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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	94-104
	)	
Petition of Arizona Corporation Commission	)	PR File No. 94-SP2
	)	
To Extend State Authority Over Rate and Entry Regulation of All Commercial Mobile Radio Services	)	

OPPOSITION OF THE
CELLULAR TELECOMMUNICATIONS INDUSTRY ASSOCIATION

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SUMMARY

Given the dynamic and competitive nature of the CMRS marketplace, and because the Petition has failed to meet the statutory standard and the requisite burden of proof, the Petition should be denied.

When Congress amended § 332(c) of the Communications Act, it granted the Commission discretion to forbear from imposing certain Title II requirements on CMRS providers. Consistent with its desire to eliminate unnecessary and burdensome regulation, Congress also preempted state regulation of entry and rates for all reclassified CMRS providers. By these actions, Congress sought to create a uniform, nationwide, and streamlined regulatory regime for CMRS.

Before the Commission may grant a state petition to regulate CMRS, the state must offer more than a simple desire to regulate CMRS. Rather, the state must prove, with evidence of market conditions, that rate regulation is necessary to protect against market failure within that state. Such a showing is difficult, if not impossible, to make in view of the Commission's definitive conclusion that the CMRS market is competitive.

Regulation imposes burdensome costs; it also can harm competition and cause rates to remain higher than competitive levels. The Commission's open entry policies,

and its systematic efforts to eliminate artificial distinctions between the various commercial mobile services, have increased the level of competition and contributed to the rapid expansion of the wireless industry.

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OPPOSITION OF THE CELLULAR TELECOMMUNICATIONS INDUSTRY ASSOCIATION

The Cellular Telecommunications Industry Association ("CTIA")[1] respectfully submits its comments in opposition to the State of Arizona's petition filed in the above-captioned proceeding.[2] In its petition, the State of Arizona requests authorization to continue rate and entry regulation over commercial mobile radio service providers who offer such services

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[1] CTIA is a trade association whose members provide commercial mobile radio services, including over 95 percent of the licensees providing cellular service to the United States, Canada, Mexico, and the nation's largest providers of ESMR service. CTIA's membership also includes wireless equipment manufacturers, support service providers, and others with an interest in the wireless industry.

[2] In the Matter of Petition of Arizona Corporation Commission to Extend State Authority Over Rate and Entry Regulation of All Commercial Mobile Radio Services, PR File No. 94-SP2 (August 9, 1994).

within the State.[3] As demonstrated below, because the State of Arizona has not met the stringent statutory burden required for retaining rate regulation, its petition should be denied.

INTRODUCTION

Before the Commission may grant a state petition to regulate commercial mobile radio services ("CMRS"), the Communications Act imposes on the state the burden of proving that market conditions for CMRS within that state fail to provide subscribers with adequate protections. In satisfying its burden of proof, a state must offer more than a simple desire to regulate CMRS. Rather, the Commission requires a state to submit pertinent evidence demonstrating that intrastate market conditions are inadequate to protect consumers and that CMRS providers are imposing unjust and unreasonable rates upon their subscribers.

The State of Arizona not only has failed to meet the requisite burden of proof. It also has failed to offer any pertinent evidence of market conditions to support its attempt to apply its regulations. Therefore, in view of the explicit statutory mandate generally to preempt state regulation of CMRS

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[3] Congress has specifically preempted the authority of the states to regulate the entry of any commercial mobile radio service. See Section 332(c)(3)(A) of the Communications Act. Accordingly, the Commission must deny the petitioner's request for authority over entry regulation of commercial mobile radio services in the State of Arizona.

entry and rates, as well as the dynamic and competitive nature of the CMRS marketplace, the Commission should deny the State's petition.

