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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 State Regulatory Authority over Intrastate Cellular Service Rates	)	PR File No. 94-SP3

RESPONSE BY LOS ANGELES CELLULAR TELEPHONE COMPANY ("L.A. CELLULAR") TO PETITION BY THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ("CPUC") TO RETAIN STATE REGULATORY AUTHORITY OVER INTRASTATE CELLULAR SERVICE RATES

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INTRODUCTION

The State of California through the CPUC has petitioned under Section 332(c)(3) of the Communications Act of 1934, as amended by the Omnibus Budget Reconciliation Act of 1993 ("Budget Act"), for continued regulatory authority over the rates charged by cellular carriers. The statutory standard for such a Petition is clear. California has the burden of demonstrating that (1) market conditions fail to protect cellular subscribers from unjust, unreasonable, or unreasonably discriminatory rates, or that (2) such market conditions exist and cellular service is a replacement for landline telephone service in a substantial part of the State. 47 U.S.C. §332c(3)(A)(i)(ii).

The CPUC does not even attempt to show that cellular service is a replacement for landline services. See page 68 of Decision 94-08-022 ("Decision"), attached as Appendix N to the CPUC Petition ("Petition"). Nor does California urge that cellular rates are unreasonably discriminatory, or that they might become so with deregulation. Cellular rates, which are published for all to see, show no unreasonable favoritism -- indeed, as will be seen, California's current rules are such that it is difficult even to make reasonable distinctions among user groups. See below at Section III.

California therefore rests its case on an argument that current cellular rates are unreasonably high. Indeed, the CPUC claims that California rates are "among the highest in the nation".[1] Implicitly, the argument is that such high rates are due to an improper failure of cellular carriers to compete, and/or to illegal collusion among them.

When the Petition alleges excessive rates and/or returns, it relies almost exclusively on its analysis of the Los Angeles and San Francisco markets. L.A. Cellular is the "A" Block carrier in Los Angeles, and is unusually well-placed to respond to arguments related to that market. However, to some extent, L.A. Cellular's response must be an exercise in shadow boxing. All meaningful factual support for California's argument has been redacted from the version provided to the State's cellular carriers. This includes statistics and graphs that are apparently drawn

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[1] This allegation at page 45 of Decision 94-08-022 is somewhat at variance with California's argument (at page 47) that its form of enlightened regulation has resulted in restraining rate increases by California carriers, while operators elsewhere have increased their rates by 32%.

proprietary as well as publicly available information regarding financial performance, rate changes, cell site construction, etc. Nor does California attempt by affidavit or otherwise to describe a single, specific instance of anti-competitive conduct or collusion among the carriers -- this notwithstanding the FCC's explicit requirement for such support.[2] For these and other reasons, the CPUC Petition ought to be dismissed for failure to state a prima facie case in terms that are sufficiently coherent to permit an intelligent response. See Part I below.

Handicapped as it is, L.A. Cellular has no choice but to submit this response based on its own operations, and on publicly available information relating to the operations of other California carriers. Beyond highlighting the procedural defects in California's showing, this response will show that:

- California's rates are not unreasonable. Rather, service charges and rates of return in California vary greatly, depending on a variety of easily explained market factors. They are in no way the result of the activities insinuated by the CPUC. See Part II below.
- The most significant non-market factor influencing cellular rates in California has been the CPUC itself. Here, the Petition studiously avoids addressing thwarted attempts by carriers to reduce rates. The irony in California is that regulatory constraints designed to protect the consumer

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[2] See 47 U.S.C §20.13(a) and Public Notice DA 94-764, dated July 8, 1994, paragraph vi.

have instead been used to shelter less efficient competitors. See Part III below.

- The preponderance of the evidence shows that as California's regulatory hand has lightened, rates have fallen, and that competition will best be encouraged by less rather than more state oversight. See Part IV below.
- Adoption of the relief sought by California would threaten clearly defined national policies. See Part V below.

I.

THE CALIFORNIA PETITION SHOULD BE DISMISSED FOR FAILURE TO STATE A PRIMA FACIE CASE FOR THE RELIEF SOUGHT

Under 47 U.S.C. §20.13(a)(5) and (b)(1), California clearly has the burden of proof in seeking authority to continue its regulation of cellular rates. This Commission has described this burden in strong terms:

> We have provided that states must, consistent with the statute, clear substantial hurdles if they seek to continue or initiate rate regulation of CMRS providers. Second Report and Order, GN Docket No. 93-252, 74 Rad. Reg. 841 ("CMRS Second Report") at paragraph 23.
>
> The following is a non-exhaustive list of examples of the types of evidence, information, and analysis that may be considered pertinent to determine market conditions and the need for consumer protection:

* * * *

(iii) Rate information for each commercial mobile radio service provider, including trends in each provider's rates during the most recent annual period or other data covering another reasonable period if annual data is unavailable.

