1-12-1993

Hearing on High Cellular Telephone Rates in California - How Should the State Regulate the Cellular Industry?

Senate Committee on Energy and Public Utilities

CALIFORNIA LEGISLATURE

SENATE COMMITTEE
ON
ENERGY AND PUBLIC UTILITIES

SENATOR HERSCHEL ROSENTHAL
CHAIRMAN

HEARING ON

HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA--HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY?

TUESDAY, JANUARY 12, 1993
ROOM 112, STATE CAPITOL, SACRAMENTO, CALIFORNIA

CONSULTANT
MICHAEL SHAPIRO

COMMITTEE SECRETARY
PATRICIA STEARNS

709-S

CALIFORNIA LEGISLATURE

SENATE COMMITTEE
ON
ENERGY AND PUBLIC UTILITIES

SENATOR HERSCHEL ROSENTHAL
CHAIRMAN

HEARING ON

HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA-- HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY?

TUESDAY, JANUARY 12, 1993
ROOM 112, STATE CAPITOL, SACRAMENTO, CALIFORNIA

CONSULTANT
MICHAEL SHAPIRO

COMMITTEE SECRETARY
PATRICIA STEARNS

[illegible]
STATE CAPITOL ROOM 4070
[illegible]

LYNNETTE STEVENS
[illegible]

COLLEEN BEAMISH
ADMINISTRATIVE ASSISTANT

California State Senate

HERSCHEL ROSENTHAL

22ND SENATORIAL DISTRICT

CHAIRMAN

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

COMMITTEES:
ENERGY AND PUBLIC UTILITIES CHAIRMAN
ENERGY REGULATION AND THE ENVIRONMENT CHAIRMAN
HEALTH AND HUMAN SERVICES
BUSINESS AND PROFESSIONS
ELECTIONS AND REAPPORTIONMENT
GOVERNMENTAL ORGANIZATION
INDUSTRIAL RELATIONS
NATURAL RESOURCES & WILDLIFE
REVENUE AND TAXATION
SUBCOMMITTEES:
HEALTH CARE COST MANAGEMENT
WOMEN IN THE WORKFORCE
MENTAL HEALTH DEVELOPMENTAL DISABILITIES AND GENETIC DISEASES
MEMBER
EARLY CHILDHOOD EDUCATION ADVISORY COUNCIL
CALIFORNIA MOTION PICTURE COUNCIL ADVISORY COMMITTEE
CALIFORNIA HERITAGE PRESERVATION COMMISSION

TABLE OF CONTENTS

California Legislature

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

HERSCHEL ROSENTHAL
CHAIRMAN

AGENDA

Tuesday, January 12, 1993
Room 112, State Capitol 1:30 p.m.

**HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA--
HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY?**

WITNESS LIST

John H. Anderson, Jr., Associate Director
U.S. General Accounting Office (GAO)

Honorable Daniel Wm. Fessler
President, California Public Utilities Commission

Wayne Perry, Vice Chairman, McCAW Cellular Communications, Inc.

Brian Kidney, Executive Director, External Affairs, PacTel Corp'n

Michael Heil, President, L.A. Cellular Telephone Co.

Peter A. Casciato, Esq., representing Cellular Resellers Association

Robert S. Foosaner, Senior Vice President, Govt. Affairs
Fleet Call, Inc.

Richard Severy, Director, Regulatory & Govt. Relations, MCI Corp'n

Jeffrey O'Donnell, Assistant Director, Division of Ratepayer Advocates
California Public Utilities Commission

Michael Shames, Executive Director
Utilities Consumer Action Network (UCAN)

California Legislature

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

HERSCHEL ROSENTHAL
CHAIRMAN

PAUL L. FADELLI
PRINCIPAL CONSULTANT
MICHAEL E. SHAPIRO
PRINCIPAL CONSULTANT
PATRICIA J. STEARNS
COMMITTEE SECRETARY
ROOM 2035, STATE CAPITOL
SACRAMENTO, CA 95814
TELEPHONE: 445-9764

OPENING STATEMENT OF

CHAIRMAN HERSCHEL ROSENTHAL

INFORMATIONAL HEARING ON HIGH CELLULAR TELEPHONE RATES:
HOW SHOULD CALIFORNIA REGULATE THE CELLULAR TELEPHONE INDUSTRY
JANUARY 12, 1993
STATE CAPITOL, SACRAMENTO

GOOD AFTERNOON. I WANT TO WELCOME EVERYONE HERE TODAY TO THE FIRST HEARING OF THE SENATE ENERGY & PUBLIC UTILITIES COMMITTEE IN THE NEW LEGISLATIVE SESSION.

TODAY WE ARE HOLDING A HEARING ON HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA. AND WE ARE ASKING THE QUESTION--HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY TO HELP LOWER RATES?

MY GOALS AS COMMITTEE CHAIRMAN HAVE BEEN TO PROTECT CONSUMER INTERESTS AND PROMOTE FAIR COMPETITION. AT THE MOMENT, I DON'T THINK EITHER OF THESE GOALS IS BEING REALIZED IN CALIFORNIA WITH RESPECT TO THE CELLULAR TELEPHONE INDUSTRY.

CALIFORNIA HAS MORE CELLULAR TELEPHONE CUSTOMERS THAN ANY OTHER STATE IN THE NATION--WITH MOST OF THOSE CUSTOMERS IN SOUTHERN CALIFORNIA, THE AREA I REPRESENT. YET DESPITE THIS HUGE DEMAND, OUR RATES ARE AMONG THE HIGHEST IN THE COUNTRY. AND ALTHOUGH CELLULAR TELEPHONE SERVICE STARTED IN CALIFORNIA IN 1984, BASIC RATES TO CUSTOMERS HAVE NOT COME DOWN SINCE THIS SERVICE BEGAN.

WE COME HERE TODAY TO ASK WHY RATES ARE STILL SO HIGH, AND WHY THERE IS SO LITTLE DIFFERENCE IN THE RATES AND SERVICES OFFERED BY THE COMPETING CELLULAR COMPANIES. I THINK THE ANSWER IS LACK OF EFFECTIVE COMPETITION.

WE ARE ALSO HERE TODAY TO HEAR WHAT THE CALIFORNIA PUBLIC UTILITIES COMMISSION HAS DONE, OR WILL DO, TO WRESTLE WITH THE ISSUE OF CELLULAR TELEPHONE REGULATION. IN PARTICULAR, I WANT TO HEAR THE COMMISSION'S RECOMMENDATIONS ON WHAT CAN AND SHOULD BE DONE TO LOWER RATES.

IN ADDITION, I WANT TO KNOW WHETHER IT IS TIME FOR NEW STATE LEGISLATION, EITHER TO FURTHER REGULATE OR DEREGULATE THE CELLULAR TELEPHONE INDUSTRY TO PROMOTE COMPETITION AND LOWER RATES. AT THIS MOMENT, I AM LEANING AGAINST DEREGULATION.

AS AN ALTERNATIVE TO NEW LEGISLATION THIS YEAR, SHOULD THE LEGISLATURE DURING THIS TIME OF DYNAMIC TECHNOLOGICAL CHANGE AND MARKET RESTRUCTURING STEP BACK AND AWAIT FURTHER DEVELOPMENTS BEFORE TAKING ACTION?

FINALLY, WE MAY BE BARKING UP THE WRONG TREE ENTIRELY IN THINKING THAT STATE ACTION IS THE ANSWER. WE MAY BE TRYING TO CHANGE SOMETHING IN CALIFORNIA WHICH CAN ONLY BE PROPERLY RE-SHAPED IN WASHINGTON, D.C. THE ANSWER TO OUR CONCERNS MAY BE TO SEND A STRONG MESSAGE TO CONGRESS, THE NEW PRESIDENT, AND THE FCC THAT THE FEDERALLY MANDATED "DUOPOLY" CELLULAR TELEPHONE SYSTEM ISN'T PROVIDING THE COMPETITIVE ENVIRONMENT THE WIRELESS COMMUNICATIONS MARKETPLACE REALLY NEEDS.