I. CONGRESS GENERALLY PREEMPTED THE STATES FROM REGULATING INTRASTATE CMRS RATES.

When Congress enacted § 6002(b)(2)(A) of the Omnibus Budget Reconciliation Act of 1993,[4] it amended § 332(c) of the Communications Act in several significant ways. In recognition of the disparate regulatory treatment of mobile service providers, Congress revised § 332 to ensure that substantially similar services would be subject to similar regulation. In recognition of the dynamic, competitive nature of the mobile service marketplace, it granted the Commission discretion to forbear from imposing certain Title II requirements on CMRS providers. Consistent with its desire to eliminate unnecessary and burdensome regulation on CMRS providers, Congress also preempted state regulation of entry and rates for all reclassified CMRS providers.[5]

By these actions, Congress sought to create a uniform, nationwide, streamlined regulatory regime designed to "foster the growth and development of mobile services that, by their nature,

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[4] Pub. L. No. 103-66, § 6002(b)(2)(A), 107 Stat. 312, 393 (1993).

[5] 47 U.S.C. § 332(c)(3).

operate without regard to state lines as an integral part of the national telecommunications infrastructure."[6] Thus, only under limited circumstances of demonstrated market failure, did Congress permit states to petition the Commission for the authority to regulate the rates of CMRS providers.[7] Specifically, § 332(c)(3)(A) requires the FCC to grant a state petition to retain authority to regulate intrastate CMRS rates only if the state can demonstrate that:

> market conditions with respect to such services fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory.[8]

In reviewing state petitions, Congress directed the Commission to "be mindful of the . . . desire to give the policies embodie[d] in Section 332(c) an adequate opportunity to yield the benefits

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[6] H.R. REP. No. 111, 103d Cong., 1st Sess. 259-261 (1993) ("House Report"). The House Report goes on to state that regulation should "enhance competition and advance a seamless national network" of commercial radio services.

[7] 47 U.S.C. § 332(c)(3)(A).

[8] Id. § 332(c)(3)(A)(i). Under an alternative test, states must demonstrate that such market conditions exist and such services have become a substitute for land line telephone exchange service in that state. Id. § 332(c)(3)(A)(ii). Moreover, to be eligible to file a petition to retain rate regulation authority, a state must have: (1) "in effect on June 1, 1993, any regulation concerning the rates for any commercial mobile service offered in the State on such date[;]" and (2) petitioned the Commission before August 10, 1994 to extend its pre-existing regulations. 47 U.S.C. § 332(c)(3)(B).

of increased competition and subscriber choice."[9] In keeping with this policy directive, the Commission should refrain from subjecting CMRS providers to unnecessary and burdensome state regulation.

II. THE COMMISSION'S RULES REQUIRE STATES TO MEET THE SIGNIFICANT BURDEN OF PROVING THAT INTRASTATE RATE REGULATION MUST BE RETAINED.

The Commission, in its implementing regulations, has demonstrated its fidelity to both the statutory language and congressional intent by establishing regulatory parity among CMRS providers, promoting competition in the mobile communications marketplace through regulatory forbearance, and requiring states to prove that continuing state rate regulation is necessary.[10] In this regard, the Commission places the burden of proof squarely upon the states to demonstrate the need for continued rate regulation. As discussed more fully below, in this case, the State of Arizona has not met its burden.

Recognizing that the existing level of competition is "a strong protector" of the interests of consumers,[11] the Commission stated that:

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[9] House Report, supra note 4, at 261. See also, H.R. CONF. REP. No. 213, 103d Cong., 1st Sess. 494 (1993).

[10] Regulatory Treatment of Mobile Services, Second Report and Order in GN Docket No. 93-252, 9 FCC Rcd 1411, 1418 (1994)("Second Report and Order").

[11] Id. at 1421.

> state rate regulation of CMRS providers will be established only in the case of demonstrated market conditions in which competitive forces are not adequately protecting the interests of CMRS subscribers.[12]

Therefore, states "must, consistent with the statute, clear substantial hurdles if they seek to continue or initiate rate regulation of CMRS providers."[13]

For states to make the necessary demonstration that market conditions fail to protect consumers from unjust or unreasonable rates or unreasonably discriminatory rates, the Commission enumerated eight different types of evidence, information, and analysis that states might provide pertinent to the Commission's examination of the marketplace.[14]

Specifically, the Commission expressed a preference for the following types of evidence: (1) information about the CMRS providers in the state, and the services they provide, (2) customer trends, annual revenues, and rates of return for each in-state company, (3) rate information for each in-state company, (4) the substitutability of services that the state seeks to

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[12] Id. at 1419 (emphasis added). See also Id. at 1504 ("Any state filing a petition pursuant to Section 332(c)(3) shall have the burden of proof that the state has met the statutory basis for the establishment or continuation of state regulation of rates") (emphasis added).

