

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
)
Petition of the People of the)
State of California and the)
Public Utilities Commission of)
the State of California to Retain)
Regulatory Authority Over)
Intrastate Cellular Service Rates)

94-105

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PR File No. 94-SP3

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

To: The Commission

OPPOSITION OF McCAW CELLULAR COMMUNICATIONS, INC.

MCCAW CELLULAR COMMUNICATIONS, INC.

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To: The Commission

OPPOSITION OF McCaw CELLULAR COMMUNICATIONS, INC.

McCaw Cellular Communications, Inc. ("McCaw"),^{1/} by its attorneys, hereby submits its opposition to the above-captioned petition ("Petition").

Introduction and Summary

In the Second Report and Order,^{2/} the Commission established a sound regulatory foundation for the continued growth and development of commercial mobile radio services ("CMRS"). The Commission correctly concluded in that proceeding that existing market conditions, together with enforcement of other provisions of Title II, render tariffing and rate regulation unnecessary to ensure that CMRS prices are just and nondiscriminatory or to protect

^{1/} McCaw provides cellular service to more than 2.5 million subscribers in 24 states, including California.

^{2/} In the Matter of Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services, Second Report and Order, 9 FCC Rcd 1411 (1994) ("Second Report and Order").

consumers. The Commission found that imposing these requirements on cellular and other CMRS providers would not serve the public interest, and that forbearance from unnecessary regulation of CMRS providers would enhance competition in the mobile services market.^{3/} Finally, the Commission assured that like mobile radio services would be subject to consistent regulatory treatment. Evaluated against these principles, the above-captioned petition must be denied.

First, Congress preempted state rate and entry regulation because it recognized that a patchwork of inconsistent state rules would undermine the growth and development of mobile services, which, by their nature, operate without regard to state boundaries.^{4/} While the statute provides a process for a state to request rate regulatory authority, it sanctions the exercise of that authority only in extreme cases: when significant market failure justifies substituting regulation for the operation of market forces.^{5/} The Commission recognized that state regulation could become a burden to the development of the wireless infrastructure -- and could impede the statutory mandate for regulatory parity. Consistent with the intent of Congress, the Commission established "substantial hurdles" that a state must clear in order to justify rate regulation of CMRS providers.

^{3/} Id. at 1467.

^{4/} See H.R. Rep. No. 213, 103d Cong., 1st Sess. 494 (1993) ("Conference Report"); H.R. Rep. No. 111, 103d Cong., 1st Sess. 260 (1993) ("House Report").

^{5/} 47 U.S.C. § 332(c)(3). See also House Report at 261-62 (in reviewing petitions filed by the states, "the Commission also should be mindful of the Committee's desire to give the policies embodied [sic] in Section 332(c) an adequate opportunity to yield the benefits of increased competition and subscriber choice anticipated by the Committee"). In this regard, the Commission should confirm the plain intent of Section 332(c) and preempt state regulation concerning all services offered by a commercial mobile service provider, including enhanced services as well as basic communications services.

Second, California has utterly failed to make the substantial showing required to justify the authority it seeks in the above-captioned proceeding. Rate regulation is unnecessary in light of current and reasonably foreseeable market conditions. The Commission has already determined that the level of competition in the CMRS marketplace is sufficient to support broad forbearance from rate regulation. The CPUC has provided no evidence that the level of competition in California departs significantly from the market conditions relied upon by the Commission, nor has it demonstrated that cellular carriers in California have exercised market power.

The economic analysis put forward to support California's claim for regulatory authority is fundamentally flawed. The CPUC ignores the fact that cellular carriers will soon face competition from so-called enhanced specialized mobile radio systems ("ESMRs") and from licensees using the 120 MHz of spectrum recently made available for personal communications systems ("PCS"); it ignores declining prices for cellular service and the substantial recent growth in subscribership and investment by cellular carriers; it attempts to "prove" market concentration by using analytical tools intended to evaluate mergers rather than the appropriateness of regulation; it concludes erroneously that cellular systems have excess capacity; and, in concluding that cellular carriers have enjoyed "excess" earnings, fails to recognize the scarcity value of the electromagnetic spectrum. At most, California's flawed economic analysis demonstrates only that the CMRS marketplace is not perfectly competitive. But, as the Commission itself has acknowledged, perfect competition is not a necessary prerequisite for forbearance.