* * * *

(vi) Specific allegations of fact (supported by affidavit of person with personal knowledge) regarding anti-competitive or discriminatory practices or behavior by commercial mobile radio service providers in the state.

(vii) Evidence, information, and analysis demonstrating with particularity instances of systematic unjust and unreasonable rates, or rates that are unjust or unreasonably discriminatory, imposed upon commercial mobile radio service subscribers. Such evidence should include an examination of the relationship between rates and cost. Additionally, evidence of a pattern of such rates that demonstrates the inability of the commercial radio service marketplace in the state to produce reasonable rates to competitive forces will be considered especially probitis.

(viii) Information regarding customer satisfaction or dissatisfaction with services offered by commercial mobile radio service providers, including statistics and other information about complaints filed with the state regulatory commission. CMRS Second Report at paragraph 252.

California does not provide any information regarding customer satisfaction or dissatisfaction with cellular services or rates. Nor does the Petition include any allegations of particular instances of unjust or unreasonable rates, or of unreasonable rate discrimination. Nor does California include the affidavit of any persons with actual knowledge of the various facts alleged by the Petition.[3]

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[3] The CPUC's discussion of interlocking ownership interests (at pages 27-29 of the Petition) is particularly troubling in that it may imply "the sharing of pricing information in joint marketing efforts." There are no "specific allegations of fact" much less affidavits supporting any such implication.

Instead, California's Petition is based almost exclusively on unsworn statements regarding service charges, rates of return, average customer bills, site utilization factors, and the like. Not only is such information unverified, but it has been filed on a confidential basis with the FCC. This is because California's "evidence" is largely drawn from proprietary information furnished by various parties to the CPUC and to the State Attorney General under statutes and regulations which prevent them from being made publicly available.[4]

L.A. Cellular contends that under applicable state and federal law, this Commission may not consider the redacted materials submitted to it by California. California has accordingly failed to make a prima facie case under the CMRS Second Report, and its Petition should be dismissed.

A. Under California Law, the Petition Should Not Have Been Filed Until After Public Hearings And the Development of an Evidentiary Record.

The CPUC's Decision 90-06-025 (the "First OII Decision") came to findings of fact and conclusions of law that in nearly all material respects are diametrically opposed to those of Decision 94-08-022, which is attached as Appendix N, and which forms the basis for the Petition. In the First OII Decision, the CPUC found that the cellular market was competitive, that cellular rates and rates of return were not

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[4] The CPUC's General Order 66-C and California Public Utilities Code 583 protect the confidentiality of information provided to the CPUC. Calif. Government Code §1118(1)(f) protects materials divulged to the California Attorney General.

unreasonable, and that the rates of return were not excessive. Opponents of the First OII Decision petitioned for rehearing, and were granted partial relief by Decision 90-10-047. However, the fundamental findings of the First OII Decision remained intact. Petitions by cellular resellers to the California Supreme Court were to no avail, and the findings and conclusions of the First OII Decision became final.

Under Section 1708 of the California Public Utilities Code, all interested parties were entitled to a public hearing before reversal of the First OII Decision.

> The Commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision. See California Trucking Assn. v. Public Utilities Commission, 19 Cal.3d 240, 244 (1977); City of Los Angeles v. Public Utilities Commission, 15 Cal.3d 680, 698-99 (1975).

When the CPUC in December, 1993 announced that it would re-examine the First OII Decision, many parties, including L.A. Cellular, requested public hearings under Section 1708. Their request was denied, and Decision 94-08-022 was arrived at without any of the procedures required by the Public Utilities Code for public testimony, cross-examination, and a formal record. Instead, the CPUC's "record" is the collection of secret materials now submitted by the CPUC for this Commission's consideration, despite the clear fact that there can be no reliance by the FCC on materials which are not a part of the public record.

B. Under Federal Law, This Commission May Not Rely on the Redacted Materials Submitted by the CPUC.

The CPUC's request for authority to continue to regulate CMRS rates is clearly based upon undisclosed information in violation of the Administrative Procedures Act ("APA").[5] There is a four part test for the adoption of a final rule pursuant to the APA, the agency must (1) act within the scope of its statutory authority, (2) follow the procedures required by the statute and by its own regulations; (3) explicate the bases for its decision; and (4) adduce substantial evidence in the record to support its decision.[6] Under this test, "it is not consonant with the purpose of a rulemaking proceeding to promulgate rules on the bases of inadequate data or data that, [in] critical degree is known only to the agency."[7] Here, the public has had no meaningful opportunity to comment on CPUC's request because nearly all of its supporting factual information, including statistics and graphs, have been redacted from the version that is publicly available. Under the circumstances the Commission is precluded by the APA from granting the CPUC's request.[8]

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[5] 5 U.S.C. §§ 551-7521.