[13] Id. at 1421 (emphasis added).

[14] Id. at 1504-1505.

regulate, (5) barriers to entry for new entrants to the market for such services, (6) specific allegations of fact regarding anti-competitive or discriminatory practices by in-state providers, (7) particularized evidence that shows systematically unjust and unreasonable rates, or unduly discriminatory rates charged by in-state providers, and (8) statistics regarding customer satisfaction and complaints to the state regulatory commission regarding service offered by in-state CMRS providers.[15]

Although the above list is not exclusive, it clearly indicates an admonition by the Commission that generalized claims and/or the mere desire to continue to regulate CMRS are insufficient to meet the statutory burden of proof that state regulation is necessary in view of existing market conditions. Thus, merely advancing generalized policy arguments or legal theories is insufficient; rather, "the states must submit evidence to justify their showings."[16]

The necessary evidentiary showing facing state petitioners is further heightened by the Commission's recent determination to

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[15] Id.

[16] Id. at 1504 (emphasis added). Moreover, the Commission also requires that any state petition must "identify and provide a detailed description of the specific existing or proposed rules that it would establish if [the Commission] were to grant [the] petition." Id. at 1505.

forbear from imposing tariff requirements on all CMRS providers. As discussed above, Congress revised § 332 to grant the Commission authority to forbear from imposing certain Title II requirements on CMRS providers if the FCC determined (1) that such regulations were not necessary to ensure just and reasonable rates and were not unjustly or unreasonably discriminatory, (2) that such regulations were not necessary to protect consumers, and (3) that such forbearance is consistent with the public interest.[17]

The issues that the Commission must consider in connection with a state's petition to regulate CMRS are essentially the same as those it considers in deciding to forbear from imposing its own regulations on CMRS. Both statutory tests require the Commission to assess the impact of market conditions on the reasonableness of rates and the protection of consumers. A state desiring to regulate CMRS, thus, must present the Commission with evidence which dictates a conclusion contrary to that reflected in the Commission's recent decision to forbear from interstate rate regulation. That is, Congress requires a state to prove, with evidence of market conditions, that rate regulation <u>is</u> necessary to protect against market failure within that state. Such a showing is very difficult, if not impossible,

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[17] 47 U.S.C. § 332(c)(1)(A).

to make in view of the Commission's definitive conclusion that the CMRS market is competitive.

After considering the state of competition in the larger CMRS arena, as well as the need to protect consumers, the Commission aptly concluded that, "there is no record evidence that indicates a need for full-scale regulation of cellular or any other CMRS offerings."[18] Therefore, it chose to forbear from interstate CMRS rate regulation, in recognition that "in a competitive market, market forces are generally sufficient to ensure the lawfulness of rate levels, rate structures, and terms and conditions of service set by carriers who lack market power."[19] Moreover, it found that the "application of Title II regulations may impede competition," while "reducing regulatory requirements . . . tends to encourage market entry and lower costs."[20]

Many of the same reasons that supported the Commission's decision to forbear from tariffing interstate rates for CMRS are equally applicable to the issue of intrastate rate regulation.

> [R]equiring tariff filings can . . . take away carriers' ability to make rapid, efficient responses to changes in demand and cost, and remove incentives for carriers to

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[18] Second Report and Order, supra note 8, at 1478 (emphasis added).

[19] Id.

[20] Id. at 1475, 1478.

> introduce new offerings . . . and impose costs on carriers that attempt to make new offerings. Second, 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. . . . [T]ariffing, with its attendant filing and reporting requirements, [also] imposes administrative costs upon carriers. These costs could lead to increased rates for consumers and potential adverse effects on competition.[21]

Having concluded that "cellular providers do face some competition today, and [that] the strength of competition will increase [in] the near future,"[22] the Commission found tariff forbearance to be within the public interest. To now permit states essentially to reimpose such obligations, albeit on the state level, the state must bear the substantial burden of proving that the significant direct and indirect costs associated with rate regulation are necessary within the intrastate market, contrary to the Commission's overall finding of competition. The State of Arizona has not done so here.