Third, the CPUC erroneously asserts that the number of cellular resellers is indicative of the level of competition in the cellular marketplace. The number or financial health of cellular resellers is irrelevant to the statutory goal of ensuring that subscribers are assured of just, reasonable, and nondiscriminatory rates. There is no evidence that facilities-based carriers are pricing wholesale service in a discriminatory manner. In any event, such carriers remain subject to the statutory prohibition on unreasonable discrimination. The appropriate remedy for a claim of discrimination is the complaint process rather than the imposition of burdensome and unnecessary rate regulations.

Fourth, the CPUC fails to demonstrate that consumers would benefit from regulation. Price controls limit the ability of regulated firms to respond to changes in technology and in cost and demand conditions. Rate regulation also deters new investments, improvements in service quality, and new entrants in the marketplace. By seeking to impose rate regulation solely on cellular operators, moreover, the CPUC would reestablish the very regulatory disparities that last year's comprehensive amendment of Section 332(c) of the Communications Act was intended to correct.

The public interest is better served by the regulatory forbearance embodied in the Second Report and Order and the introduction of additional competition through the allocation of new spectrum for CMRS, and Congress intended for these policies to be given "adequate opportunity to yield the [anticipated] benefits of increased competition and subscriber choice" before state rate regulation was imposed on CMRS providers.^{6/} Given the acknowledged harms from such

^{6/} House Report at 261.

regulation and the CPUC's failure to demonstrate the need to impose price controls on cellular carriers, the Petition should be denied.^{2/}

I. SECTION 332(c) AND THE SECOND REPORT AND ORDER IMPOSE AN EXTREMELY DEMANDING STANDARD FOR THE AUTHORIZATION OF STATE REGULATION OF CELLULAR SERVICES

In evaluating the CPUC Petition, the Commission must resist the invitation of the CPUC to engage in a de novo analysis of competition in cellular markets and the appropriate regulatory framework for addressing these market conditions. The Second Report and Order clearly sets forth the Commission's general analysis with respect to the level of competition in cellular markets, and makes fundamental policy choices with respect to appropriate regulation. These fundamental policy decisions, as well as the framework established by the Section 332(c), dictate that the grant of state petitions to permit rate or tariff regulation should be very much the exception rather than the rule.

In any petition for rate regulation authority, the statute and the Commission's rules clearly place the burden on the petitioning state to justify the need for such authority. The CPUC has failed to meet that burden. Rather, there appears to be little basis for the CPUC's Petition other than a regulatory philosophy and a set of underlying assumptions that are fundamentally at odds with the basic framework adopted by the Commission in the Second

^{2/} It is important to bear in mind that denial of the petition does not foreclose state regulatory authorities from returning to the Commission at a later date should evidence appear that consumers are indeed being injured because rate regulation is not being exercised at the state level. Thus, the burden of proof is properly placed on the petitioning state to show why free market forces should not be given a chance to operate now.

Report and Order.^{8/} In the absence of the proof required by the Commission, the CPUC's Petition must be rejected.

The Commission has already determined that the level of competition in the CMRS marketplace, together with enforcement of other provisions of Title II, render tariffing and rate regulation unnecessary to ensure that CMRS prices are just and nondiscriminatory or to protect consumers.^{2/} Inasmuch as the Commission did not insist on perfect competition as a prerequisite for deregulation,^{10/} the "substantial hurdle" to be met by states seeking to regulate cellular services cannot be satisfied with the CPUC's dubious evidence of market imperfections or less than fully competitive conditions. Rather, the Second Report and Order suggests a three-part test, with each state required to meet its burden of proof on each part of the test.

First, to support a petition for rate authority, the petitioning state must show that market conditions unique to that state are substantially less competitive and substantially more likely to cause harm to consumers than the market conditions that have been found generally to support the Commission's decision to forbear from rate and tariff regulation. Second, since the Commission expressly relied upon the continuing applicability of Section 201 and 202's requirements for just, reasonable, and not unreasonably discriminatory rates, and the availability of the complaint procedure under Section 208 to address any residual competitive problems, the CPUC must demonstrate that whatever unique competitive problems it has identified cannot be

^{8/} In this regard, it is noteworthy that two of the states filing petitions both opposed forbearance from regulation at the federal level, in addition to seeking to preserve state authority. See Comments of the State of California in Gen. Docket No. 93-252; Comments of the State of New York in Gen. Docket No. 93-252.