[6] United Steelworkers v. Marshall, 647 F.2d 1189, 1206 (D.C. Cir. 1980).

[7] National Black Media Coalition v. FCC, 791 F.2d 1016, 1023 (2d Cir. 1986) (quoting United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240, 251 (2d Cir. 1977) (emphasis added in Nova Scotia Foods Prods.).

[8] Because this proceeding involves the "prescription for the future of rates," 5 U.S.C. 551(4), it falls under the rulemaking definition of the APA. Nevertheless, even if the Commission considers this proceeding to be adjudicatory, the same rulemaking analysis articulated above would apply to this proceeding. See Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 653-56 (1990). See

L.A. Cellular and others similarly placed are thus faced with a Hobson's choice. Having been denied its right under California law to cross-examine the resellers, Nextel and others who contributed to the CPUC's findings, L.A. Cellular must either rely on this Commission to ignore entirely the confidential materials submitted to it, and dismiss the California Petition as unfounded, or L.A. Cellular must attempt to answer the Petition on its merits. If L.A. Cellular chooses to answer, it must guess at the contents of the redacted materials, and for its own part reveal proprietary information in order to counter them.[9]

Given the stakes, L.A. Cellular has no choice but to do both. It therefore requests that this Commission decline to consider any of the materials submitted by California under seal. Without such materials, and without the affidavits required by the CMRS Second Report, the Petition cannot stand, and should be rejected.

also, K. Davis and R. Pierce, I ADMINISTRATIVE LAW TREATISE §8.2, 377-388, 381-383 (1994).

[9] The CPUC's Herfindahl analysis (at pages 29, et seq.), for example, is entirely redacted, and is based on market share information which is also under seal. However, Charles River Associates states in its Report that the CPUC combined the shares of the two FCC licensees in each market on the assumption that they are non-competitive, and thereby arrived at inflated concentration indices. See page 3 of Report of Charles River Associates [etc.] ("Charles River Report"), attached as Appendix A to the Response of the Cellular Carriers Association of California, filed herein.

One can only imagine how many other allegations by the CPUC would be found to be similarly flawed if subjected to similar scrutiny. For example, the CPUC's entire analysis of rates, rate changes, operating expenses, and cellular investments are all based on appendices which have not been made available to L.A. Cellular or others similarly placed. Indeed, the redacted Petition in many parts verges on the incoherent. See, for example, pages 52-53 regarding cell site utilization.

the CMRS Second Report, the Petition cannot stand, and should be rejected. Alternatively, the Commission should find that even if the CPUC's Petition is accepted in its entirety, the countervailing evidence set forth below warrants denial of the relief sought.

II.

NEITHER THE RATES CHARGED NOR THE RETURNS EARNED BY CALIFORNIA CELLULAR CARRIERS ARE UNREASONABLE

The most significant single flaw in the CPUC's analysis is its near total reliance on what it calls the "basic" rate for cellular service in the Los Angeles market. This rate, established by the Commission itself in a 1984 decision for the L.A. SMSA Limited Partnership[10], was adopted by L.A. Cellular as a reseller shortly thereafter. Making much of the fact that neither carrier has changed this rate since, the CPUC would have the FCC believe that California cellular rates are immutable, that they are "stuck" at an unreasonably high level, and that they will not change absent regulatory coercion.

What the CPUC fails to tell the FCC is that the so-called "basic" rate cited by it is in no way typical for Los Angeles, and that Los Angles is not typical of California. Fewer than one in five of L.A. Cellular's new customers chooses the so-called "basic" plan. More than 80% of the Company's customer base is now on alternative, lower

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[10] See D. 84-04-014. The L.A. Cellular SMSA Limited Partnership was later known as PacTel Cellular, and is now known as AirTouch Cellular.

cost plans, with the "basic" plan being used primarily by short-term subscribers with peak-hour calling patterns. The result of this migration is that the Company's rates have fallen by all relevant criteria. Whether measured in terms of actual buying power, or billings per minute, or billings per account -- the result is the same: a steady decline in cellular service charges. See Part IIA below.