TODAY WE STAND AT A CROSS-ROADS. THE DIRECTION WE GO WITH CELLULAR TELEPHONE SERVICE IN CALIFORNIA WILL BE DETERMINED BY A COMBINATION OF FEDERAL GOVERNMENT AND PUC DECISIONS, NEW TECHNOLOGIES, NEW COMPETITORS, CONSUMER ACTION AND POSSIBLY STATE LEGISLATION. THE ROAD THAT I PREFER TO TRAVEL IS THE ONE THAT LEADS TO AGGRESSIVE COMPETITION AND LOWER CUSTOMER RATES.

WE HAVE WITH US TODAY A PRESTIGIOUS GROUP OF WITNESSES TO HELP LEAD US ALONG THE RIGHT PATH. THEY INCLUDE THE U.S. GENERAL ACCOUNTING OFFICE, THE PUBLIC UTILITIES COMMISSION, THE CELLULAR INDUSTRY, INDUSTRY COMPETITORS AND CONSUMER GROUPS. I REGRET THAT THE FEDERAL COMMUNICATIONS COMMISSION - THE FCC - DECLINED TO ATTEND. HOWEVER THE FCC INDICATED IT WOULD BE SENDING THE COMMITTEE WRITTEN TESTIMONY FOR THE RECORD.

I LOOK FORWARD TO THE WITNESS TESTIMONY, AND I WOULD ASK THE WITNESSES TO LIMIT THEIR REMARKS TO ABOUT 15 MINUTES, SO WE HAVE TIME FOR ALL THE WITNESSES TO SPEAK AND FOR QUESTIONS.

LET'S BEGIN THEN WITH GAO, THE INVESTIGATIVE ARM OF THE U.S. CONGRESS, WHICH RECENTLY STUDIED THE STATUS OF COMPETITION IN THE CELLULAR TELEPHONE INDUSTRY. WELCOME TO CALIFORNIA.

* * * * * * *

NEWTON R. RUSSELL
VICE CHAIRMAN
ALFRED E. ALQUIST
LEROY GREENE
GARY HART
PATRICK JOHNSTON
LUCY KILLEA
HENRY MELLO
REBECCA Q. MORGAN

California Legislature

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

HERSCHEL ROSENTHAL
CHAIRMAN

PAUL L. FADELLI
PRINCIPAL CONSULTANT
MICHAEL E. SHAPIRO
PRINCIPAL CONSULTANT
PATRICIA J. STEARNS
COMMITTEE SECRETARY
ROOM 2035, STATE CAPITOL
SACRAMENTO, CA 95814
TELEPHONE: 445-9764

TO: **MEMBERS, SENATE ENERGY & PUBLIC UTILITIES COMMITTEE**

FROM: **COMMITTEE STAFF**

SUBJECT: **JANUARY 12, 1993, COMMITTEE HEARING ON:**

**HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA--
HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY?**

California has more cellular telephone customers than any other state in the nation. Yet even with this large volume of users, our cellular rates remain one of the highest in the country. Cellular telephone service commenced in California in 1984--yet basic rates have not come down since this service began.

This committee hearing will explore issues involving the **persistence of high level rates for cellular telephone service** in California. The hearing will focus on the manner in which federal and state regulators, the cellular telephone industry, cellular industry competitors, and consumer groups are seeking to promote competition and thereby lower cellular telephone rates.

The questions to be raised at the hearing are:

- Why have cellular telephone rates in California not fallen?

- Is there a lack of adequate competition?

- What should be done to lower rates?

With the goal of promoting competition and lowering cellular telephone rates, the California Public Utilities Commission (PUC) recently issued a decision revising cellular telephone industry regulation. Consumer groups and cellular industry competitors known as resellers support the PUC decision. They argue that it is pro-competitive and will lead to lower rates. Cellular telephone companies oppose the decision arguing that further deregulation rather than more rigorous regulation will best stimlulate competition.

INTRODUCTION TO THE PROBLEM

Over the last few years, there have been growing complaints both nationally and in California about **insufficient competition** in the cellular telephone industry. Lack of full competition allows cellular companies to maintain **high rates**. These high rates discourage many customers from using the service, and force existing customers (mainly businesses) to pay more than may be necessary for this mobile communication service. According to the January 1993 edition of CONSUMER REPORTS, consumers who use cellular telephones cited usage fees as the biggest drawback.

Cellular telephone service is one of the fastest growing industries in the country. In 1984, there were less than 100,000 cellular telephone users. By 1993, there were about 10 million. The industry's revenue stream has increased along with customer growth--from $482 million in 1985 to over $5.7 billion in 1991.

California, the state with the largest cellular service market in the country, has over one million cellular subscribers, with an estimated 800,000 in Southern California. Customers pay a monthly service charge plus they are charged for the minutes of airtime used. **The cost of basic cellular service--combined monthly and per call charges--has remained unchanged in California since 1984**. In contrast, the cost of basic cellular telephone handsets, available from numerous manufacturers, has dropped by 90% in nine years.

High rates keep cellular service essentially a business tool for those who can afford it, rather than a broad-based utility service available to numerous customers at reasonable rates. The typical cellular telephone user in California is male, 39-55 years old, owns or manages a small business or works in sales, and earns $45,000-$80,000 per year. Only a small percentage of cellular subscribers are nonbusiness users.

It is estimated that national demand for cellular telephone service will continue to increase at a fast pace, with a three-fold growth to over 28 million customers by 1998. Customer demand for cellular service is expected to shift from primarily business customers to both business and residential. A recent CONSUMER REPORTS survey found that business use was only the second-most-popular reason for owning a celluar phone; a higher priority use was to have the mobile phone available for emergencies. And many consumers purchased cellular phones to keep in touch with family members.

New cellular technology such as **digitalization** will be used to accommodate this growing demand. First generation digital systems offer a 3-4 fold gain in customer capacity, with future generation digital systems promising 10-20 times current carrying capacity. The L.A. Cellular Telephone Company is presently undertaking digital conversion of its system to meet new demand.

Will future cellular telephone services, particularly those demanded by nonbusiness customers, be more affordable than today's service? The answer to that question will depend in part on how the cellular industry is regulated.

FEDERAL COMMUNICATIONS COMMISSION (FCC)

The FCC regulates the allocation and use of radio waves, including that used by cellular telephones, and licenses cellular telephone carriers to use specific radio wave frequencies. In 1981, the FCC authorized **two carriers** in each geographic market area to build facilities and offer cellular telephone service. California has 30 service areas. Under this **duopoly** system, one license was reserved for the local telephone company (**wireline** licensee) and the other license was reserved for applicants not affiliated with any local telephone company (**nonwireline** licensee). When this all began over a decade ago, the FCC believed that two carriers in each market would be sufficient to provide competition.

These duopoly "facilities-based" carriers provide **wholesale** cellular telephone services. **Retail sales** to customers are made in several ways including the use by cellular carriers of their own sales force, the use of agents, or reliance on resellers.

Resellers buy blocks of cellular telephone numbers from cellular carriers at bulk wholesale rates. They then sell cellular services at retail rates and establish themselves as the customers' cellular telephone company. Resellers **compete** with the carriers' sales force and agents to sign up new retail customers.

U.S. GENERAL ACCOUNTING OFFICE (GAO) REPORT

At the request of Congress, in July 1992, the GAO (Congress' investigative arm) issued a report entitled: CONCERNS ABOUT COMPETITION IN THE CELLULAR TELEPHONE SERVICE INDUSTRY. The GAO found that:

- the duopoly cellular market structure established by the FCC does not appear to have resulted in competitive prices for consumers;
- restricted market entry and lack of adequate substitutes for cellular service increase the likelihood of prices above competitive rates;
- the existence of resellers, whose costs are controlled by the wholesale cellular carriers, will not lead to lower retail prices under the current regulatory system;
- neither the FCC nor states are investigating cellular industry costs and profits, which may be necessary to determine whether competition exists; and
- if new mobile communication technologies operated by companies independent of cellular carriers do not emerge quickly to compete with existing cellular systems, the FCC and states should take further action to ensure competition in the cellular industry.