^{2/} Second Report and Order, 9 FCC Rcd. at 1467.

^{10/} See, e.g., id. at 1472.

adequately addressed through these federal remedies. Finally, in the unlikely event that a state can satisfy the factors described above, it must also show that any residual risks to consumers, *i.e.*, the marginal benefits of the proposed state regulation, outweigh the substantial costs associated with regulation. As a threshold matter, of course, the state must also "identify and provide a detailed description of the specific existing or proposed rules that it would establish if [the Commission] were to grant the [CPUC's] Petition."^{11/} Approval of a state petition that fails to meet this test would contravene the statutory framework, resulting in the imposition of rate regulation under circumstances in which the Commission itself has found such regulation to be unnecessary and counterproductive.

A. State Regulation Is Presumptively Inconsistent With The Objectives Of Section 332(c) As Implemented By The Commission

Congress' adoption of amendments to Section 332 in the Budget Act was based upon three overarching policy objectives: first, the need for symmetrical regulation of competitive service providers, notwithstanding the anachronistic regulatory categories of the past; second, the need for a consistent and coherent national regulatory framework for mobile services, which by their nature are not confined by state boundaries; and third, the need to minimize regulatory distortions of free market competition so that competitive success is dictated not by regulation but by success in meeting the needs of consumers. State regulation in general, and regimes of the sort proposed by California that regulate only cellular carriers in particular, are inherently inconsistent with these objectives. Fidelity to the statutory framework, as interpreted by the

^{11/} Second Report and Order, 9 FCC Rcd. at 1505.

Commission in the Second Report and Order, dictates a very substantial burden of proof on the states to justify any proposed state regulation.

With respect to the first objective, Congress revised Section 332 because it found that the regulatory structure governing mobile services -- which permitted "private" mobile services to escape regulation while functionally equivalent "common carrier" services were subject to state as well as Federal rules -- could "impede the continued growth and development of commercial mobile services and deny consumers the protections they need."^{12/} Congress recognized that the implementation of original Section 332 had created a cockeyed marketplace in which ESMR licensees, but not their cellular competitors, were exempt from Title II of the Communications Act and from state regulation, and where radio common carriers were forced to compete against private carrier paging operators that faced essentially no regulation at the Federal or state level.^{13/}

In the Second Report and Order, the Commission appropriately emphasized these considerations in fashioning critical elements of the regulatory scheme for commercial mobile radio services. Thus, the Commission concluded that its elaboration of the elements of the commercial mobile radio service definition would

ensure[] that competitors providing identical or similar services will participate in the marketplace under similar rules and regulations. Success in the marketplace thus should be driven by technological innovation, service quality, competition-based pricing decisions, and responsiveness to consumer needs -- and not by strategies in the regulatory arena. This even-handed regulation, in

^{12/} House Report at 260.

^{13/} See id. at 260 & n.2.

promoting competition, should help lower prices, generate jobs, and produce economic growth.^{14/}

Both Congress and the Commission expressed serious concern, however, that this "even-handed regulation" could be disrupted by state regulation. The legislative history of the Budget Act instructs the Commission to "ensure that [state] regulation is consistent with the overall intent . . . that, consistent with the public interest, similar services are accorded similar regulatory treatment."^{15/} The Commission echoed this concern in observing that "our preemption rules will help promote investment in the wireless infrastructure by preventing burdensome and unnecessary state regulatory practices that impede our federal mandate for regulatory parity."^{16/}

The CPUC Petition proposes exactly the sort of regulation which Congress feared, and which the Commission sought to avoid in adopting its preemption rules. By proposing only to regulate cellular carriers, the State of California has in essence proposed to maintain at the state level exactly the sort of asymmetrical regulation which led to the adoption of the amendments to Section 332 in the first place.