Nor is Los Angeles a guide to the rest of California. On the contrary, Los Angeles is unique. No American market has the same geographic expanse, population size, commuting habits, and demographic characteristics. Elsewhere in California, cellular rates are lower -- as would be expected where demand is lower and the population less mobile. Such variations are precisely what would be expected in a properly functioning, competitive market, i.e. that in markets where demand is less, and congestion is less, cellular rates are lower. Where demand is high, and capacity is strained, rates are higher. The same is true of rates of return. If as the CPUC alleges there were no effective competition, one would expect uniformly high rates of return across the State. But in California, carriers have realized higher returns in congested markets requiring high investments to fund system expnsion. Elsewhere rates of return are lower, or are even negative. And within individual markets there are significant differences in the returns earned by facilities-based carriers. See Part IIB below.

After summarizing (in Part IID) the current status of cellular pricing in California, L.A. Cellular (in Part IIE) will address the CPUC's astonishing argument that cellular

carriers have neglected to expand their systems in order to create an artificial shortage -- and higher prices -- in the market. The fact is precisely the reverse: expansion activity is greatest where demand is greatest and prices are highest. See Part IIE below.

A. Alternative Plans Have Reduced the Rates Actually Paid In Los Angeles By Up to 34% Prior to Adjustment for Inflation.

1. The So-Called "Basic Plan".

The Los Angeles SMSA Limited Partnership was the first cellular carrier certificated in California. Before issuing a Certificate of Public Convenience and Necessity ("CPC&N"), the CPUC required extensive financial analyses, including cost and revenue projections, and rate of return calculations. After fifteen months of fiercely contested proceedings, the CPUC approved of so-called "basic" rates for PacTel Cellular. See D.84-04-014 at pp. 33 et seq. At retail, these rates included a monthly access charge of $45.00 and usage charges of 45 cents per peak minute, and 27 cents per off-peak minute. At wholesale, similar rates were prescribed, but at a level that would yield a gross margin to resellers of about 23%. Id.

L.A. Cellular, PacTel's non-wireline competitor, needed desperately to shorten the so-called wireline headstart enjoyed by PacTel. To avoid litigation delays, L.A. Cellular (at the urging of CPUC staff) conformed its initial filing to the approved, PacTel rate.

Regulatory imperatives ensured that these original rates would remain in each company's official tariffs even after initial certificates were issued by the CPUC. Until very recently, a carrier which reduced its rates on a promotional basis had no assurance that they could be raised to prior levels if necessary. Even today, the "Rate Plan Guidelines" contained in the CPUC's Decision 93-04-058 establish a mechanism whereby rates may be returned to prior levels provided that such ceiling levels are explicitly set forth in the carrier's tariffs. See Decision 93-04-058. For these reasons alone, there has continued to be an incentive for carriers to retain their original "basic" rate structures in published tariffs, even though actual, effective rates are considerably different.[11]

With some exceptions, therefore, price competition in California has not taken the form of permanent, across-the-board reductions in the "standard" or "basic" rates approved by the CPUC. Instead, it has taken the form of promotional discounts, and alternative rate plans. Nearly all cellular customers claim the benefits of one or the

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[11] The CPUC also notes that even where rates have fallen there is often little difference as between the scheduled charges of facilities-based carriers in the same market. Charles River Associates have noted in their Report at page 23 that there is in fact far more intra-market variation than the CPUC admits. And where rate similarity exists, it is entirely explainable. As between fully built systems in the same market, cellular service quality may not differ greatly. Most economists agree that where similar products or services are available from multiple sources, natural market forces will cause rates to be similar if not identical. (Charles River Report, pages 21-23) This is especially foreseeable where rates are formally published in tariffs, from which customer-specific deviations are difficult if not impossible. The CPUC itself recognized this fact in Decision 90-06-025 at page 49 (mimeo). ("In a fully competitive market, the prices of individual firms track closely and may even be identical").

other, or both, and as a result pay significantly less for cellular service than the CPUC would imply.

2. Price Competition Through Short Term Promotions.

The CPUC's initial tariff procedure made it extraordinarily difficult to reduce rates without losing the marketing advantages that would ordinarily motivate competitors. From 1983 to 1990, no cellular rate or service condition could be modified by a facilities-based carrier except by an advice letter filed 40 days in advance of the proposed change. D. 88-05-067. Not only customers, but also competitors had standing during this period to protest the change, and in many instances pro-consumer advice letters were withdrawn or delayed as a result of protests by resellers, competing carriers, and CPUC staff itself. Put simply, the tariff mechanism required that competitors give advance notice to each other of marketing strategies, and furnished commercial rivals with an almost irresistible opportunity to block or delay pro-consumer initiatives.[12]

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[12] L.A. Cellular for its part has never opposed any of the hundreds of advice letters filed by competing cellular carriers in Los Angeles. However, many L.A. Cellular filings have been withdrawn, delayed, or blocked at the insistence of competitors and CPUC staff. To the best of L.A. Cellular's knowledge, no consumer objection to any L.A. Cellular tariff proposal has ever been filed with the CPUC.