In developing its report, the GAO studied 30 major cellular markets in the country, including Los Angeles, San Francisco, San Jose and San Diego. **GAO found that the duopoly market structure imposed by the FCC was restricting full competition, which in turn was likely leading to excessively high rates.** In particular, the GAO found that in most of the nation's largest markets, the prices charged by the two cellular carriers were almost identical.

The GAO also observed that the FCC's approval of wireline and nonwireline carriers forming **partnerships** worked against the maintenance of competition in the cellular industry. For example, in the San Francisco Bay area:

PacTel Cellular + McCaw are partnered
in competition with GTE/Contel

While in the Los Angeles area:

PacTel Cellular + GTE/Contel are partnered
in competition with McCaw + L.A. Cellular

Thus, PacTel Cellular, McCaw and GTE/Contel find that **competitors in one market are their partners in another**. These arrangements raise questions about the adequacy of competition in the industry.

The GAO was also critical of the FCC's reliance on the entry of new, advanced communication technologies to stimulate competition. GAO pointed out that **progress may be delayed in getting new technologies into the marketplace** because of controversies over the source of radio spectrum and methods of licensing these new providers. GAO also expressed concern about allowing existing cellular carriers to obtain licenses for the new technologies, arguing that this could inhibit competition.

REGULATION BY THE CALIFORNIA PUBLIC UTILITIES COMMISSION (PUC)

States, such as California, have the legal authority, consistent with federal law, to regulate cellular telephone service. In 1984, the California PUC commenced its regulation of the cellular telephone industry by essentially allowing retail **rates to be based on what the market could bear**.

The PUC provided the cellular carriers this rate flexibility to accommodate an "infant" industry's need to attract capital necessary for major investments. However, the PUC made clear that its future forbearance from more rigorous regulation was predicated on the basis that the emerging services would be **priced competitively**.

Until 1992, the commission's approval of flexible cellular telephone rates was left largely untouched. However, after numerous commission proceedings, workshops and investigations over the last few years, the PUC concluded that further regulatory action was needed to enhance competition and lower rates. In particular, the commission found that **increased competition between cellular carriers and resellers** would be the best means for achieving reasonable rates as cellular telephone technology and markets continued to change.

Consequently, in October of 1992, the commission issued a decision which sought to promote competition by regulating the costs that cellular phone companies can charge resellers. The **PUC decision:**

- required cellular carriers to **allocate costs fairly between wholesale and retail services;**

- required cellular carriers to **unbundle wholesale tariffs**-- in other words charge separately for each wholesale service;

- authorized **resellers** to petition the PUC to establish their own **switching facilities**--(a wholesale cellular computer service that links wireless cellular phone calls to the telephone wire network)--which allows resellers to partially compete with cellular carriers at the wholesale level;

- maintained a current ban against cellular carriers competing in the same service area against the carrier's reseller **affiliate,** in order to avoid unfair competition.

SUPPORT FOR THE DECISION

The **resellers** and **consumer groups,** as well as the **MCI** long-distance telephone company, **support** the PUC decision arguing that it is pro-competitive. Some supporters have speculated that the commission's **decision could lower retail rates by as much as 30%.**

The resellers have argued that the current **wholesale rates** charged by the cellular carriers are too high, creating excess profits for the carriers and leaving resellers incapable of setting lower retail rates. Resellers support the PUC decision because it segregates and adjusts wholesale rates at a more competitive level. The resellers also maintain that under the PUC decision, they will be able to begin operating their own **switches** within a year, which will allow them to offer significantly lower rates.

Supportors of the PUC decision maintain that these regulatory changes will put pressure on the two FCC-licensed cellular carriers in each service area to reduce their retail rates to meet the competition generated by resellers. This appears to be the goal of the PUC decision.

OPPOSITION TO THE DECISION

Cellular telephone carriers strongly oppose the PUC's recent decision. In general, the industry believes that rate regulation will seriously hinder the entrepreneurial spirit of cellular competitors. They argue that **minimal regulation**--and possibly total **deregulation**--would better stimulate competition and lead to lower rates. In support of its position, the industry points to other states' willingness to deregulate or minimize regulation of cellular carriers. Some representatives in the industry have indicated it may be time for California to consider **legislation** regarding the regulation of the cellular industry.

In reaction to the PUC's recent decision, the industry points out that **lower rates will reduce profits, which in turn will reduce industry incentive to invest in system improvements.** The industry maintains that they need a light-handed regulatory environment that will continue to attract the capital investments and technological innovation necessary to meet customer needs and capacity growth.

Cellular carriers also argue that rates in some cases have gone down for customers taking advantage of "discount" plans. They maintain, however, that **lower prices across-the-board will greatly stimulate demand, which will overload system capacity and degrade service.** They point out that the maintenance of high rates will discourage excessive demand and provide profits necessary for growth.

The industry has urged the PUC to grant a **rehearing** of the decision, arguing that it violates both federal and state law. The PUC has issued an order **staying** (postponing) the decision until such time as it completes its consideration of the applications for rehearing.

EMERGING TECHNOLOGY

As communication technology advances and new products provide a service similar to cellular telephone service, more competition with cellular carriers will likely be introduced. Effective competition could thrive particularly if "new" entrants (non-cellular carriers) provide these new services.

For example, **Fleet Call** has been given FCC permission to operate a cellular-like mobile phone system in six large metropolitan areas, including the Los Angeles and San Francisco regions. Fleet Call believes it may be able to position itself as the third major provider of mobile telephone services in direct competition with cellular carriers. However, it also acknowledges that due to the substantial financial resources available to cellular carriers, the existing duopolists may subsidize the sale of cellular telephone service at prices below those which Fleet Call can compete. **Personal communication networks (PCN)** offer another example of potential competition. PCN are cellular-type portable phone services which may become a suitable alternative to mobile cellular telephone systems. The FCC may license PCN service as early as 1994.

The cellular industry argues that the imminent arrival of Fleet Call and PCN will adequately promote competition, and justifies light-handed PUC regulation. In contrast the GAO urges regulatory caution for two reasons: (1) the potential for FCC delay in licensing new technologies, and (2) the possibility that existing cellular carriers may secure the FCC licenses for these new communication services thereby inhibiting competition.

Later this year, the PUC will examine these new communication products and technologies as part of a broad **investigation of mobile** telephone services and wireless communications. The cellular industry has urged the PUC to consolidate a requested rehearing of its October decision into this investigation. Supporters of the decision argue that it should be implemented immediately to promote competition and should not await the outcome of the PUC investigation.

ISSUES FOR COMMITTEE CONSIDERATION

- **FEDERAL ISSUES**

Should California (Legislature/Governor/PUC) seek to influence the Congress, the President, and the FCC to modify the present duopoly system. Are the PUC's efforts to promote greater competition and lower rates futile given the FCC-mandated market structure? What is the PUC doing to influence the federal government on this matter?

- **STATE REGULATION**

Given the FCC duopoly system, what is the best way for California to regulate cellular telephone rates? Is the recent PUC decision the best option? How important are resellers in stimulating competition? Are there other regulatory models in other states that have been proven to promote cellular rate competition? Would it be beneficial to adopt GAO's recommendation to investigate industry profits to determine whether effective competition exists?

- **CAPACITY LIMITATIONS**

Is limited system capacity a serious industry constraint? Will new technologies such as digitalization solve this problem? If limited system capacity is a serious problem, is the use of high rates to suppress demand the best solution to the problem?

- **NEW TECHNOLOGIES**

What are the prospects for Fleet Call? Will it be a third, equal and effective competitor, or frustrated by start-up delays and duopolist unfair competitive practices? How soon are we likely to see PCN services licensed by the FCC? Will consumers consider both Fleet Call and PCN (1) substitutes for, and true competitors with, cellular telephone service, or (2) new and different types of communication services not in direct competition with cellular telephones?

