

## PUBLIC UTILITIES COMMISSION

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March 21, 1995

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MAR 22 1995

William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W. Room 222  
Washington, D.C. 20554

FCC MAIL ROOM

Re: PR Docket No. 94-105; Ex Parte Presentation

Dear Mr. Caton:

Attached on behalf of the California Public Utilities Commission is a further analysis of the standard of review. This material was provided to Michael Wack and Stan Wiggins of the Wireless Bureau.

In accordance with Section 1.1206(a)(1) of the FCC's Rules, two copies of this notice are being submitted to your office.

Sincerely,

Ellen S. Levine  
Counsel for California

ESL:dp

Enclosures

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List A B C D E

**CALIFORNIA'S ANALYSIS OF STANDARD OF REVIEW  
UNDER THE COMMUNICATIONS ACT, AS AMENDED**

**PR Docket No. 94-105  
March 21, 1995**

THE CPUC HAS MET THE LEGAL STANDARD UNDER THE COMMUNICATIONS  
ACT, AS AMENDED, AND HENCE ITS PETITION MUST BE GRANTED  
March 21, 1995

The California Public Utilities Commission ("CPUC") has satisfied the statutory standard set forth in 47 U.S.C. {332(c)(3), as amended by the Omnibus Budget Reconciliation Act of 1993 ("Budget Act"). As set forth in Attachment A hereto, the CPUC has presented substantial evidence in this record that intrastate cellular service markets in California are not yet adequately competitive to protect subscribers from unjust and unreasonable rates for cellular service.[1] To inject needed competition into these markets, the CPUC has ordered the unbundling of cellular service rates in order to enable switch-based resellers to interconnect with and provide alternative cellular service to the incumbent duopoly cellular providers. Effective competition from switch-based resellers, and eventually, from personal communications services and enhanced specialized mobile radio service which today offer no stand-alone cellular-like service to a single subscriber in California, will obviate the need for continued state regulatory oversight of cellular service rates.[2] However, today there simply is no effective competition between the duopoly cellular carriers in cellular service markets within California.

Accordingly, by its petition, the CPUC has sought authority to continue overseeing the rates for intrastate cellular services for a limited period of 18 months, commencing September 1, 1994, during which time the CPUC will implement its program to allow switch-based resellers to compete with the incumbent cellular

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1 The cellular carriers either ignore this evidence, attempt to rebut it with seriously flawed studies which rely on undisclosed, confidential data, or respond with irrelevant arguments. For example, their claim that certain cellular prices have fallen says nothing at all about whether the prices are just and reasonable. If Coke and Pepsi are the only two providers of cola in a market with high entry barriers, the fact that Coke and/or Pepsi may drop their cola prices from \$25 per bottle to \$15 per bottle does not make these prices reasonable.

2 Nextel does not currently provide stand-alone cellular-like service to a single customer in California. Nextel, however, does provide enhanced specialized mobile services in California.

Moreover, the future entry of Nextel into cellular service markets has not currently had any downward impact on the value of cellular licenses, which at about \$200 per POP reflect the present ability of cellular licensees to extract duopoly rents. The CPUC would not expect the future entry of PCS to currently affect cellular license values and prices either.

providers.[3] The program is consistent with Congress' intent in Section 332(c) that there be "an adequate opportunity ... for increased competition and subscriber choice." [4] Granting the CPUC petition will generate competition where none currently exists, compel the incumbent duopoly carriers to charge just and reasonable rates for their services, and afford consumers for the first time a meaningful choice in obtaining cellular service in California. [5]

#### I. The CPUC Petition Meets The Standard Set Forth In The Budget Act

Under Section 332(c)(3)(B), the CPUC has timely petitioned to continue "exercising authority over [cellular service] rates." Section 332(c)(3)(B) directs the FCC to review the petition to determine whether the state has demonstrated that "(i) market conditions with respect to [intrastate cellular services] fail to protect subscribers adequately from unjust and unreasonable rates..." Where a state, like California, has made such demonstration, the FCC "shall authorize the State to exercise under State law such authority over rates, for such period of time, as the [FCC] deems necessary to ensure that such rates are just and reasonable..." After such period of time has elapsed, "any interested party may then petition the FCC "for an order that the exercise of authority by a State pursuant to subparagraph [(c)(3)(B)] is no longer necessary to ensure that the rates for [cellular service] are just and reasonable."

As set forth in its petition, reply to oppositions to petition, and its reply to supplemental comments in opposition to petition, the CPUC has presented substantial evidence demonstrating that California cellular markets are not yet effectively competitive to protect subscribers adequately from unjust and unreasonable rates. [6] The CPUC has met the

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3 The CPUC is actively implementing this program today, despite the stubborn resistance of the duopoly carriers to any form of competition.

4 House Report at 261. Among other things, Congress also intended for the FCC to consider the number of market entrants providing wireless service. Id. Today, in California markets, there are only two providers of stand-alone cellular service within each MSA and RSA, who in many cases are affiliated with each other. There is currently no independent third-party provider in any of these markets which provides stand-alone cellular-like service.

5 Cellular service has become an essential service to many businesses, and can no longer be regarded as "discretionary."

6 See in general Reply By California to Oppositions to CPUC Petition at 97-107.

statutory standard. The FCC must then determine "the period of time ... [the FCC] deems necessary" for continued state authority in order to ensure that rates are just and reasonable.[7]

There is no requirement, once the state has demonstrated the failure of market conditions to ensure just and reasonable rates, that the state demonstrate the efficacy of its regulations in order to continue its regulatory oversight. To the contrary, in allowing the state to petition to "continue exercising authority over ... rates," Congress understood that, in circumstances of intrastate market failure, the state is in the best position to continue to protect its citizens from unjust and unreasonable rates.