Cellular carriers are not the only utilities confronted by this perversion of the regulatory process. In its recent Proposed Decision in a proceeding (I.87-11-033) involving intra-LATA telecommunications competition, the CPUC has declared that while customer-specific contracts must continue to be filed as tariff deviations, only

Notwithstanding these procedural blocks, carriers in the years prior to 1990 filed advice letters waiving activation fees, granting up-front credits, and similar promotional benefits. When in 1990 the Commission partially simplified its procedures by the First OII Decision, an increased number of filings forgave or reduced charges to defined groups of customers on a promotional basis. The First OII Decision (D.90-06-025) allowed certain promotional rate discounts and credits to be filed on a same-day basis. When the CPUC abolished other restrictions in 1993 (Decision 93-04-058), these filings became a flood. D. 93-04-058 allowed rates to be reduced on a provisional basis rom tariffed ceilings, with no penalty attached if they were later returned to ceiling levels. In addition to activation fee waivers and airtime credits, carriers reduced rates for mobile-to-mobile calls, provided "free" off-peak calling, and have dramatically reduced roamer charges. Though the CPUC Petition does not even acknowledge the existence of such promotional offerings, they are indistinguishable in their actual effect from rate reductions. For example, L.A. Cellular estimates that during the past five years it has extended more than $11,500,000 in various promotional credits to its customers.

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bona fide third party customers will have standing to object on the ground that such contracts are discriminatory. Competitors, which have hitherto been able to block approval of their rivals' contracts, will only be able to do so in the future if they show direct harm to themselves, e.g., by predatory pricing.

3. Price Competition Through Alternative Rate Plans.

The CPUC acknowledges the existence of alternative rate plans, but dismisses them cavalierly as involving hidden costs in the form of early termination charges. Petition at page 43. One preliminary remark is obvious. The fact is that over 80% of L.A. Cellular's customers, with full knowledge of these "hidden costs" have chosen alternatives to "basic" rates.[13] While the CPUC may feel that the benefits of such alternatives are illusory, L.A. Cellular submits that cellular customers are better judges of their own interests.

Indeed many of the alternative plans to which customers have migrated involve no extended term commitments or termination penalties. For example:

- The Company's "Nite Owl" and "Security" Plans are available on a month-by-month basis to customers having only an occasional need for cellular service.
- The Company's programs for corporations, associations, and other affinity groups include month-to-month alternatives with discounts of up to 17% off the basic rate.

Other plans do involve extended term commitments.[14] These serve legitimate

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[13] AirTouch, which is L.A. Cellular's facilities-based competitor, has reported to the CPUC that 80% of its customers are on discount plans. The Charles River Report (at page 13) indicates statewide averages of 69% in larger markets and 77% in medium markets.

[14] Such commitments are modest. L.A. Cellular's existing customer contracts provide for a twelve-month term. By virtue of D. 94-08-022, early termination charges have been pro-rated so that, for example, a nominal $150 charge

business purposes. One of these is to meet the challenge posed by new entrants like Nextel. While the CPUC may feel otherwise, L.A. Cellular cannot understand how a price reduction in anticipation of added competition from others can be construed as anti-competitive. The exact reverse would appear to be the case.[15]

In truth, extended term discounts made their appearance in California long before the advent of Nextel, and reflect other motivations as well. The CPUC Petition at page 49 estimates a marketing cost of $300 for each new retail customer. If operating profits per month for the average customer approximate $25, twelve months of continuous billings are necessary for the carrier to recover these up-front costs. To secure such longevity, and to combat high churn rates, carriers like L.A. Cellular offer deeper discounts to customers willing to commit themselves to service for at least twelve months. In short, extended term discounts are a legitimate and praiseworthy response to a competitive market, and are solid evidence against the point urged by the CPUC.

Finally, there are so-called "bucket plans", pursuant to which a customer may choose to pay a fixed monthly amount for both access and a pre-set level of usage. These plans too entail substantial price reductions. While the CPUC claims that the

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would be reduced by one-twelfth, i.e., $12.50 for each month the unit has been on service prior to termination.

[15] See this Commission's Second Report and Order in GN Docket No. 93-252, 9 FCC Rcd 1411, 1478 ("CMRS Second Report") ("Competition, along with the impending advent of additional competitors, leads to reasonable rates") (emphasis added).