- **PARTNERSHIPS, PURCHASES AND SPIN-OFFS**

Should the legislature and regulators be concerned about (1) cellular company parterships which allow competitors in one California service area to be partners in another; (2) the proposed purchase by AT&T of an interest in McCaw Cellular; and (3) Pacific Telesis' proposal to spin-off its cellular telephone businesses? Do these telecommunication corporate restructures and interrelationships undermine competition and reasonable rates?

- **NEED FOR LEGISLATION**

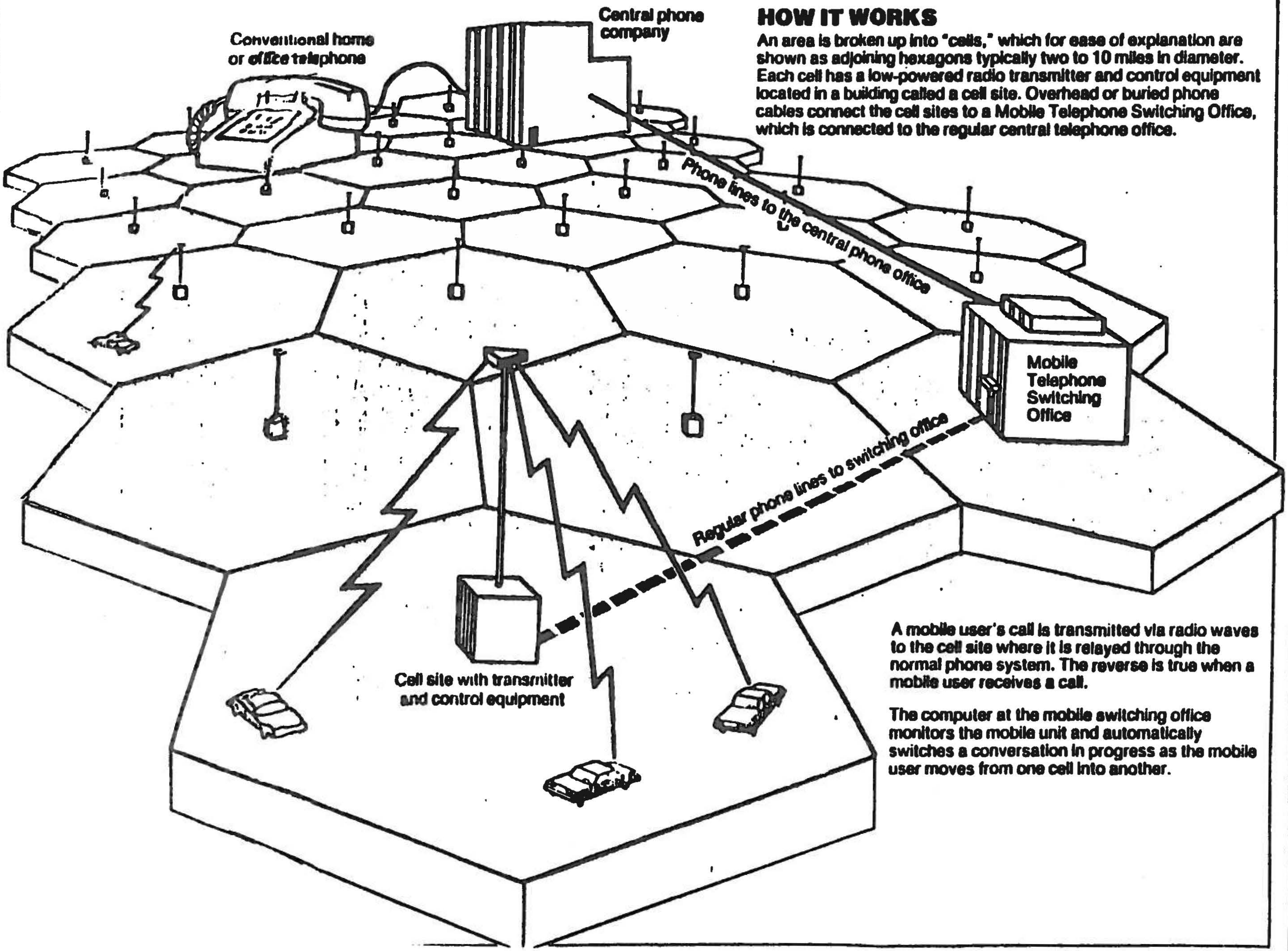
Is there a need for state legislation at this time? If so, in what form: **deregulation? rate regulation? industry reporting?** Should state legislation await an assessment of both the implementation of the PUC's recent decision, and the outcome of the commission's investigation of new communication technologies?

* * * * *

The cellular telephone story

HOW IT WORKS

An area is broken up into "cells," which for ease of explanation are shown as adjoining hexagons typically two to 10 miles in diameter. Each cell has a low-powered radio transmitter and control equipment located in a building called a cell site. Overhead or buried phone cables connect the cell sites to a Mobile Telephone Switching Office, which is connected to the regular central telephone office.



A mobile user's call is transmitted via radio waves to the cell site where it is relayed through the normal phone system. The reverse is true when a mobile user receives a call.

The computer at the mobile switching office monitors the mobile unit and automatically switches a conversation in progress as the mobile user moves from one cell into another.

JANUARY 1993

BEYOND VALIUM: NEW DRUGS, NEW DANGERS

NAX
0.25

A PUBLICATION OF CONSUMERS UNION • NO ADVERTISING • $2.95 U.S./ $3.25 CAN.