It is equally clear that state regulation is presumptively incompatible with Congress' express desire for uniform national regulation of commercial mobile services. Enactment of revised Section 332 was guided by a recognition that Federal jurisdiction was the most appropriate regulatory locus for mobile services "that, by their nature, operate without regard

^{14/} Second Report and Order, 9 FCC Rcd. at 1420.

^{15/} Conference Report at 494.

^{16/} Second Report and Order at 1421.

to state lines as an integral part of the national telecommunications infrastructure.^{17/} Again, the Second Report and Order was careful to carry out this objective. As the Commission observed,

[W]e have engendered a stable and predictable federal regulatory environment, which is conducive to continued investment in the wireless infrastructure. Our definition of CMRS not only represents fidelity to congressional intent, but also establishes clear rules for the classification of mobile services, minimizing regulatory uncertainty and any consequent chilling of investment activity.^{18/}

State regulation of the sort proposed by the CPUC also undermines Congress' express instruction that the Commission carefully consider whether market conditions justify forbearance from most forms of regulation under Title II of the Communications Act. In interpreting this mandate, the Commission established "as a principal objective, the goal of ensuring that unwarranted regulatory burdens are not imposed upon any mobile radio licensees who are classified as CMRS providers . . ."^{19/} Thus, the Commission concluded that

In deciding whether to impose regulatory obligations on service providers under Title II, we must weigh the potential burdens of those obligations against the need to protect consumers and to guard against unreasonably discriminatory rates and practices. In making this comparative assessment, we consider it appropriate to seek to avoid the imposition of unwarranted costs or other burdens upon carriers because consumers and the national economy ultimately benefit from such a course.^{20/}

Further, the Commission emphasized the need to

^{17/} House Report at 260. See also Conference Report at 490 (intent of revised Section 332 is to "establish a Federal regulatory framework to govern the offering of all commercial mobile services") (emphasis supplied).

^{18/} Second Report & Order at 1421 (emphasis supplied).

^{19/} Id. at 1418 (emphasis supplied).

^{20/} Id. at 1419.

ensur[e] that regulation is perceived by the investment community as a positive factor that creates incentives for investment in the development of valuable communication services -- rather than as a burden standing in the way of entrepreneurial opportunities -- and by establishing a stable, predictable regulatory environment that facilitates prudent business planning.^{21/}

The same factors which militate strongly against regulation at the federal level militate equally strongly against burdensome regulation at the state level.

In light of these Congressional objectives, and the policy decisions embodied in the Second Report and Order, the Commission properly established a strong presumption against granting state petitions for authority to regulate commercial mobile services, including cellular services. The Commission acknowledged that Congress made a fundamental choice "generally to preempt state and local rate and entry regulation of all commercial mobile radio services..."^{22/} The Commission thus "vigorously implemented the preemption provisions of the Budget Act,"^{23/} by requiring that states "clear substantial hurdles if they seek to continue or initiate rate regulation of CMRS providers."^{24/}

Beyond these clear, if general, statements, the Commission's substantive analysis of competition in cellular markets and the appropriateness of regulation establishes several important benchmarks for evaluating state showings. Based on the Commission's analysis and conclusions, McCaw submits that the states must provide conclusive proof on three independent issues before a Petition to retain or impose regulation may be granted.

^{21/} Id. at 1421.

^{22/} Id. at 1504 (emphasis supplied).

^{23/} Id. at 1419.

^{24/} Id. at 1421.

B. The CPUC Must Demonstrate That Prevailing Market Conditions In California Are Substantially Less Competitive Than The Commission Found Generally; That Federal Remedies Are Inadequate To Address Such Conditions; And That Any Residual Benefits Of State Regulation Outweigh The Costs Of Regulation Recognized By The Commission

The CPUC's Petition cannot be evaluated in a vacuum. Rather, the Commission must take as the starting point for its analysis the policy decisions and conclusions already made in the Second Report and Order. The CPUC loses sight of the fact that the Commission has already considered whether competitive conditions in cellular markets warrant various forms of regulation, and found that they do not. The Commission has also held that the regulatory framework it has adopted should suffice to remedy competitive abuses or unjust and discriminatory rates. Finally, the Commission has generally found that rate, entry and tariff regulations, as a general matter, are costly and burdensome and should be avoided wherever possible.