In any event, the CPUC has in place a regulatory framework governing cellular services which affords the incumbent carriers wide flexibility to adjust rates in accordance with market-based principles. In particular, cellular carriers may lower rates to any level they choose on same-day notice, and may raise rates on same-day notice to a market-based cap established by the cellular carriers themselves.[8] At the same time, the CPUC is actively encouraging additional competition and meaningful consumer choice for cellular services from switch-based resellers by ordering the unbundling of rate elements for services which can be provided competitively.[9] The injection of needed competition by

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7 In recognizing the role played by state commissions, Congress understood that interstate and intrastate markets for wireless services may differ. Accordingly, the FCC's conclusions with respect to interstate cellular markets do not necessarily apply to particular intrastate cellular markets. Indeed, were the contrary true, then it would have been superfluous for Congress to provide that states may petition the FCC to retain their authority in intrastate markets.

In addition, Congress did not intend that all providers of wireless services be treated the same. To the contrary, Congress expressly recognized that dominant and non-dominant providers of commercial mobile radio services could be treated differently. House Report at 260-61 (permitting permissive detariffing of non-dominant carriers).

8 The CPUC's regulatory framework has evolved over time, and currently affords the carriers' substantial rate flexibility. Nevertheless, the duopoly carriers have refused to lower their rates to just and reasonable levels, and hence the CPUC has adopted measures to spur competition from a third party provider.

9 The unbundled rate elements are for interconnection with the landline carrier and for blocks of NXX numbers. Both elements are currently bundled with airtime charges set by the duopoly

(Footnote continues on next page)

switch-based resellers in cellular service markets will thereby ensure that cellular service rates will fall to just and reasonable levels in the near future. [10]

## II. The CPUC Petition Is In The Public Interest

In the end, granting the CPUC petition is fully consistent with Congressional intent, federal policy as set forth in FCC orders, and in the public interest. The CPUC petition seeks to retain its authority only to stimulate market forces in currently non-competitive cellular markets. The CPUC petition is for a limited period of time. Once effective competition for cellular services from third-party providers emerges, [11] the minimal rate regulatory oversight that the CPUC currently exercises will no longer be necessary to ensure just and reasonable cellular rates.

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(Footnote continued from previous page)

carrier. However, the underlying functions are competitively provided, and could be obtained directly from the landline carrier and directly from the administrator of number blocks.

In addition, the CPUC has left it to the reseller and cellular carrier to negotiate the technical terms and conditions for interconnection. The CPUC has not mandated any particular technical conditions and requirements.

10 The CPUC's unbundling program is consistent with Congress' recognition that "the right to interconnect [is] an important one which the [FCC] shall seek to promote..." House Report at 261. The program is also consistent with FCC unbundling requirements for enhanced services and both special and switch-based access services. In addition, it is consistent with the FCC's finding that "a strong resale market for cellular service fosters competition." In the Matter of Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services, CC Docket No. 94-54, NPRM at ¶138.

11 Competition for cellular services will emerge once the duopolists cease dragging their feet in implementing the CPUC unbundling program in their effort to stymie any competition.

## ATTACHMENT A

- Significant barriers to entry have kept competition from emerging. Personal Communications Services ("PCS"), a likely substitute for cellular service, will have to develop a geographically dispersed and operational network prior to offering service at competitive prices.
- Based on well-accepted statistical indices used by the Federal Communications Commission ("FCC") and the U.S. Department of Justice, the market for cellular services is and will remain highly concentrated even if Nextel were a viable competitor today. The high degree of market concentration (HHI Index of 3750) is strong evidence of market power by the incumbent duopolist cellular carriers.
- The incumbent duopolist cellular carriers are earning supracompetitive rates of return which are not commensurate with returns earned in a competitive market. The average rate of return on net investment of the incumbent carriers in the three major urban markets in California were 30.9 percent over 1989-1993. These returns compare to an average of only 13.9 percent over the same period for the telecommunications service industry as a whole.
- The extraordinarily high value for cellular licenses at \$200 per POP compared to a value of only \$14 per POP for broadband PCS licenses can only reasonably be attributed to the cellular carriers' ability to extract duopoly rents due to the current lack of effective competition. In contrast, the substantially lower value of PCS licenses demonstrate that PCS licensees anticipate a much more competitive market than cellular carriers currently enjoy.
- Q-ratio analysis, a well-accepted methodology for determining market power, indicates that the incumbent duopolist cellular carriers enjoy undue market power. In a competitive industry, the Q-ratio is close to 1. The cellular industry's Q-ratio is between 6.7 and 13.5. The additional value given cellular firms beyond the value of their assets reflects the expectation that such firms can earn duopoly rents.
- Prices for cellular services in California have not substantially declined commensurate with what would be expected in effectively competitive markets. Revenue Per Minute of Use for California's cellular carriers has fallen by just 5.6 percent in real terms between 1989 and 1993, or a mere 1.4 percent per year. Basic cellular rates have remained high despite declining costs. Evidence of parallel pricing behavior and interlocking ownership alliances between carriers further indicate that cellular markets are not engaging in price competition.