Consumer Reports

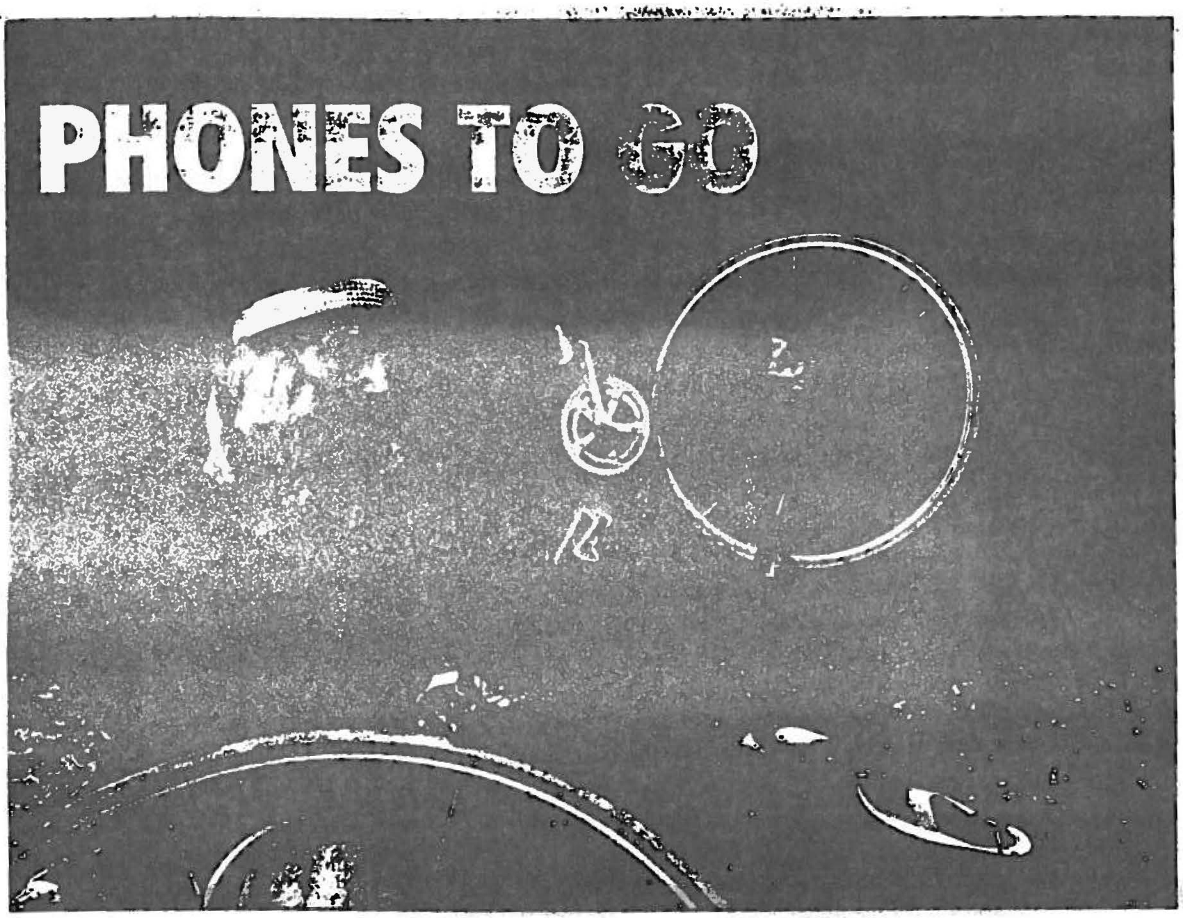
BRAND-NAME RATINGS

- Cellular phones
- Light entrées
- Bathroom scales
- Audio tapes
- Slow-cookers
- ROAD TEST: Ford Probe GT
  - Mazda MX-6 LS
  - Honda Prelude Si
  - Eagle Talon TSi

PHONES TO GO

01
0 140197 4
02747

PHONES TO GO



In our first report on cellular telephones, we look at the system, the service, and 19 lightweight, portable models.

en years after their introduction, cellular phones have been welcomed into American homes, briefcases, and cars faster than any other consumer electronics product, including color TV sets and VCRs. Not even an extended recession has dented their popularity. Nationwide, the number of cellular-phone users grew by an average of 7300 per day during most of 1992, bringing the total to 10 million by December.

Several developments over the past few years have combined to increase the number of users:

☐ Cellular carriers, the companies that operate local cellular systems, spent billions to install transmitting towers in more and more cities, towns, and wide-open spaces.

☐ Technology transformed the phones themselves. Professionally installed mobile car phones and heavy, handbag-sized transportables were joined by another type of phone, the handheld portable. It's usually small enough and light enough for a jacket pocket.

☐ Because of a marketing technique called bundling, consumers get a discount on the phone itself if they sign up for service when they buy the phone.

Those developments have begun to free cellular phones from their image as a techno-toy for executives and owners of fancy cars. In a recent survey of CONSUMER REPORTS readers—10 percent of whom own a cellular phone—business use was only the second-most-popular reason for buying a cellular phone. Even more readers bought their phone to use during emergencies, and many bought it to keep in touch with family members.

Our readers had mixed feelings about their purchase. Although 55 percent reported that they were "very" or "completely" satisfied with cellular-phone service, about the same percentage had experienced one or more problems with service. Moreover, 12 percent of our readers' phones have needed repair. That's unusually high for products with a median age of one year.

The three types of cellular phone are discussed on page 12. Because industry surveys—and our own—indicate that portables will soon be the most widely used type, they're the ones we tested for this report. We focused on 19 of the smallest, lightest portables available. They represent about half the models on the market. The lightest of the light weighed less than half a pound, but the constant leapfrogging among brands vying for the lightweight title pretty much guarantees that the current minimum will soon be eclipsed.

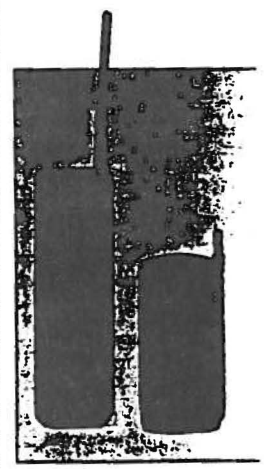
The prices listed in the Ratings represent a national average of advertised prices for a phone *plus* a contract to activate phone service. The contract requires you to purchase service for a set period and, generally, to pay the carrier an activation charge of $40 or so. In effect, by signing a contract, you get a discount; ordering the phone à la carte adds hundreds of dollars to its price.

Note also that the price of a specific phone model can vary from store to store by hundreds of dollars. The most extreme example we've seen: a *Motorola Micro TAC Lite*, with contract, advertised for $209 in one place and $1300 in another.

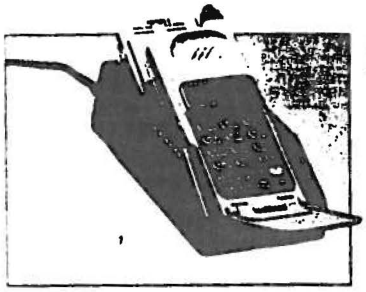
Obviously, it's extremely important to shop around until you've determined a reasonable price for the phone-and-contract combination you want. But that doesn't necessarily mean you should buy the least expensive combination. The phone is a one-shot payment; you'll pay for service month after month. Selecting the best cellular carrier and contract can be as important as saving $50 on a phone. For help in making those selections, see page 11.

How the phone works

Because it serves as a link in an elaborate wireless communications system (see the box on page 10), a cellular phone operates differently from other types of phone, whether corded or cordless. For starters, when you turn the phone on, an indicator shows the strength of the sig-



Small and smaller At nearly 13 inches long, the Technophone, the tallest phone we tested, might topple from a pocket. The Fujitsu, tied for shortest at 6 inches, would barely peek out.



Ready to go The rapid recharger on the Motorola Micro TAC Lite (above) and Technophone lets you recharge the battery in an hour or two. With other phones, recharging can take more than eight hours.

nal received from a nearby cellular transmitter. There is no dial tone because the phone isn't in contact with the local phone company's lines; it's communicating with an intermediary, the cellular carrier.

To make a call, you enter the number as you would on any Touch-Tone phone. It appears on the phone's display as you tap the buttons, so you can correct errors. Then you press the Send key. When a call is over, you press the End key or turn the power off to break contact with the carrier's tower.

When the phone's power is off, you can neither make nor receive calls. People who call you hear a message from the cellular carrier stating that the phone is not available. To make the phone available for incoming calls, you must put it on standby—turn the power on—so the carrier's equipment can find you. But think twice before you give your number out: You pay a cellular carrier as much for a call you answer as for one you make, although the caller pays for the traditional non-cellular charges.

You can hold a cellular conversation nearly anyplace—beneath a highway underpass, inside a building, or miles from the nearest town—as long as the transmitter signals from both phone and carrier are strong enough. If you move out of a transmission tower's range during a call, you probably won't even know when the system hands you off to a closer tower; at worst, the conversation will be punctuated by a brief pause or click. It can happen, however, that the tower toward which you are headed has no available channel for your call, in which case you'll be unceremoniously dropped.

Another consequence of using airwaves in place of phone wires is a loss of privacy. Anyone with an inexpensive device called a radio scanner can listen in on your cellular conversation. (Technically, that's a Federal crime, but it would be difficult to finger the perpetrators.) Although Congress banned the manufacture of radio scanners that can pick up cellular frequencies, it did nothing to reduce the large number of scanners already in use.