III. STATE RATE REGULATION IS UNNECESSARY IN VIEW OF COMPETITIVE FORCES WITHIN THE CMRS MARKETPLACE.

Commercial mobile services are rapidly becoming an indispensable part of the national information infrastructure. Currently, mobile communications are the fastest growing segment of the telecommunications industry with no single provider

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[21] Id. at 1478.

[22] Id.

capable of fully meeting consumer demand. Growth and entrepreneurism in commercial mobile services are being driven by such factors as digital technology, economies of scale, and an ever-increasing consumer demand for such cost-effective services. Investment in CMRS has further been spurred by the flexible and substitutable nature of available wireless technology and services. In addition, expansion of the wireless industry has been aided by the Commission's open entry policies and its systematic efforts to eliminate artificial distinctions between the various commercial mobile services.

Further, such regulation can impose burdensome costs which may ultimately harm competition and cause an increase in rates. To illustrate, cellular rates in states that regulate cellular prices are approximately five to fifteen percent higher than rates in states that are free of regulation.[23] Thus, regulation "does not lead to lower prices" in those markets.[24] Further, regulation, not the lack of competition, may explain the higher rates of which the states complain.

Together, all of these factors demonstrate that state regulation of intrastate rates is unnecessary to protect

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[23] See Affidavit of Jerry A. Hausman at 3 (September 14, 1994). Dr. Hausman's Affidavit is attached hereto.

[24] Id.

consumers. The cellular industry, which, for reasons of spectral limitations, has only two licensees per geographic market, itself performs competitively. And the cellular industry has by no means tapped out the consumer demand for mobile services. Moreover, other mobile services providers currently provide services that are readily substitutable for cellular services and additional competitive entry is promised in the near future.

A. Economic analysis supports the conclusion that the cellular marketplace performs competitively.

Drs. Stanley M. Besen, Robert J. Larner, and Jane Murdoch, of Charles River Associates, concluded after careful analysis regarding the state of competition in the cellular marketplace that, "the business of supplying cellular telephone communications has been characterized by rapidly increasing volume, declining prices, expanded service offerings, and significant technological change."[25] Significantly, they stated that the cellular services industry has performed the way economists expect a "young industry driven by market forces and developing in a competitive context" to operate.[26] In other

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[25] Drs. Stanley Besen, Robert J. Larner, and Jane Murdoch, Charles River Associates, "The Cellular Service Industry: Performance and Competition" (Nov. 1992) submitted as an Appendix to CTIA Reply Comments in GN Docket 90-314, at 1 (Jan. 1993). A copy of the above is attached hereto.

[26] Id. at 4.

words, the performance of cellular is, in fact, already competitive.

The conclusion reached by Drs. Besen, Larner, and Murdoch as to the competitive nature of the cellular services industry is buttressed by the high rate of intra-industry churn, i.e., customers switching from one cellular carrier to another. EMCI, Inc., in its CELLTRAC survey, noted average annual churn rates of nearly 25 percent among commercial mobile services customers.[27] Of this turnover, roughly one third is intra-industry churn, i.e., customers switching to competing cellular providers.[28] The rate of intra-industry churn is evidence of the dynamic nature of the cellular communications industry and the absence of barriers to customers changing service providers therein.[29] Further, the high degree of intra-industry churn underscores the fact that cellular service providers are facing competition from within their own ranks, not to mention from other commercial mobile service providers.

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[27] See e.g., EMCI, U.S. Cellular Marketplace, 1993 at 34-35.

[28] Id. See also Robert F. Roche, "Competition and the Wireless Industry" ("Roche Study") at 14-15. A copy of Mr. Roche's study is attached hereto.

[29] For example, unlike "800" service, number portability is not an issue because most cellular customers do not publicize their cellular number, and therefore have no investment or interest in it.

Drs. Besen, Larner, and Murdoch attribute the competitive performance of the cellular industry to the rapid rate of technological development, explaining that such a phenomenon "imparts a high degree of variability to the services offered and the prices of those services."[30] They concluded that the dynamism of the cellular industry prevents competitors from entering into collusive arrangements that would inflate prices and harm the public interest.[31] Additionally, the panelists that participated in the Commission's recent panel discussions on consumer demand for personal communications systems ("PCS") agreed that the rapid growth and competition that marks the cellular industry is expected to spread across the entire mobile telecommunications marketplace.[32] The introduction of unnecessary state regulations to an already competitive market will only serve to dampen existing levels of competition and thereby harm the public interest.