Each of these findings strongly reinforces the presumption against state regulation. Looked at another way, in order to justify state regulation, the CPUC must be required to produce evidence that each of these general conclusions is not warranted with respect to the unique conditions in that state. If, on the other hand, the CPUC fails to carry its burden of proof on each of these issues, its Petition must be denied.

The CPUC's Petition sets forth a variety of purported "evidence" in an attempt to establish that the market for provision of cellular service in California is less than fully competitive. While this Opposition will conclusively demonstrate that none of this "evidence" supports such a conclusion, it is critical to keep in mind that the Commission adopted its forbearance regime even though it was unable to conclude, on the record before it, that cellular

markets were fully competitive. Thus, after an extended discussion of the record with respect to the competitiveness of cellular markets, the Commission concluded that

[i]n summary, the data and analyses in the record support a finding that there is some competition in the cellular services marketplace. There is insufficient evidence, however, to conclude that the cellular services marketplace is fully competitive.^{25/}

Despite the Commission's unwillingness to find that the cellular market was "fully competitive" on the record before it, the Commission expressly refused to find that the competitive imperfections in these cellular markets warranted tariff, entry or rate regulation. To the contrary, the Commission found that the record established that "there is sufficient competition in this marketplace to justify forbearance from tariffing requirements."^{26/} Similarly, the Commission observed that "there is no record evidence that indicates a need for full-scale regulation of cellular or any other CMRS offerings."^{27/}

As a legal matter, by expressly forbearing from entry, rate or tariff regulation of cellular services, the Commission found, under the statutory standard, that such regulation was "not necessary to ensure that the charges, practices, classifications, or regulations for or in connection with CMRS are just and reasonable and are not unjustly or unreasonably discriminatory"^{28/} and that such provisions are "not necessary for the protection of consumers."^{29/} This is the same

^{25/} Second Report and Order, 9 FCC Rcd. at 1472.

^{26/} Id. at 1478.

^{27/} Id. (emphasis supplied)

^{28/} Id.

^{29/} 47 U.S.C. § 332(c)(1).

standard applicable to state petitions for rate regulatory authority.^{30/} A state cannot satisfy this standard merely by submitting evidence that competition in cellular markets is less than perfect. Rather, states must be required to show that market conditions in their state are substantially less competitive than those which the Commission found not to justify regulation at the federal level.

Even if a state succeeds in demonstrating the existence of competitive conditions worse than those already considered by the Commission, which California has not, this does not end the inquiry. In deciding to forbear from regulation at the federal level, the Commission found that

continued applicability of Sections 201, 202 and 208 will provide an important protection in the event there is a market failure. . . . In the event that a carrier violate[s] Sections 201 [requiring interconnection] or 202 [prohibiting unjust and unreasonable rates and practices], the Section 208 complaint process would permit challenges to a carrier's rates or practices and full compensation for any harm due to violations of the Act.^{31/}

The requirement of just, reasonable, and nondiscriminatory rates and the ongoing availability of the complaint process serve also to remedy potential abuses that may arise in the states. In order to support a finding that state regulation is necessary to protect consumers from unjust and unreasonable rates or discrimination, a state must demonstrate that the Federal requirements and procedural remedies preserved in Section 332(c) are inadequate to eliminate any abuses or potential for abuse proven by that state. This the CPUC has failed to do.

Even if a state were able to demonstrate unique competitive conditions and that Federal law is insufficient to address these conditions -- a showing that none of the petitioning states has

^{30/} Compare id. with 47 U.S.C. § 332(c)(3).

^{31/} Second Report and Order, 9 FCC Rcd. at 1478-79.

satisfied -- the state must make the further showing that, on balance, state regulation is an appropriate response and produces net benefits. As the Commission has recognized time and again, the mere fact that regulation has benefits does not end the inquiry. As the Commission observed in the context of tariffing requirements, regulation "imposes administrative costs and can [itself] be a barrier to competition in some circumstances."^{32/}

The Second Report and Order itself identified substantial costs associated with tariffing, one of the major regulatory requirements proposed by the CPUC,^{33/} and found that "[i]n light of the social costs of tariffing, the current state of competition, and the impending arrival of additional competition, particularly for cellular licensees, forbearance from requiring tariff filings from cellular carriers, as well as other CMRS providers, is in the public interest."^{34/} Fidelity to this analysis clearly requires that a state seeking to impose regulation show that any

^{32/} Second Report and Order, 9 FCC Rcd. at 1479.