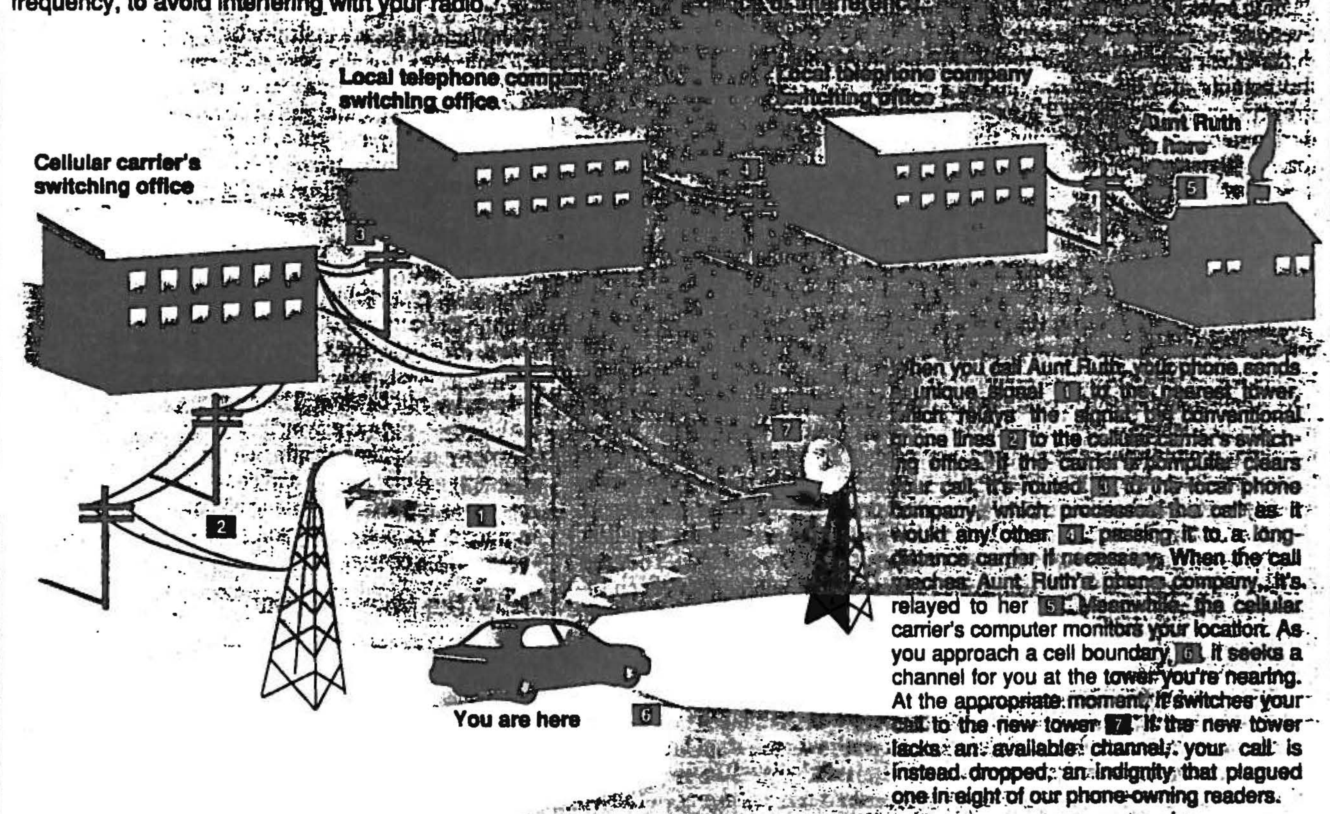
When you leave the area covered by your cellular carrier you are, in cellular parlance, roaming. A light or message on the phone shows whether the area you're in is covered by another carrier. Even if the new area is covered, you won't be able to make calls unless the other carrier's computer can recognize your phone. More and more carriers are agreeing to recognize each other's customers. Where that's not the case, you'll have to give the other carrier advance notice to use your phone in its territory. Your own carrier can tell you how to do that.

Rather than make roaming calls, though, you might be better off using a pay phone when away, because roaming calls incur substantial charges above regular cellular airtime rates. Tack-ons of $3 for

HOW THE SYSTEM WORKS

The word "cellular" reflects the carving of cities, counties and rural regions into areas called cells, each of which [illegible] transmission tower. The towers receive calls via [illegible] waves like those your FM tuner receives but at a different frequency, to avoid interfering with your radio.

[illegible] the system's signals are low in power, they [illegible] the cell, which generally has a diameter [illegible] mile and 20 miles. That way the same frequen[illegible] channels can be used in nearby cells with little [illegible] of interference.



When you call Aunt Ruth, your phone sends a unique signal 1 to the nearest tower, which relays the signal by conventional phone lines 2 to the cellular carrier's switching office. If the carrier's computer clears your call, it's routed 3 to the local phone company, which processes the call as it would any other 4, passing it to a long-distance carrier if necessary. When the call reaches Aunt Ruth's phone company, it's relayed to her 5. Meanwhile, the cellular carrier's computer monitors your location. As you approach a cell boundary 6, it seeks a channel for you at the tower you're nearing. At the appropriate moment, it switches your call to the new tower 7. If the new tower lacks an available channel, your call is instead dropped, an indignity that plagued one in eight of our phone-owning readers.

Illustrations by Gary Cox

BUNDLING UP

SHOPPING FOR CELLULAR SERVICE

When you shop for a cellular phone, you'll probably find it bundled with service (California is an exception; there, phones are sold unbundled). Signing up for service when you buy the phone can save you hundreds of dollars on the cost of the phone itself. We've even seen mobile phones offered free to anyone who bought a pie, for instance, or tires—provided the buyer contracted for service.

Dealers can offer such low prices because cellular carriers, eager to increase their customer base, will pay them up to $400 each time they sell a phone with service. Customers are so prized by the industry that it has its own name for them—"pops," short for members of the population.

But attracting new customers isn't easy. Although the average monthly cellular bill nationwide has dropped from nearly $100 to less than $70 in the past five years, rates are still high. In some cases, a cellular call costs more than 50 times as much as a conventional call. In Delaware, for example, you'll pay about 4 cents for a five-minute local call from a garden-variety phone, but you'll pay up to $3 to make the same call from a cellular phone. CONSUMER REPORTS readers who use a cellular phone cited usage fees as the biggest drawback of phone service.

In most industries, competition would drive rates down, but the cellular-phone business, like the cable-TV business, is not an open market. Each of America's 734 cellular districts has at most two licensed carriers, and in much of the country, their prices are hardly competitive. The General Accounting Office, the investigative arm of Congress, recently found that in about two-thirds of the nation's largest markets, the prices charged by the two local carriers are almost the same.

When you buy a phone, the dealer may let you choose between the two carriers and among several payment plans. Or the dealer may try to present you with a fait accompli—one carrier, one plan. Based on our experience with local carriers and on information we obtained from around the country, there are often substantial differences in service—and, occasionally, in price—between competing carriers and plans. There are a number of strategies you can use to choose a carrier and service.

Do your homework. If your area has two carriers, get rate sheets directly from both. (Check under Mobile Telephone Services in the Yellow Pages.) Those sheets will list terms for a one-time activation charge and for all the plans the carriers offer, so if a salesperson fails to mention a plan that interests you, mention it yourself. If you know people who own a cellular phone, find out how satisfied they are with their carrier. And don't be taken in when a carrier brags of having oodles of cells or channels: If its transmitters are in poor locations, its competitor may provide better service.

Avoid long-term commitments. Signing a one-year contract commits you to spending probably hundreds of dollars more than the cost of the phone and risking cancellation fees as high as $400 if you change your mind in midstream. Until you know which carrier is better for you, make the shortest commitment possible. Carriers know that the longer you use their service, the less inclined you are to bother switching to their competitor, so not all carriers offer a month-to-month subscription. Still, many offer contracts that last less than a year.

Selecting a plan. Most carriers have plans tailored to common calling patterns. They stipulate a fixed fee for a monthly time allotment. Despite the fee, the sales brochures tout that time as "free." If you exceed the allotment, you pay a stated amount for each extra minute used during "peak" hours (usually daytime, Monday through Friday) and a lower amount for "off-peak" use. Here are three typical plans:

- An "economy" plan has a low monthly minimum, perhaps $20 to $30, and no free airtime, so you pay extra for every minute of every call. This plan is appropriate if you need a phone only for emergencies.
- A "standard" or "basic" plan has a higher monthly fee than an economy plan and includes 30 or so free minutes, as well as lower rates for any extra airtime. It's designed for people who use a phone more than occasionally.
- An "executive" plan calls for a monthly fee of $100 to $200, includes several free hours, and has the lowest rates for extra airtime. It's best for someone who uses the phone a lot—a salesperson, for instance.