B. Cellular services providers do not occupy the entirety of the CMRS marketplace, leaving an untapped demand to be filled by other CMRS providers.

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[30] Drs. Besen, Larner, and Murdoch, "The Cellular Service Industry: Performance and Competition" at 7.

[31] Id.

[32] See Roche Study at 18-21. See also *FCC En Banc Meeting*, April 11, 1994, (testimony of Elliott Hamilton, Vice President and Director, U.S. Wireless Consulting, transcript at

While cellular is growing at an annual rate of more than forty percent, existing subscribership is small in comparison to the potential overall market for the broad range of available CMRS services.[33] The total number of domestic cellular subscribers is 19.3 million, or only about 8 percent of the U.S. population.[34] If the pool of addressable mobile consumers is used, the total number of current subscribers to cellular services represents only 16.7 percent of the potential market. This leaves over 83 percent of the population either served by other CMRS providers or untapped and ripe for mobile services to be provided by a diverse range of competitors.

C. Other CMRS providers are competing with cellular service providers.

In promulgating rules to implement § 332, the Commission stated that it would consider as "pertinent to determine market conditions and the need for consumer protection" such factors as the substitutability of services offered by CMRS providers, opportunities for new entrants to the commercial mobile services marketplace, and the existence of barriers to such entry, among

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46-49; testimony of Mark Lowenstein, Director, Wireless Mobile Communications, Yankee Group, transcript at 35-40).

[33] See Roche Study at 24-25.

[34] "Mid-year Results Show Wireless Customers Near 20 Million Mark; Monthly Bill Drops," CTIA News Release (September 6, 1994.

others.[35] Economists have analyzed these factors and have found evidence that strongly supports the presumption against state regulation of commercial mobile services.

The unclaimed portion of the CMRS marketplace is vast and competition by non-cellular CMRS providers for subscribers already exists. Competition will only increase with the further development of additional mobile services. Existing CMRS providers currently offer a wide range of mobile services to compete with cellular, including advanced and wide area paging, specialized mobile radio ("SMR"), enhanced specialized mobile radio ("ESMR"), PCS, wireless cable, traditional radio services, mobile satellite, basic exchange telecommunications radio service ("BETRS"), wireless facsimile, and broadband video (28 GHz LMDS).

Current providers of mobile services, such as cellular, paging, and SMR, are the beneficiaries of technological advancements which enable them to offer increased service capabilities to their customers. Similarly, these companies as well as new entrants will soon be eligible to offer new services, such as PCS, enabling them to compete with a broader array of other CMRS providers. In addition, scale economies have reduced the cost of manufacturing mobile communications equipment and infrastructure. These factors result in lower prices for

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[35] Second Report and Order, supra note 8, at 1504-1505.

consumers, increased innovation, and decreased barriers to entry into new commercial mobile services.

In a December 1992 study, EMCI, Inc. predicted that technological development and market conditions, combined with regulatory changes, will permit the various commercial mobile services to compete against each other and, in fact, serve as cost-effective substitutes.[36] Not even two years have passed since that study, and already we are witnessing SMR providers switching from dispatch to mobile telephone service and paging companies moving from one-way to two-way messaging and voice services. In addition, digital SMR and paging systems are increasingly able to provide substitutable services by deploying new technologies and through frequency reuse.

In a second study by Drs. Besen, Larner, and Murdoch, ESMR was found to serve as a competitive alternative to cellular services and certain applications of PCS were also found to serve as potential competitive substitutes.[37] Drs. Besen, Larner, and Murdoch discussed the increase in ESMR's quality, capacity, and

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[36] EMCI, *The Changing Wireless Marketplace,* Cellular Brief at 3 (December 17, 1992).

[37] Drs. Stanley M. Besen, Robert J. Larner, and Jane Murdoch, Charles River Associates, "An Economic Analysis of Entry by Cellular Operators into Personal Communications Services," submitted as an Appendix to CTIA Comments in GN Docket 90-314, at 37-38 and generally (Nov. 1992). A copy of the above is attached hereto.

service offerings that is likely to result from the consolidation of radio frequencies, digital technology, multiplexing technology, and the use of multiple base stations.

Dr. Jerry A. Hausman, MacDonald Professor of Economics at the Massachusetts Institute of Technology, concurs in the prediction that ESMR will serve as a close substitute to cellular service and adds that the competition for the CMRS market is already vigorously underway.[38] As evidence for this conclusion, Dr. Hausman, in the 1994 Affidavit, cited recent developments in the mobile services industry. One such development is the fact that Nextel, which started operations in 1993, has already begun to provide ESMR in Los Angeles, San Francisco, and Sacramento,[39] and plans to expand its digital network to Chicago, Milwaukee, San Diego, and the New York City metropolitan area later this year.[40] Nextel recently purchased enough spectrum to provide ESMR to between seventy and 85 percent of the U.S. population.[41]

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[38] See Affidavit of Jerry A. Hausman, United States v. Western Elec. Co., Civil Action No. 82-0192, at 5-8 (June 15, 1994) ("1994 Affidavit").

[39] NEXTEL COMMUNICATIONS, INC., 1994 ANNUAL REPORT 2 (1994).

[40] 1994 Affidavit at 5.

[41] 1994 Affidavit at 5. See also, Motorola Could Strengthen Strategic Position of MIRS Technology Following Merger of Major SMR Companies 12 Mobile Phone News at 1, Aug. 15, 1994. By comparison, McCaw, the largest cellular carrier, has service areas covering only about 25 percent of the U.S. population.

In his Affidavit, Dr. Hausman demonstrates that the market for ESMR is dynamic and rapidly developing by discussing the recent efforts of other companies to construct ESMR networks to compete for subscribers in the CMRS marketplace. Dr. Hausman also describes the plans of ESMR companies to construct networks throughout the Southeastern, Rocky Mountain, and Pacific Northwest regions.[42]

PCS mobile wireless providers also promise to offer substitutable services to those currently offered by the cellular industry. At the Commission's first narrowband PCS auction in July 1994, six companies successfully bid for ten licenses to provide nationwide wireless service in direct competition with current CMRS service offerings. Additional significant competition from broadband PCS, i.e. head-to-head competition with cellular and other CMRS providers, is expected in the U.S. in the near future.[43]

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[42] 1994 Affidavit at 6.

[43] Dr. Hausman points out that PCS already exists in the United Kingdom. Two companies, including a US West partnership, currently operate competing PCS networks in the UK. Since PCS began operation in the UK in 1993, prices already have dropped by about 20-33 percent. If the PCS experience in the UK is portentous of the future state of competition in the US, cellular companies will soon be competing against ESMR, SMR, and numerous PCS companies for a share of the U.S. mobile communications services marketplace. 1994 Affidavit at 5.

The substitutability of commercial mobile services is also a consumer, or demand-side, phenomenon. From the consumers' perspective, cellular service could be supplanted by ESMR or PCS if cellular prices or service quality is deemed unsatisfactory. Consumer demand for commercial mobile services is growing. And the demand will only increase as technology develops and the competing CMRS providers continue to offer overlapping services.

To illustrate, the cellular industry currently is experiencing an inter-industry churn rate, that is, customers substituting other telecommunications services for cellular, of nearly sixteen percent.[44] Thus, notwithstanding the fact that cellular services have been growing at an annual rate of approximately forty percent, market analysts have estimated that traditional SMR services and paging have grown at an annual rate of fourteen and 22 percent, respectively.[45] Dramatic growth is also expected for the PCS and ESMR industries. Currently, over 25 million people in the U.S. use cellular, SMR, or paging services. Projections for the combined market, including PCS, range from 38 million to 68 million customers by the year 2001.

Activity within the current mobile services marketplace clearly demonstrates that market forces are such that continued

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[44] EMCI, U.S. Cellular Marketplace, 1993 at 34-35.

[45] Roche Study at 24, n.90.

state regulation of rates is not only unnecessary for consumer protection, but can actually impede competition.