^{33/} The Commission observed that

[i]n a competitive environment, requiring tariff filings can (1) take away carriers' ability to make rapid, efficient responses to changes in demand and cost, and remove incentives for carriers to introduce new offerings; (2) impede and remove incentives for competitive price discounting, since all price changes are public, which can therefore be quickly matched by competitors; and (3) impose costs on carriers that attempt to make new offerings.... tariff filings would enable carriers to ascertain competitors' prices and any changes to rates, which might encourage carriers to maintain rates at an artificially high level. Moreover, tariffs may simplify tacit collusion as compared to when rates are individually negotiated, since publicly filed tariffs facilitate monitoring.... [T]ariffing, with its attendant filing and reporting requirements, imposes administrative costs upon carriers. These costs could lead to increased rates for consumers and potential adverse effects on competition.

Id. at 1479.

^{34/} Id.

demonstrated benefits to state regulation outweigh these costs. The CPUC's Petition fails even to recognize the need to make these showings. As demonstrated below, its Petition must be denied.

II. THE CPUC HAS FAILED TO DEMONSTRATE THAT RATE REGULATION OF CMRS IS NECESSARY TO PROTECT CONSUMERS

A. The California Petition Seeks General Authority To Impose Pervasive Regulation On Cellular Carriers, Including Rate Of Return Regulation

The California Petition requests that the Commission authorize the CPUC to continue to exercise open-ended regulatory authority over cellular rates for a period of eighteen months from September 1, 1994. In addition to seeking authority to extend the effectiveness of its regulations which were in effect as of June 1, 1993, the CPUC seeks authority to implement further modifications to those regulations. In fact, in an order issued August 4, 1994,^{35/} the CPUC - - without Commission approval -- adopted significant new cellular rate regulations, including requirements that wholesale cellular tariffs be unbundled and that new wholesale rates applicable to roaming services be established. As described below, existing CPUC regulations also include a stringent set of requirements mandating that the margin between wholesale and retail rates be maintained on a rate element by rate element basis, and constraining numerous other forms of rate innovations and competitive responses by cellular carriers. The California Petition indicates that the CPUC envisions the implementation of yet further regulations if its rate authority is extended, including "ways to adjust price caps referenced against excessively high rates of return

^{35/} D.94-08-022 in I.93-12-007, "Investigation on the Commission's Own Motion into Mobile Telephone Service and Wireless Communications," (the "Interim Opinion") (August 3, 1994).

of carriers."^{36/} In other words, the California Petition seeks authority for the CPUC to impose in its discretion the full panoply of possible rate regulations on cellular carriers, including rate of return regulation based on cost of service.

While conceding that it "expects to see effective competition from new entrants into California cellular markets" within eighteen months, the CPUC seeks this authority because it has concluded that the cellular marketplace is uncompetitive at the present time.^{37/} The CPUC bases this conclusion on the alleged cumulative impact of several factors, including the present structure of the cellular market, perceived barriers to entry into the mobile communications market, market concentration, the degree of price competition, the level of earnings of wholesale carriers, and the availability of competitive alternatives to cellular service.^{38/} As demonstrated in detail below, the CPUC's analysis of each of these criteria is based on erroneous factual premises, faulty economic reasoning, or unproved assumptions.^{39/}

^{36/} California Petition at 81.

^{37/} Id. at 7.

^{38/} Id. at 6. The CPUC purports to have evaluated the "cumulative impact" of these criteria. However, nowhere does the California Petition attempt to explain how the "cumulative impact" of these various differing measures of market competitiveness was estimated or evaluated. In fact, none of these criteria supports the CPUC's conclusions, and "cumulation" is merely an effort to create a coherent story out of insignificant fragments. The California Petition provides no overall framework for the integration of the analysis of the various conclusions which it separately discusses as partially supportive of the concept that the cellular market is uncompetitive. The California Petition makes no showing that these separate issues can properly be cumulated, and are not merely different approaches to analyzing common underlying facts.