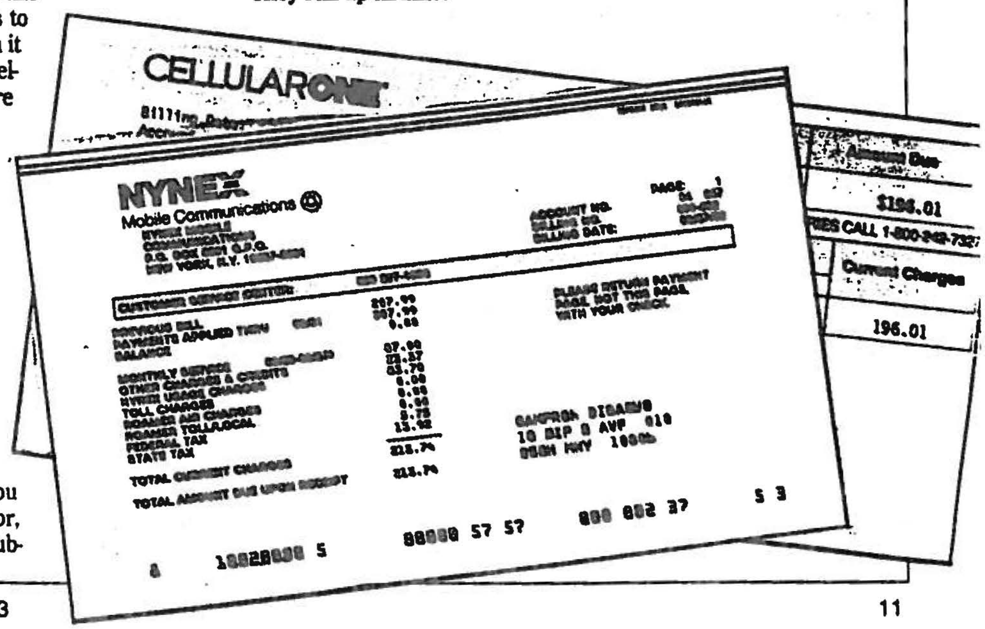
In practice, carriers usually have a wider variety of plans than this, and some may offer discounts based on volume, or throw in services like call waiting or call forwarding. We found one plan that allowed off-peak calls for free. If you're not sure which plan is best for you, take the one with the lowest monthly fee until you establish a usage pattern. If you need to switch to a higher-volume plan before the contract is up, you shouldn't have any trouble.

Check the details. Major differences between carriers can sometimes be hidden in fine print. We found a carrier that had three more peak hours per day than its competitor. During those hours, using the competitor would save you 60 percent.

A carrier that charges a full minute for an extra second's airtime is more expensive than one that measures airtime in 30-second increments; the smaller the increments, the better.

Some carriers make you dial extra numbers to reach a long-distance company other than the one with which they're affiliated; others let you select your own company when you sign up.

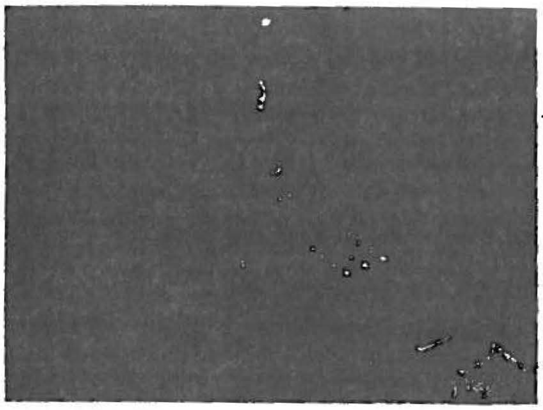
Finally, think twice about using features and services you can live without—conferencing, perhaps, or hotlines that give information on sports, trivia, or weather at the touch of a few keys. They run up airtime.



TRAVELING TELEPHONES

The trio of cellular relatives includes mobile and transportable phones in addition to portables. Mobile and transportable models have more power than portables and make somewhat better connections, but they're bulkier.

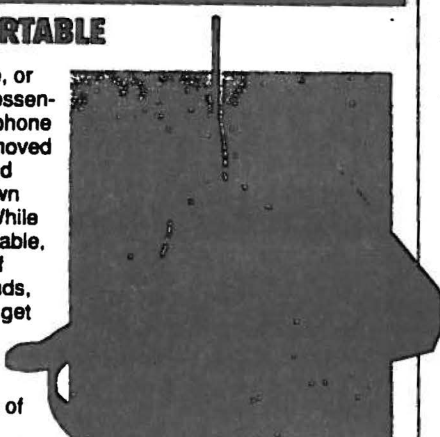
MOBILE



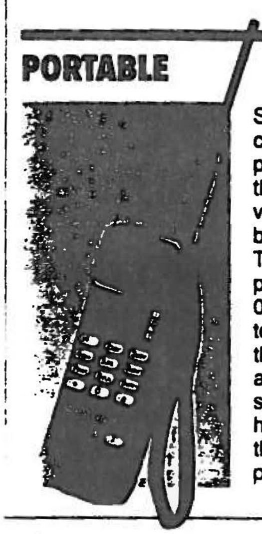
The oldest type of cellular phone, a mobile phone is permanently (and, generally, professionally) installed in a vehicle and draws its 3 watts of transmitter power from the vehicle's battery. It's used with an antenna that is mounted outside the vehicle.

TRANSPORTABLE

A transportable, or bag, phone is essentially a mobile phone that can be removed from the car and used with its own battery pack. While technically portable, with a weight of about five pounds, it's not likely to get taken far on foot. As a rule, it's the least expensive type of cellular phone.



PORTABLE



Similar in appearance to a cordless phone handset, a portable generally weighs less than a pound. It's the most versatile type of cellular phone but also the most expensive. The limited power of a portable phone's transmitter—0.6 watts or, in one model we tested, 1.2 watts—reduces the effectiveness of its coverage in areas that have poor service. With some models, however, you can buy a kit that boosts the transmitter's power to 3 watts.

each day you make roaming calls, plus 50 cents to $1 per minute of airtime, are typical. Make a long-distance roaming call and you'll also incur charges from your long-distance carrier. If you travel to a particular area frequently, it may be cheaper to register your phone there, under a second number, and pay a monthly fee than to incur roaming charges when you visit.

Cellular features

Light though they may be, the portables we tested are heavy on features, a number of them standard:

Memory and speed dialing. A portable phone is often used away from a Rolodex or phone directory, so it's useful to be able to store numbers in the phone itself. All our portables store at least 30 numbers, and nearly all let you enter an identifying name with each.

Phone numbers are stored in sequentially numbered memory locations, but with all models except the *Uniden* and *Radio Shack* you need not remember which location contains Aunt Ruth's number; you can simply scroll through all the names until hers pops up. If you do recall exactly where you put a number, you can speed-dial it by pressing two or three keys.

Call timer. Because cellular calls are so expensive—in some places, a daytime call lasting 10 minutes can cost $8 to $10—keeping track of airtime is a virtual necessity. In addition to a timer that shows the elapsed minutes for the current call, there's another that tallies conversational minutes cumulatively. That way, if you're running up a huge bill, you can find out and mothball the phone until the first of the month. Most of the models can also be set to beep at regular intervals to remind you of the passing time.

Battery-low indicator. On the road, a phone's battery is its lifeline, but it typically sustains conversation for no more than an hour or two and standby status for about 8 to 14 hours. In fact, short battery life was the biggest complaint CONSUMER REPORTS readers had about the functioning of their portable phone. (That problem may diminish, however, with the recent introduction of nickel-metal hydride batteries, which are supposed to last longer than the nickel-cadmium batteries now used in cellular phones.) An indicator to tell you the battery has run down reminds you to recharge, if you're at home. On the road, it's a warning to pop in a fresh battery or head for a phone booth.

Own-number display. Every activated cellular phone has its own phone number. If you don't refer to it often, or if you lend the phone to a friend who doesn't know it, being able to call it up on the phone's display is helpful.

Roaming features. All models can be assigned more than one phone number, to let you register with more than one carrier, and all let you temporarily halt their ability to roam so you don't inadvertently run up extra charges.

Some models offer extra features and conveniences:

Battery-strength indicator. Most of the tested phones have an indicator that shows not just whether the battery is low, but roughly how much life is left. Nickel-cadmium batteries are notorious for conking out precipitously. A strong battery level means you have some time left, but not necessarily a lot.

Power tools. Two models—the *NEC* and the *Fujitsu*—include an extended-life battery. According to the manufacturer, the *NEC's* lets you talk for two hours on a charge. Most models have a recharger that produces so little current it can take more than eight hours to recharge a standard battery. The rapid rechargers that come with the *Technophone* and *Motorola Micro TAC Lite* cut the time to an hour or two.

Any-key and automatic answer. The first lets you answer incoming calls by pressing any key, useful when you need to answer quickly without looking at the phone. The second is even handier—it picks up calls for you after a couple of rings. On phones without these features, you have to press the Send key to answer a call.

One-touch dial, speakerphone. It is dangerous, of course, to dial while you're driving, but if you need to make a call when stopped in traffic, these two features can help. Three phones—the *Mitsubishi*, *Audiovox*, and *DiamondTel*—have two dedicated keys that will dial numbers you've previously assigned them. That cuts down on dialing time. Most of the phones can be bought with a speakerphone kit, so you can keep both hands on the wheel while talking.

Automatic number selection. If you have two or more phone numbers, most models make you switch manually between them when you travel. The *Blaupunkt*, *Oki*, *AT&T*,

and *Murata* switch automatically.

Built-in help. Nearly every cellular phone has features you won't use very often. If you need to disable long-distance calling, for example, and the instruction book isn't handy, most models will display instructions at the touch of a key or two.

Making the connection

A cellular phone's most important jobs are to establish a connection with the carrier's transmitter—more demanding than keeping up an existing connection, because the phone has to hunt down the strongest available channel—and to minimize channel noise when conditions are less than ideal. Those are factors that concern our cellular-phone-owning readers—two in five complained about poor reception. And they're the factors we weighed most heavily in ranking the tested phones.

We equipped our electronics lab with a device that mimics the transmitter used by cellular carriers. Then we simulated such situations as making a call in a moving car, far from a carrier's transmitter, or within the potpourri of reflected and competing signals found in a large city. An experienced panel judged how well each model held its own against background noise and how natural the speaker's voice sounded. We also tested phones in the field, signing on with local carriers. In our case, the field was midtown Manhattan and the suburbs as well as real fields in nearby rural areas.

In the lab, some phones had an easier time than others initiating a connection with a weak transmitter signal, and some tamed noise far better than others. The more considerate models spared our panelists' ears by cutting off incoming sound when the noise grew too rough, although they didn't always cut the connection altogether. Maintaining a connection in spite of excessive noise is a real advantage: If conditions improve quickly, you won't have to dial again. The *Audiovox* was the champion noise buster, maintaining understandable conversations under far worse conditions than any other model. The noisiest model, the *NEC*, suffered from crackling and static.

Phones that performed best in the lab also excelled in the field, but the differences between the best and worst were less pronounced with one of the two carriers we used. That result highlights the importance of selecting the right carrier.

We also found major performance differences in connection strength, the ability to keep an existing call going when the tower signal gets weaker. That may not be an issue when you stay put for an entire call, but a 10-minute drive down the interstate could put quite a bit of space between you and the transmitting tower. Even small movements of your hand or head can significantly change the level of the received signal. The *Fujitsu* and *Motorola Micro TAC Lite* hung on longer than the rest when signals grew weak. The *Uniden*, *DiamondTel*, *Mitsubishi*, and *GE* lost their connection more easily than the others.

For the most part, the phones provided reasonably good voice quality and loudness, although one panelist found the *Motorola Metro One Ultra II's* overemphasis of some sounds hard on the ears.

In the store, you may not think about how easy a phone is to use. When you're fumbling with an uncooperative keypad on a dark country road, you will. To arrive at our convenience score, we judged the keypad's design, the display's readability, and how easy it was to store, retrieve, and dial numbers in the phone's memory. Details about what we especially liked or didn't like in particular models are in the Ratings.

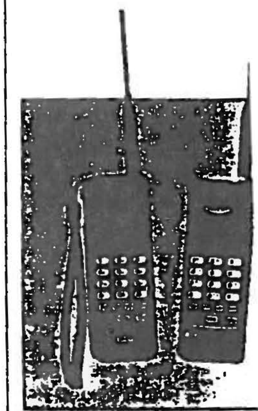
Recommendations

If you'll be calling in an area with strong coverage—in a city or a place with flat terrain—any of the tested phones will provide a good connection. Suburban and rural areas may demand more of a cellular phone. If you suspect you'll be using the phone where the coverage is spotty, stick with models in the upper half of the Ratings. The *Audiovox*, *Fujitsu*, and *Motorola Micro TAC Lite* are your best bets—all were especially adept at making and keeping a connection. Of the three, the *Micro TAC Lite* would be the most comfortable in a pocket.

If you expect to make most of your calls from your car, a number of phones, noted in the Ratings, offer optional kits that let you power the phone with a car battery, boost transmitter power to 3 watts, add an externally mounted antenna, or convert to a speakerphone. Or consider buying a permanently installed mobile phone—a mobile phone is generally less expensive than a portable, and the extra power it provides is likely to make for better connections.

Once you've narrowed the choices, be sure to compare prices at several dealers. Within the space of a few miles, we found identical phones—bundled with identical contracts for airtime—priced hundreds of dollars apart. And shop for a carrier and contract as if they were part of the cost of the phone. Typically, you'll spend more on a year's service than you did on the phone. ■

Turn page for Ratings



Peas in a pod
The Oki and AT&T phones we tested differ only cosmetically, yet you're apt to shell out hundreds of dollars extra for the AT&T name.

On the Horizon

NEW SIGNAL, NEW SYSTEM

Cellular carriers in large cities are having problems handling all the calls being made. As a result, existing cells are being split into smaller ones, but that's just a stopgap measure. The long-term solution lies in digital transmission and phones.

Current cellular technology uses an analog technique to transmit voices over airwaves. Digital transmission turns the human voice into the 0's and 1's of computer language before it's transmitted. That offers better sound quality, greater privacy from eavesdroppers, and, most important, more capacity—which could result in lower airtime charges as the number of customers grows. Work is already under way to convert existing systems to digital.

The conversion to digital doesn't mean that today's phones will be obsolete next year. Carriers plan to support analog phones for at least three or four years. But if you want to take advantage of digital technology once it's available from your local carrier, a few cellular phones with both digital and analog capability are just starting to arrive on store shelves.

A bit further from fruition is a new cellular system known as a personal communications service. Like the current cellular network, PCS would rely on airwaves, but it would incorporate many more receiving and transmitting stations than now exist. That increase would allow for lower-power transmissions and, in turn, for phones so small they're being likened to Dick Tracy's two-way wrist radio.

If PCS becomes a reality, callers may eventually have one easily toted phone that will work everywhere—within an office building, on the road, and, yes, even on a ski slope.

S.F. Examiner
12-11-92

Cheap (cellular) talk

ONE WOULD HAVE to be living deep in a mine not to be aware that the price of cellular telephones has dropped dramatically in recent years. Hardware that once cost $2.000 can be had for around $200.

Unfortunately for California's million cellular subscribers, the cost of using a portable phone hasn't changed since 1984. The basic cost remains $45 a month, plus usage charges of up to 45 cents a minute.

In October, the California Public Utilities Commission voted unanimously to increase competition in the cellular marketplace by limiting profits that system operators make from selling air time to businesses known as resellers, who in turn sell it to cellular subscribers.

The PUC's decision means that monthly changes could drop to $31.50 and peak usage charges to 39 cents per minute.

Now, however, California's only cellular system operators, PacTel Cellular, a unit of Pacific Telesis, and GTE California, are lobbying the PUC to reverse its Oct. 6 decision. Commissioners are scheduled to decide whether to reconsider their vote next Wednesday, