

McCaw's experience should not be surprising. As cellular carriers attempt to penetrate the corporate market, they are under pressure to discount their services significantly in order to secure multi-phone, regional, or even national contracts with attractive business customers. Resellers benefit from this discounting activity because they can qualify for similar reduced rates under the non-discrimination rule of Section 202, which cellular carriers are bound to observe.^{53/} Furthermore, there is every reason to believe that those carriers would have a strong incentive to have their retail marketing done in the least-cost manner, regardless of whether that involved independent resellers or vertical integration or both.^{54/} Even if facilities-based carriers enjoyed market power, they would exploit their position most effectively by raising the price of their services rather than discriminating against resellers. To the extent that resellers play an important role in marketing the services of a facilities-based carrier, the latter's attempt to squeeze resellers would simply increase its own costs of providing service to consumers.^{55/}

In many cases in which a wholesale supplier offers service both through company-owned retail outlets and through independent resellers, complaints by the resellers are common. Their existence is not evidence of anticompetitive behavior, however.^{56/} To the contrary, if their

^{53/} One of the many ironies that characterizes the CPUC's policy of cellular regulation is that it actually may have hurt resellers financially, by restricting the market forces that drive bulk rates down. As is described above, the CPUC ordered cellular carriers in 1990 to ensure that non-reseller bulk customers be charged at least 5% more than resellers. This rule, and the fact that all bulk prices must be tariffed, have tended to discourage deep discounting of major account rates in California.

^{54/} Owen Declaration at ¶ 96.

^{55/} *Id.* at ¶ 98.

^{56/} *Id.* at ¶ 101.

complaints arise in connection with a carrier's attempts to reduce retail prices, it may be inferred that they are objecting to a trend that favors consumers: a reseller's margin is threatened whenever retail prices approach a supplier's production costs, but this development is precisely what a competitive marketplace promotes. Similarly, when cellular resellers complain about bulk discounts that are available only to high-volume affiliates of the facilities-based carriers, they are in effect asking for protection from competition from these affiliates, either in the form of a discriminatory low price applicable to low-volume resellers or in the form of umbrella pricing of high-volume service to the affiliates.^{57/}

C. The Petition Suffers From Several Significant Procedural Deficiencies

Even apart from the dubious merits of the Petition, it suffers from two significant procedural defects. First, contrary to the plain language of Section 332(c), the CPUC has adopted new CMRS rate regulations and now seeks "grandfathered" treatment of these regulations pending the disposition of the Petition. The Commission should issue an order declaring the adoption of these rules null and void.

Second, the Petition improperly includes confidential information that should not have been provided to the Commission. The Commission should return that information to the CPUC and evaluate the Petition without considering it.

1. The CPUC Seeks To Grandfather Rate Regulations That Were Not In Effect On June 1, 1993

Section 332(c) of the Communications Act preempts state rate regulation of commercial mobile services unless a state successfully petitions the Commission for authority to engage in

^{57/} Id. at ¶ 116.

such regulation under statutorily-established standards.^{58/} The statute provides for a limited "grandfathering" of pre-existing state rate regulations:

(B) If a State has *in effect on June 1, 1993, any regulation* concerning the rates for any commercial mobile service offered in such State on such date, such State may no later than 1 year after the date of enactment of the Omnibus Budget Reconciliation Act of 1993, petition the Commission requesting that the State be authorized to *continue* exercising authority over such rates. If a State files such a petition, the State's *existing regulation* shall, notwithstanding subparagraph (A), *remain in effect* until the Commission completes all action (including any reconsideration) on such petition.^{59/}

The instant petition was filed under the authority conferred by this provision. In it, the CPUC seeks grandfathered treatment for, *inter alia*, the rules and policies adopted in the Interim Opinion.^{60/} In fact, the Interim Opinion imposed new rate regulations on cellular carriers on August 4, 1994, more than one year after the grandfathering deadline established by law. Without the grant of authority from the FCC to impose these new rate regulations, the CPUC is preempted from imposing them. The Commission should issue an interim order declaring the adoption of the Interim Opinion null and void. As demonstrated herein, moreover, the regulations imposed by the Interim Opinion do not meet the statutory standards that a state must satisfy to obtain a grant of rate regulation authority.

There can be no doubt that the Interim Opinion imposes significant additional new rate regulations on cellular carriers:

1. The Interim Opinion requires cellular carriers to break apart into components, or "unbundle," the unitary service which the cellular carriers provide to all customers today, including wholesale

^{58/} 47 U.S.C. § 332(c)(3).

^{59/} 47 U.S.C. § 332(c)(3)(B) (emphasis added).