^{39/} As discussed in Section IIC below, it is important to bear in mind that the numerous conclusions of the CPUC repeated in the California Petition are not evidence in this proceeding, and are entitled to no decisional weight. It is the burden of the California Petition to present sufficient accurate and verifiable facts in its petition to support the conclusions it urges the Commission to draw. With respect to its conclusions, which are themselves not fact but merely expressions of "probabilities," the CPUC has presented no expert testimony, and has not

In addition, the California Petition suffers from a separate and overriding deficiency. It fails to provide any factual evidence that the regulatory program which the CPUC desires to impose would provide any benefits whatsoever to the public, much less outweigh its costs, even if the degree of competition in the current cellular market were as limited as the California Petition erroneously alleges. In fact, the status of California cellular market about which the California Petition complains is the result of a decade of pervasive CPUC regulation, and the California Petition presents no evidence justifying a finding that the future effects of such regulation would have any different impact on the market.

The California Petition describes the CPUC's history of regulation of the cellular industry as consistent with the "basic philosophical direction" of the Commission, and repeats vague generalities that reliance upon competitive market forces, rather than interventionist regulation, is the true goal of the CPUC.^{40/} However, the accuracy of these generalities must be measured against the scope of the specific regulatory authority which the CPUC actually requests this Commission to grant.

supported its alleged facts and conclusions with affidavits of any such experts. In this instance, this point is critical because there are serious inaccuracies in the unredacted portions of the factual data alleged in the California Petition, and there is no reason to believe that the redacted data provided to the Commission is any more accurate. Because of the intensely factual nature of the proper analysis of the degree of competition in a market, the Commission must proceed with care in evaluating the factual assertions, methodologies, and economic conclusions of the California Petition. The basis on which the CPUC gathered the facts which it asserts in the California Petition is the subject of numerous pending Applications for Rehearing and probable subsequent judicial appeals. These applications raise such questions as reliance upon controversial studies while ignoring contrary analyses; compilation of incompatible data provided in confidence to the CPUC; and failure to provide parties with any opportunity to rebut external materials.

^{40/} California Petition at 9.

In fact, the CPUC's pervasive program of cellular regulation is premised on fundamental disagreement with the Commission on two basic points: the justification of price regulation based on industry structure, and the value of maintaining retail resellers in business through regulatory fiat. As explicitly delineated in the California Petition, the CPUC has in numerous decisions indicated that this Commission's historic cellular licensing policy has precluded the development of effective competition for cellular services by creating a "duopoly" market structure in which cellular carriers control "bottleneck" facilities,^{41/} and which is so inherently defective that regulatory intervention is required, despite this Commission's contrary conclusions.^{42/} Thus, the CPUC's fundamental belief that a two-carrier marketplace cannot be competitive has conditioned it to conclude that cellular rates must be unreasonable if they are not dropping precipitously and that returns are excessive if they exceed those established for landline telephone monopolies; this mindset has increasingly led it to espouse various forms of cost-of-service regulation for cellular carriers.

The proper regulatory strategy to increase the competitiveness of the cellular marketplace has already been identified and undertaken by this Commission through the allocation of additional spectrum to mobile services. This will increase supply and make new entry possible, and does not require the artificial propping up of resale competitors which do not increase supply or invest in infrastructure facilities. The Commission's actions render state regulation unnecessary.

^{41/} See, e.g., *id.* at 7; Interim Opinion at 14.

^{42/} See, e.g., D.90-06-025 at 2; California Petition at 10.

B. The CPUC's Regulatory Policy Is Premised Erroneously On Creating And Maintaining Viable Retail Resellers

The California Petition indicates that the CPUC has followed two major policies over the past decade in its regulation of the cellular market: (1) adopting market-based rates for cellular services, and (2) fostering competition for cellular service by establishing a "viable resale plan."^{43/} While the CPUC did permit the original retail rates proposed by cellular carriers to be established on the basis of market studies rather than cost analyses,^{44/} in that same decision the CPUC mandated the establishment of wholesale rates which have no origin in marketplace forces. Thus, from its very beginning a fundamental premise of the CPUC's decade-long regulatory program for cellular, and an equally fundamental premise of the California Petition, has been that the protection of retail cellular resellers through controlled wholesale prices will materially increase the competitiveness of the cellular marketplace for end users. Because of this reliance on retail cellular resale as one of the two legs of its regulatory strategy, the CPUC has repeatedly found it necessary to adopt regulations designed to ensure the financial viability of resellers. Its regulatory program has become obsessed with detailed attempts to assure that resellers obtain "adequate" margins between wholesale and retail prices, with the objective of ensuring that the resellers receive guaranteed financial viability.^{45/} In addition to explicit

^{43/} California Petition at 12.

^{44/} D.84-04-014 at Finding of Fact 18.

^{45/} Currently-effective CPUC requirements, for example, mandate that for any new retail rate plan offering, an identical "clone" of each rate element of that plan must be made available to resellers, and that the margin between these rate elements must be the current "mandatory" margin found in the carrier's basic rate plan. This margin has never been reviewed or justified on any basis, other than the supposition that it reflects the margin necessary for the financial viability of a "hypothetical reseller." California Petition at 12.

orders requiring that a wholesale "clone" rate element must also be made effective for every new retail service plan rate element, these regulations include the requirement that large customers must be charged a rate at least 5% above reseller rates,^{46/} and strict restrictions on the ability of cellular carriers to market their services to trade associations and affinity groups.^{47/} At the resellers' behest, the CPUC has barred any service promotion, including rate reductions or credits in consideration for a customer's maintaining a service agreement for a prescribed period, valued in excess of \$100 of service credits or \$25 for any gift, cash, or other article.^{48/} The Commission only recently lifted the \$100 cap, but continues to require that any promotion be tariffed and that the margin between the wholesale and retail rate be protected.^{49/} Furthermore, California is the only state which prohibits the bundling of cellular equipment and service by both carriers and their agents.^{50/}

In short, based on its fundamental disagreement with this Commission's initial decision to license only two cellular carriers in each market, the CPUC has implemented -- and seeks

^{46/} D.90-06-025 at 89, Ordering Paragraph 18. The CPUC's justification for this price differential has been that resellers, which must be certified by the CPUC, have regulatory costs not borne by other bulk purchasers.

^{47/} These include a prohibition on performing billing services for end users of such master customers. See id. at 88.

^{48/} D.90-06-025, Ordering Paragraphs 6(b) and 16(c).

^{49/} D.94-04-043 at 7.

^{50/} D.89-07-019, Conclusion of Law 4. The Commission has extended its ban to include the bundling of cellular service with long distance service and delegated authority to its Advisory and Compliance Division to reject any tariff filing which "offers bundled regulated services with services not provided through the cellular carrier' Certificate of Public Convenience and Necessity." Resolution T-15007, September 2, 1992.

authority to continue -- a pervasive regulatory program for the cellular industry premised upon assuring the viability of cellular resellers as a cure for this mistaken duopoly industry structure.

It is fundamentally incorrect to argue, as the CPUC does, that the level of competition in the CMRS market can be enhanced by increasing the share of retail sales made through independent resellers. In order to reduce prices, a regulatory policy would need to increase capacity and output in the market. Resellers do not add capacity. Regulations aimed at ensuring them a market share are likely to reduce returns for CMRS carriers, deter investment, and thereby reduce capacity below levels that would result from market forces. In short, the CPUC's efforts to foster the growth of a reseller industry raises prices to consumers.^{51/}

The CPUC appears to be concerned that, in the absence of regulation, facilities-based carriers will inflate wholesale prices and run their retail operations at a loss in order to put independent resellers in a price squeeze. There is, however, no persuasive evidence that the exercise of market power by facilities-based carriers is a significant problem.^{52/} The California Petition offers no evidence -- at least none that is available to the public -- showing that resellers are systematically discriminated against by facilities-based carriers in states where tariffing is not required. McCaw's own experience suggests such a showing cannot be made, because the bulk discounts available to resellers in McCaw's non-California systems match or even exceed those mandated by the CPUC.

^{51/} See Declaration of Bruce M. Owen, President, Economists Incorporated ("Owen Declaration"), attached hereto as Exhibit A, at ¶ 94. At McCaw's request, Economists Incorporated undertook an economic analysis of the need for and potential effects of state rate regulation of CMRS providers.

^{52/} See Owen Declaration at ¶¶ 62-95.