concentrated" category of the market concentration index used in the Justice Department's Merger Guidelines, and the ineffectiveness of resellers as competitors to facilities-based duopoly, the FTC staff overall does not agree with earlier FCC suggestions that cellular is produced in an industry with a competitive structure.

The U.S. Department of Justice, in its comments, states that "there is insufficient evidence to warrant the conclusion that the cellular service market is in fact 'workably competitive.'"

1. Price Cap at Current Rates

Under this alternative, the Commission would cap wholesale cellular rates at existing levels. The price ceiling would provide a modest restraint on any additional exercise of duopoly market power. This model does little to actively lower rates, instead it relies on new entrants to place downward pressure on rates. However, carriers that do reduce prices may raise them again without regulatory approval up to the price cap, thus alleviating the fear of downward only approval for price changes. These requirements would be phased out as the mobile telephone market becomes sufficiently competitive. Further, under this alternative, the margin requirement would remain in place in order to prevent "anticompetitive squeezes" of independent resellers.

This alternative has the advantage of providing some regulatory oversight without the uncertainties of developing a cost-based cap. On the other hand, many of the inefficiencies and administrative difficulties of the existing cellular framework would remain.

This proposal mirrors our existing framework for cellular carriers. However, its adoption makes clear the status of new entrants; we would classify them and treat them as non-dominant. Additionally, this order proposes a mechanism for the relaxation of regulation when effective competition exists. Finally, in the event a particular carrier experiences extreme financial hardship, we envision a cost-based rate proceeding as a prerequisite to increasing rates.

2. Cost-based Price Cap

Under a cost-based price cap alternative, the Commission would determine a standard operating cost for cellular carriers and a market value for spectrum. This cap would act as a ceiling on wholesale rates for bottleneck services.

This approach may reduce opportunities for cross-subsidy by eliminating monopoly returns. Further, this approach would render several aspects of Commission regulation unnecessary. For

instance the need for wholesale/retail margin requirements might be superfluous.

However, the cost-based price cap alternative poses difficulties, including the challenge of valuation of spectrum and developing a capping mechanism for each geographic market. However, the direct constraint on the exercise of market power by cellular duopolists has advantages over widening the array of indirect regulatory measures in an attempt to correct weaknesses in the existing regulatory framework.

Under a cost-based price cap mechanism, in a fashion similar to the price cap we have adopted for our largest local exchange carriers, an initial "true up" to cost with an appropriate rate of return would be necessary. Once a starting point is established, an index reflecting economy-wide price changes and perhaps adjustments for productivity improvements and exceptional events could be used.

Implementing a cost-based rate setting regime would require determining what portion of each radio licensee's market value is appropriate to include in measuring a company's rate of return and determining whether rates are "reasonable." The current market value of cellular carriers' operations in California is well into the billions of dollars, and most of that value as reflected in financial markets has nothing to do with the worth of the carriers' tangible assets. The overwhelming portion is a combination of: (1) the value of the allocation of radio spectrum and (2) the value of expected monopoly returns as a result of the limited competitiveness of the duopoly structure.

To achieve the Commission's telecommunications goals of promoting efficiency, fairness and choice, the Commission must exclude monopoly returns as much as possible from rates.¹⁸ Such a task entails separating spectrum value from excess profits. Conceptually, the value allocated for spectrum is that price which

18 See also 36 CPUC 2d at pp. 475-6, 495 (1990).

a license would command in the market if all radio spectrum holders were free to sell their assigned frequencies to firms interested in entering the market for mobile telephone services.¹⁹

While extraordinarily challenging, this task is critical to assuring that new regulated prices are neither "too high" nor "too low." In a fortuitous, but not unrelated way, the entry of additional mobile service competitors may provide an answer to this dilemma. One way of assessing the value of spectrum for mobile telephone which maybe much freer of monopoly power value "contamination" is to look at the sale prices of SMR licenses that are being converted to public mobile telephone use. While a rough indicator, the price that an additional market entrant is able and willing to pay to acquire SMR spectrum may approximate the value of cellular spectrum.

In assessing this option, the Commission is extremely sensitive to the issue of implementation. As described above the task of developing cost-based rates will place a substantial drain on both the resources of the Commission and interested parties. Additionally, such a process will require substantial public disclosure of cellular operations. Given the fact that the ultimate Commission goal is to promote effective competition, the process of publicly analyzing a duopolist's finances may retard this goal.

Thus, in evaluating the Cost-based Price Cap option, interested parties should consider its benefits in light of the Commission's overall goal which is to lessen regulation when market forces are clearly able to police the market. In other words, if the regulatory regime the Commission imposes will be transitory it may not make sense to embark on a lengthy, complicated and costly process to accurately true up rates? Indeed, a danger exists that

¹⁹ We note that spectrum allocated to mobile telecommunications cannot be used for other purposes. Those other uses represent the opportunity cost of the spectrum allocated to mobile telecommunications.