^{60/} Petition at 81.

customers which intend to resell the service. This unitary offering includes several network and functional components (such as interconnection with the landline network, billing and call routing) which cellular carriers must now disaggregate from the offering on both the technical and service definition levels.^{61/}

2. The Interim Opinion requires cellular carriers to unbundle their existing wholesale tariffs when served with a Commission order granting a Certificate of Public Convenience and Necessity ("CPCN") for a cellular reseller to operate a switch, to reflect this service unbundling.^{62/}
3. The Interim Opinion requires cellular carriers to charge "a wholesale rate" to the home carriers of roaming cellular subscribers, including subscribers of resellers and other home carriers with which the serving carrier may have no agreement concerning roaming charges.^{63/}

In each instance the Commission has adopted new regulations governing the prices that cellular carriers may charge for the unbundled elements. That is, current tariffed rates will act as a price ceiling and carriers may price each unbundled element at a market rate, provided that the sum of the unbundled rate elements does not exceed the current tariffed rate for the bundled service. None of these rules was in effect on June 1, 1993.

^{61/} This requirement modifies D.93-05-069 at 7-9.

^{62/} This requirement modifies D.93-05-069 at 7-9.

^{63/} This requirement modifies Resolution T-14621 (granting McCaw provisional authority to implement revised roaming rates) and purports to resolve A.93-01-034 (application of McCaw to establish permanent roaming rates).

The CPUC's curious interpretation of its continuing rate authority^{64/} ignores the plain language of the statute and, because the Interim Opinion applies solely to cellular carriers, exacerbates the regulatory disparity among CMRS providers that Congress sought to eliminate through the enactment of Section 332(c). The language of Section 332(c)(3)(B) is clear on its face. The "existing regulation" referred to in the second sentence is simply a shorthand for the regulation "in effect on June 1, 1993" in the first sentence. This meaning is reinforced by the verbs "continue" and "remain in effect," which obviously refer to regulations that have become effective, not general authority to regulate which exists whether or not specific regulations are made effective pursuant to such general authority.^{65/} Thus, during the pendency of a petition such as the instant one, Section 332(c)(3)(B) permits a state to continue to enforce only those rate regulations that were in effect on June 1, 1993.

^{64/} Notwithstanding the clarity of Section 332(c)(3)(B), the Interim Opinion curiously interprets Section 332 to allow the imposition of new cellular rate regulation after June 1, 1993, concluding that "it is the authority to regulate, not the specific rules in effect at some point in time which is subject to extension pending a ruling on the [FCC] petition." Interim Opinion at 82. The CPUC purports to rely on the Second Report and Order to support its interpretation, but provides no citation to any specific provision in that order which makes such a finding.

^{65/} The CPUC's contrary interpretation violates basic canons of statutory construction. These include avoiding "any statutory interpretation that renders any section superfluous and does not give effect to all of the words used by Congress." See Central Montana Elec. Power Co-op, Inc. v. Bonneville Power Admin., 840 F.2d 1472, 1478 (9th Cir. 1988); accord Hughes Air Corp. v. Public Util. Com'n, 644 F.2d 1334, 1338 (9th Cir. 1981). It is also a "basic rule of statutory construction that one provision should not be interpreted in a way which is internally contradictory or that renders other provisions of the same statute inconsistent or meaningless." Id. A statute must be interpreted in order to effectuate legislative intent through the use of extrinsic aids, including the ostensible objects to be achieved, the evils to be remedied, the legislative history, and the statutory scheme of which the statute is a part. Department of Fish & Game v. Anderson-Cottonwood Irrigation Distr., 8 Cal.App.4th 1554, 1562 (1992).

The Interim Opinion conflicts with several other elements of the Commission's regulatory scheme for CMRS. For instance, it undermines Congress' attempt to minimize regulatory disparities among CMRS providers, including disparities resulting from state regulation.^{66/} As noted above, the rate regulations contained in the Interim Opinion apply solely to cellular providers. The Interim Opinion's regulation of CMRS interconnection rates, including the establishment of unbundled wholesale tariffs, also contravenes the Commission's finding that Section 332(c) preempts state authority over such rates.^{67/} Particularly in view of the Commission's ongoing inquiry into the interconnection obligations of CMRS providers, sanctioning this exercise of state authority would subject cellular providers to interconnection regulations and policies that are potentially inconsistent with what the Commission may ultimately decide. Such a result would undermine Congress' goal of a seamless national wireless infrastructure.^{68/}

2. The Petition Improperly Relies Upon Undisclosed Information That The Commission May Not Consider

It is well established that the Commission cannot rely on undisclosed data in support of a decision.^{69/} This is especially true of technical or statistical data.^{70/} When relevant

^{66/} See Conference Report at 494 (Commission shall ensure that any approved state rate regulation "is consistent with the overall intent of [Section 332(c)] . . . , so that, consistent with the public interest, similar services are accorded similar regulatory treatment").

^{67/} See, e.g., Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services, Notice of Proposed Rulemaking and Notice of Inquiry, FCC 94-145 (rel. July 1, 1994), at ¶ 143.

^{68/} House Report at 260.

^{69/} See, e.g., National Black Media Coalition v. FCC, 791 F.2d 1016, 1023-24 (2d Cir. 1986) (invalidating FCC action based on unpublished data).

materials are excluded from the record, the Commission fails to receive important input through comments on those matters, and thus cannot be said to have taken all relevant factors into account in reaching its decision.^{71/} Any agency decision that fails to take all relevant factors into account must necessarily be overturned as arbitrary and capricious.^{72/} In order to render a validly enforceable decision, particularly one involving technical or statistical data, the Commission cannot rely on materials not disclosed in the record.^{73/}

The CPUC Petition is based in part on technical and statistical data furnished to the CPUC pursuant to the provisions of the CPUC's General Order 66-C, which provides for the confidential treatment of materials that are of a proprietary nature. Having violated this agreement by including it in the Petition and filing it with the FCC, the CPUC attempted to rectify the violation by filing a request for proprietary treatment of its supporting documents^{74/} and by substantially redacting essential portions of the public version of the Petition.

The CPUC's efforts to have the FCC consider the confidential data in this proceeding are unavailing. Because the redacted information was furnished to the CPUC under a promise

^{70/} United States v. Nova Scotia Food Products, 568 F.2d 240, 251-53 (2d Cir. 1977) (concluding that failure to disclose scientific data relied on by agency was procedural error).

^{71/} National Black Media Coalition, 791 F.2d at 1018; Nova Scotia Food Products, 568 F.2d at 252 (noting that technical data is especially prone to comments because it is necessary to explore the techniques and methodologies used to generate the data, and any extrapolations that were made from the data).

^{72/} Id.; see also Nova Scotia Food Products, 568 F.2d at 251-53.

^{73/} See Nova Scotia Food Products and National Black Media Coalition, supra.

^{74/} See State of California, Request for Proprietary Treatment of Documents Used in Support of Petition to Retain Regulatory Authority Over Intrastate Cellular Services Rates, GN Docket No. 93-252, PR File No. 94-SP3 at n.2 (filed Aug. 9, 1994).

of confidentiality, it should not have been provided to the FCC in the first place. In any event, the data cannot be disclosed to the public for comment.^{75/} In the absence of public comment on the information, the Commission cannot rely on it in support of any action it takes on the Petition.

For the foregoing reasons, the proprietary information should be returned and the Petition evaluated without reliance upon it. As demonstrated herein, the publicly available information in the Petition does not justify the rate authority sought by the CPUC.

D. California Has Enjoyed A Decade Of Expanding Cellular Service And Declining Cellular Prices

The Petition attempts to paint a picture of California cellular duopolists engaged in a pervasive effort to abuse market power by maintaining artificially high prices to the detriment of consumers. However, the facts are that cellular carriers in California are expanding their networks and lowering prices, not keeping supply low to obtain alleged monopoly rents. As the CPUC itself has found as recently as 1990, cellular systems in California are expanding as rapidly as possible.^{76/} The CPUC has also determined that such expansion is contrary to the assumption that cellular carriers are restricting supply in a manner which would result in excess profits.^{77/} The position espoused by the California Petition is in stark contrast to the findings of the CPUC in 1990, and is bereft of any explanation of the facts which would support this complete reversal.

^{75/} 47 C.F.R. § 0.457 (1993).

^{76/} D.90-06-025 at 48-49.

^{77/} Id. at 59-60.

1. California Cellular Carriers Are Investing To Meet Subscriber Demand

Cellular carriers first began to offer service only ten years ago, and cellular services have become widely available (as a result of system construction) only within the last five years. Since the industry's inception, California cellular carriers have established a remarkable record of aggressive investment in system infrastructure and rapid customer growth. The CPUC itself acknowledges that cellular subscribership in California has nearly tripled since 1990, to well over one million customers.^{78/} McCaw estimates that the current number actually exceeds two million California customers.^{79/} Moreover, there is no sign that the rate of subscriber growth is declining. The cellular industry, including McCaw's cellular systems in California, has reported record increases in customers in 1993 and thus far in 1994.^{80/}

The popularity of cellular service has been supported by, and has created a demand for, sustained infrastructure investment by California cellular carriers. Above all, cellular customers expect reliable service and as broad a geographic area of coverage as possible. Thus, cellular carriers have competed in building their systems to meet these expectations. Today, competing cellular facilities serve every market in California, offering service to more than 90 percent of

^{78/} CPUC OII at 9.

^{79/} Industry and financial analysts' estimates place current cellular subscribership at more than 19 million; California markets have historically served about 15% of all U.S. cellular subscribers, suggesting that the California total exceeds 2 million.

^{80/} Nationwide, systems controlled by McCaw and those in which its subsidiary, LIN Broadcasting, owns an interest reported subscriber growth during 1993 of more than 40%.

the State's residents.^{81/} However, to the extent each carrier succeeds in attracting new customers, it must also continue to invest in network improvements. Thus, carriers have been required to build new cell sites in order to accommodate additional subscribers without sacrificing service quality. The continued demand for more cells creates significant financial, governmental, and technical challenges.^{82/}

McCaw and other California carriers have done their utmost to overcome these challenges. In 1988, McCaw's California systems were served by 36 cell sites; today, more than 270 are in service and over 300 are projected to be in service by the end of 1994. McCaw's total investment in plants in California has grown from \$30 million in 1988 to more than a quarter of a billion dollars today. McCaw's experience is consistent with that of the industry as a whole: surveys conducted by the Cellular Telephone Industry Association ("CTIA") show that the number of cell sites constructed, and the amount of cellular infrastructure investment, has grown by roughly 25% annually for the past several years in California. The charts contained in Exhibit B attached hereto summarize a picture of a dynamic

^{81/} As a result of its aggressive construction programs, McCaw's California cellular affiliates have dramatically increased the square mileage coverage of their systems in the least three years alone. Today, most of the MSAs served by those systems have cellular coverage over at least 90% of their geographic area.

^{82/} Furthermore, cell site construction cannot proceed without an extensive series of approvals such as land use permits, building permits, FAA approvals, etc., which are more stringent in California than in almost any other state. Ironically, CPUC regulations, which allow the CPUC to review the compliance of cellular carriers with local zoning and building code requirements, add another layer of bureaucracy to the process. The lengthy approval procedures, which sometimes require that preferred cell site locations be abandoned, contribute to the costs and time required to install new sites. Finally, the installation of new sites within the fabric of an existing system involves numerous technical challenges, including reconfiguration of the surrounding cells. See George Calhoun, Digital Cellular Telephone (Norwood: Artech House) at pp. 113-120.

and expanding industry which is aggressively investing to meet the increasing demand for its services. This record is not what one would expect of collusive duopolists.

2. Decreasing California Cellular Prices Reflect The Competitive Market

Even as cellular carriers continue to invest in system improvements and capacity enhancement, they have brought cellular service prices down. Data submitted to the CPUC by the Cellular Carriers Association of California show that between 1990 and 1993, cellular rates have declined roughly 18% in real terms; during that time, McCaw's cellular systems in California introduced "package plans" -- which offer monthly access and a pre-set package of airtime for a discounted monthly fee -- providing subscribers with immediate discounts ranging between 5% to 15% over traditional basic rates, depending on individual usage patterns. A majority of McCaw's customers in California are now taking advantage of these rate discounts, which have helped the company maintain an annual growth rate of over 40% in cellular subscribership over the last two years.

The cellular industry's record on price decreases in California compares favorably to telecommunications service pricing overall, which climbed by 3% during 1990-1993.^{83/} The decline in cellular service pricing in California did not, however, occur because of the CPUC's regulatory scheme but virtually in spite of it. California carriers' rate decreases mirror those implemented by cellular operators across the nation, and reflect competition between carriers, expected entry by new competitors, and the desire to improve pricing in order to open new

^{83/} California Petition at 41. Since the figures are redacted from the California Petition, it is not possible to state the amount of decline which the CPUC asserts, or to determine whether it accurately reflects all of the rate reductions which have occurred in California. See FCC Monitoring Report, May 1993, at 401.

market segments. Unfortunately, price experimentation in California has lagged because carriers' attempts to introduce new rate plans have foundered on ambiguous CPUC tariffing rules, which have resulted in bureaucratic delays, or reseller complaints that retail price cuts have not been matched with equivalent wholesale discounts designed to safeguard the resellers' margins. As the CPUC has dismantled some of its price restrictions, carriers have enjoyed greater freedom to innovate, though they have yet to be given the flexibility they have in other states.

E. The CPUC's Flawed Economic Analysis Fails To Justify The Imposition Of Rate Regulation On Cellular Providers

The Commission has found that the CMRS marketplace is sufficiently competitive to justify forbearance from rate and tariff regulation.^{84/} Nothing in the Petition undermines this conclusion with respect to California. The CPUC has failed to demonstrate the exercise of market power by cellular carriers, including supracompetitive pricing, and its claims about anticompetitive behavior are based on faulty economic analysis. Nor has the CPUC has shown any benefits from its past regulation of cellular carriers, and its Petition ignores the substantial costs that rate regulation imposes upon service providers and the public. By contrast, there is evidence of sufficient competitive behavior and consumer benefits in the CMRS marketplace to justify the preemption of economic regulation by the CPUC. The increasing competition in the CMRS marketplace further supports preemption of state rate regulation.^{85/}

^{84/} See Second Report and Order, 9 FCC Rcd at 1470, 1472, 1478-79.

^{85/} See Owen Declaration.

In order to determine whether there is a need for regulatory intervention, market share and concentration must be computed for properly defined antitrust markets. The CPUC foreordains its conclusion in support of cellular regulation by defining cellular "as a separate market from other wireless telecommunications, at least for the present and near-term future."^{86/} In so doing, however, the CPUC ignores the fact that the mobile telecommunications marketplace is becoming increasingly competitive. The Commission is currently in the process of licensing digital broadband PCS that will compete with existing CMRS providers. ESMRs are also consolidating their facilities into a nationwide network.^{87/} Digital PCS systems and ESMRs, moreover, are likely to have more effective capacity than cellular systems, which will have to support a substantial analog customer base for the foreseeable future.^{88/} Even in advance of the entry of new market participants, the real price of cellular service, after adjusting for inflation, has declined.^{89/}

Regulation can be justified only if there is evidence of market power or a likelihood that such power will be exercised in the future. There is no evidence that the CMRS marketplace in California suffers from either defect.

^{86/} California Petition at 24.

^{87/} Owen Declaration at ¶¶ 29-37; accord Second Report and Order, 9 FCC Rcd at 1470.

^{88/} See Owen Declaration at ¶¶ 44-47.

^{89/} Id. at ¶ 68.

1. The CPUC's Use Of The Justice Department Merger Guidelines As The Framework Of Its Analysis Is Erroneous

The CPUC adopts the Department of Justice's Horizontal Merger Guidelines (the "Guidelines") as the framework for its analysis of the competitiveness of the California cellular market, despite the fact that the CPUC is arguing for the imposition of regulation on an existing entire industry, not analyzing the projected effect on competition of a proposed merger of specific firms.^{20/} The CPUC's reliance on the Guidelines and their measurement procedures in this instance is misplaced. The Guidelines are aimed at stopping mergers that may have the effect of reducing competition; their concern is with an incipient effect on competition. The Guidelines and their associated analytical mechanism are not necessarily applicable in determining whether prices at present are above competitive levels, whether companies are engaged in other anticompetitive activities, or whether regulations to deal with such problems would be appropriate.^{21/}

The standards embodied in the Guidelines are much stricter than the appropriate standards for evaluating the appropriateness of a decision to regulate a market, as the Department of Justice has explicitly recognized.^{22/} Thus, application of these standards might find a proposed merger would be undesirable from a policy perspective because it held the potential to reduce competition, while even after the merger, competitive problems might not be sufficient to warrant imposing regulation on the market. In short, the Guidelines are not the proper framework for evaluation of the economic question presented by the California Petition.

^{20/} California Petition at 21-23.

^{21/} Owen Declaration at ¶ 17.

^{22/} Id. at ¶ 18.

2. The CPUC Improperly Quantifies Market Shares

The CPUC purports to demonstrate the market shares of cellular carriers at both the retail and wholesale levels, and concludes that the cellular market is becoming less competitive based on these measures.^{23/} In fact, the CPUC fails to use the proper measure of market share: *effective* capacity. When this measure is used, and the proper market definition applied, the market share of each cellular carrier is likely to be 10.2%.^{24/}

Moreover, the CPUC provides no evidence that the declining market shares of independent resellers are the result of actions by facilities-based carriers. It is worth noting that whatever has been happening to the market share of resellers in California has occurred even though cellular carriers have been required to provide services to resellers at a mandatory margin below retail prices.^{25/} Given this margin, it is difficult to imagine how the CPUC can conclude that the resellers' rates are subject to the "market power" of the facilities-based carriers. One plausible explanation for declining reseller market share in California is that, as cellular rates decline and subscriber monthly revenues decrease, thinly-capitalized resellers may find it less attractive to incur the substantial up-front costs of acquiring new customers aggressively.

In any event, the market share of resellers has no particular implications for competition or for consumer well-being. Suppliers may be vertically-integrated into retailing or they may sell only through resellers or they may use both of these organizational forms; all of these

^{23/} California Petition at 31-34.

^{24/} Owen Declaration at ¶¶ 42-45.

^{25/} See pp. 20-22 *supra*.

options are compatible with competition.^{26/} What matters to the consuming public are the retail price and the quality of the service that is offered, and there is absolutely no evidence that resellers have a uniquely beneficial impact on either of these attributes.

3. The CPUC Erroneously Disregards Price Discounts Available Through Package Airtime Plans

The California Petition bases its request for continuing regulatory authority on two aspects of cellular pricing in California: the similarity of rates of the basic rate plans of the two carriers in most California markets, and the industry practice of implementing rate reductions by means of optional rate plans which are available to subscribers as alternatives to the basic plans. However, similarity of prices is to be expected in competitive markets. The CPUC's antipathy to optional rate plans, and refusal to recognize them as meaningful rate reductions to subscribers, is both confusing and erroneous.

The California Petition admits that the level of basic plan rates have fallen in nominal terms in California markets overall from 1989 to 1993.^{27/} The CPUC does not believe this decrease is sufficient, alleging that costs should have fallen even more.^{28/} The CPUC forgets that many cellular systems incurred significant start-up costs, which they are only now recouping. Furthermore, the CPUC ignores the fact that the rapid growth of cellular subscribers has created an equally rapid need for cellular carriers to expand their networks, and thus the

^{26/} Owen Declaration at ¶ 99.

^{27/} California Petition at 41. Since the figures are redacted from the California Petition, it is not possible to state the amount of decline which the CPUC asserts, or to determine whether it accurately reflects all of the rate reductions which have occurred in California.

^{28/} California Petition at 39.

economies of scale which characterize the landline local exchange and the telephone CPE market have yet to emerge in the cellular services industry.

However, this admitted decrease in basic plan rates totally ignores the additional effect on subscribers of the availability of both (i) optional permanent rate plans which provide lower rate levels, and (ii) various promotional or other forms of temporary rate reductions. The California Petition attempts to create the impression that such rate alternatives are only available for short periods of time, and that they are not meaningful rate reductions because they often require subscribers to make minimum commitments (of time or quantity of use) which are not required by basic plans. In fact, however, such alternatives are available on an ongoing basis throughout California, allowing subscribers to choose the combination of rate structure and commitments which best match their requirements. All of McCaw's California systems have such alternative rate plans in effect on a permanent basis. These alternative plans have proven popular with subscribers, and the California Petition admits that an ever-increasing percentage of California subscribers utilize these plans.^{99/} One can infer that discount plans have reduced effective prices for a substantial share of users, even after taking account of conditions and termination fees in the discount plans.^{100/} It is simply erroneous to ignore the very real cost savings which result for these subscribers, and to focus solely on the level of basic rates. In fact, when these plans are considered, the California Cellular Carriers Association has

^{99/} D.94-08-022 at 47.

^{100/} Owen Declaration at ¶ 72.

determined that cellular rates in California have dropped during the last four years by roughly 18 percent in real (i.e., inflation-adjusted) terms and by 10 percent in nominal terms.^{101/}

The similarity of basic plan prices in each market noted by the California Petition does not form any basis for regulation of California cellular prices.^{102/} The similarity of prices in California markets is as much evidence that the markets are competitive as that they are not. Additionally, the California Petition fails to recognize the competition between cellular carriers which exists on the basis of service quality, features, geographic coverage, and other non-price characteristics of service which affect its value in the eyes of consumers.

4. Cellular Providers Lack The Ability To Collude To Set Prices

The Commission has recognized that CMRS providers do not have control over bottleneck facilities.^{103/} More generally, given the presence of two cellular carriers, no firm has significant unilateral market power. Because one cellular provider could undercut efforts by the other to exercise market power unilaterally, the exercise of market power to set prices would require coordinated behavior or collusion by at least two cellular providers and, in the near future, by providers of PCS and ESMR providers.

There are a number of characteristics of the market for CMRS that would make it difficult to collude to raise prices. These characteristics include rapid technological change, which is accompanied by the introduction of new services and the expansion of capacity, and the rapid expansion of demand. Collusive arrangements are difficult to reach and maintain

^{101/} Comments of CCAC in I.93-12-007 at 21.

^{102/} Owen Declaration at ¶ 71.

^{103/} Second Report and Order, 9 FCC Rcd at 1499.

where, as in the case of CMRS, there is a wide range of services, variations in services among providers, and numerous pricing plans. It is unlikely that new market entrants, with their natural incentive to cut prices to gain market share, would willingly charge high prices that would deter subscribers.^{104/}

5. The CPUC Erroneously Concludes That Cellular Systems Have Excess Capacity And That Cellular Carriers Have Priced To Constrain Demand

Despite the irrefutable facts that the cellular subscribership growth has been robust -- and is only increasing -- and that infrastructure investment has grown tenfold in the last decade, the CPUC asserts that cellular carriers have kept prices high, constraining demand. As evidence for this conclusion, the CPUC references data -- redacted from the public version of its Petition - - that purportedly shows that the cellular systems enjoy excess capacity. Essentially, the CPUC argues that the presence of excess capacity proves that the cellular industry in California is not competitive, since a truly competitive market would presumably have set prices at a level where demand always meets available supply. The CPUC is wrong both on its facts and its economics.

The CPUC's accusation is inconsistent with its own analysis of the cellular industry's use of package plans, which it claims were designed to "increase usage of existing spectrum

^{104/} Owen Declaration at ¶¶ 55-59. The CPUC suggests that the opportunities for collusion are enhanced by the fact that providers may be partners in one market and competitors in another. California Petition at 28. The CPUC does not explain why this ownership pattern would facilitate collusion, however, and there is no empirical evidence that two companies with a joint venture in one antitrust market are more likely to collude in other antitrust markets. In this particular case, such a result is made more implausible by the fact that conditions in each market differ as do the identities of third party competitors. Owen Declaration at ¶ 55-59.

capacity."^{105/} Furthermore, the CPUC's analysis fundamentally misconstrues cellular system capacity dynamics. Evidently, the CPUC assumes that data indicating unused capacity in certain cells within a system warrants a finding that the system itself has excess capacity and that prices should be cut in order to "clear" the carrier's inventory of available radio channel. This analysis overlooks two critical facts. First, at any given point, cellular systems are designed to accommodate short-term subscriber growth -- which industry statistics show is continuing to accelerate -- and episodes of exceptional traffic demand, such as occur in connection with special events, natural disasters (e.g., earthquakes, fires) or accidents. Second, any cellular system will experience excess capacity in its perimeter cells, which handle less traffic than its core cells. Consequently, even a system that experiences commercially unacceptable call blockings on its core cells during peak hours will appear, by unsophisticated measures at least, to have unused capacity.

The CPUC also argues from increases in the number of subscribers per cell between 1985 and 1992 that capacity was not fully utilized during that period. This inference is unjustified from the evidence. There are any number of other explanations for this increase, including declines in the average number of minutes of air time per subscriber and the

^{105/} California Petition at 54. Presumably, the CPUC believes that the appearance of package plans confirms the conclusion that California systems have excess capacity today and that carriers were not trying to generate sufficient demand previously. Whatever one may think about the validity of this inference, it only undercuts the CPUC's case for future rate regulation: if carriers are now pricing service to stimulate demand, what is the basis for suggesting that CPUC rate-setting authority continues to be necessary?

development of techniques that have increased the capacity per cell (e.g., cell sectioning) and new radio technologies.^{106/}

Finally, the CPUC's analysis ignores the added short-run marginal costs that would arise if cellular carriers actually could operate all of their cells at capacity; those costs include out-of-pocket costs, marketing costs, and the costs associated with increased blocking and other symptoms of system congestion. Those expenses would put upward pressure on prices as a system approached some arbitrarily defined "full capacity."^{107/} If the CPUC's goal is to set prices that ensure cellular traffic is always at a system's full capacity, one can question how such a policy would serve the public interest. Customers would not only have to contend regularly with system blockage during peak hours, but in all probability would wind up paying higher prices to boot.

6. In Assessing Earnings, The CPUC Erroneously Assigns No Value To The Radio Spectrum And Relies On Accounting Results Rather Than Economic Measures Of Market Power

The California Petition asserts that the earnings of cellular carriers in California metropolitan areas are evidence of "undue market power."^{108/} However, the CPUC "rates of return" contained in Appendix F of the California Petition are erroneous on a number of grounds

^{106/} Owen Declaration at ¶ 92.

^{107/} *Id.* at ¶ 89. While the CPUC defines maximum capacity using a rule of thumb about the probability of blocking that would prevail under competition, the CPUC produces no evidence that the assumed probability of blocking is related to the level that would prevail under competition. In reality, competition would not produce the same probability of peak period blocking everywhere. ...A cellular provider may seek to distinguish itself in the market by offering a relatively lower probability of blocking than its competitors. That probability may not be close to the levels assumed by the CPUC's definition of maximum capacity. *Id.* at ¶¶ 90-91.

^{108/} California Petition at 49.

and the CPUC fails to demonstrate that cellular earnings in California, even in the metropolitan areas, are in any manner excessive.^{109/}

McCaw has operated cellular systems for approximately eight years. The Company reported its first quarterly profit just a few months ago. While some California systems in which it is a partner, such as the Los Angeles and San Francisco non-wireline systems, have been profitable for several years, McCaw's experience in California overall replicates that of the Company throughout the United States: until recently, it spent more per year on customer acquisition and system investment than it received in service revenues. This experience suggests that the CPUC ignores reality when it calculates cellular carriers' rates of return and applies these results to prove market power. Indeed, the CPUC commits two fundamental errors worth highlighting.

First, the CPUC relies upon financial reporting results to calculate the "rate of return" of cellular carriers,^{110/} and seeks to draw economic conclusions about the competitiveness of the market from those rates of return. This line of argument is fatally flawed. Accounting rates of return are not relevant to assessing market power. Those rates are calculated on the basis of book value rather than replacement value. The book value of tangible assets is an accounting consequence heavily dependent on numerous historical events that have nothing to do with economic profits or market power.^{111/} Replacement costs, rather than book costs, would have

^{109/} *Id.* at 47. The California Petition admits that cellular earnings are negative or "low" in non-urban areas, but nevertheless seeks authority to regulate cellular pricing in these areas.

^{110/} *Id.* at 48.

^{111/} Owen Declaration at ¶ 77.

been appropriate to use for economic analysis. Additionally, start up losses should have been capitalized and included in a firm's rate base for economic analysis purposes.^{112/}

Erroneously, the CPUC assigns no value to the radio spectrum in its calculation of rates of return.^{113/} The CPUC's decision to assign no value to the radio spectrum in its rate-of-return calculation flies in the face of the billions of dollars expected to be paid for PCS spectrum in the Commission's auctions,^{114/} and ignores the relative scarcity of the spectrum available for cellular service. In order to ensure the most efficient use of this spectrum, cellular service must be priced at a level that covers opportunity costs. If prices are set too low, people willing to pay a higher price will be precluded from obtaining service by people who valued the service less. Whether or not the cellular licensee obtained its spectrum for free or purchased it in the market has no effect on the service prices that are needed to achieve an efficient allocation of resources. Even in a competitive market, the prices at which cellular systems are sold will reflect the competitive scarcity value of spectrum. Likewise, in order to be meaningful for economic analysis, rates of return and q-values must be based on replacement costs that include the competitive scarcity value of spectrum.^{115/}

^{112/} Id.

^{113/} California Petition at 56. In another proceeding, the CPUC itself admitted that the value of spectrum for purposes of the economic evaluation of the market power of cellular carriers was not zero. See Order Instituting Investigation, D.932-12-007 (Dec. 17, 1993), at 21.

^{114/} The Commission received winning bids of \$617,006,674 for ten narrowband PCS licenses alone. See Public Notice, "Announcing the High Bidders In The Auction of Ten Nationwide Narrowband PCS Licenses" (released August 2, 1994).

^{115/} Owen Declaration at ¶¶ 77-83. The CPUC's statement that it would "expect the value per-MHz of licensed spectrum to be roughly equivalent" across uses, Interim Decision at 60, makes no economic sense. Given the legal restrictions on the reallocation of spectrum among uses, the relative market value of one MHz of spectrum allocated to two different services

In short, the CPUC fails to demonstrate that cellular rates in California are unreasonable because they result in excessive earnings for the carriers. No such excessive earnings have been shown to exist historically, and the entry of additional competitors into the wireless service market makes the chances of such earnings in the future even less likely than has been the case in the past.^{116/}

F. The CPUC Ignores The Substantial Costs Of Rate Regulation And Presents No Evidence That Regulation Would Benefit Consumers

By all accounts, including its own, the CPUC's past attempts to impose on the cellular industry regulation which has served the public interest have proven unsuccessful. Its fundamental policy of reliance upon cellular resellers to increase the perceived competitiveness of the market has not produced any results other than the imposition of high costs upon the regulated utilities.^{117/} Its extended effort to implement cost-based rates for wholesale cellular services -- including its attempt to impose a 14.75 percent rate of return^{118/} -- has been wholly fruitless. On the other hand, all the while the CPUC has successfully constrained cellular carriers with a panoply of detailed and changing tariff rulings designed to maintain the reseller margin. These restrictions have cost consumers significant amounts due to the inability of

depends heavily on the relative demand for those services. Owen Declaration at ¶ 66.

^{116/} The CPUC's analysis of cellular q-ratios is also flawed. See Owen Declaration at ¶¶ 79-85.

^{117/} Id. at ¶ 116.

^{118/} In its D.92-10-026, the CPUC determined that 14.75 percent would be the cost of capital which it permitted to be used when establishing wholesale rates. The Commission later eliminated this finding. D.93-05-069.

California carriers to offer the type of inducements to increased cellular system use which are commonly available in other states.^{119/}

The CPUC has presented no convincing evidence that its regulation of cellular carriers has provided significant benefits to consumers. To the contrary, rate regulation of the cellular industry has not reduced prices. In fact prices were five to 16 percent higher in states that required advance notice tariff filings than in states that did not regulate prices.^{120/}

In addition to yielding no benefits, continued state price regulation would impose substantial costs. First, regulated prices would inevitably be below the efficient level in many circumstances because regulators simply lack the resources to determine the most efficient price levels. As the Petition itself suggests, moreover, regulators are likely to establish prices on the faulty economic analysis. For example, the CPUC appears to believe that prices should be set with reference to the historical cost of tangible assets, neglecting other replacement costs including the scarcity value of spectrum.^{121/}

Price regulation would also limit the ability of regulated firms to respond to changes in technology, costs, and demand, thereby deterring new investments, improvements in quality, the introduction of new services, and the entry of competitors. Such regulation, especially when

^{119/} As one example, it has been estimated that the CPUC's bundling prohibition has forced California subscribers to pay millions of dollars more for cellular telephone equipment than would have been the case in the absence of such a ban. See Testimony of Jordan Roderick of McCaw in I88-11-040 at 12. Roderick's testimony stated that 22,500 Motorola flip phones were distributed to McCaw dealers and sold in California. At an average price of \$200 per phone, California customers paid \$3.6 million more than purchasers of the same phones in Seattle and \$4.47 million more than customers in Dallas. Roderick did not address the California market, only McCaw customers.

^{120/} Owen Declaration at ¶¶ 104-106.

^{121/} Owen Declaration at ¶ 109.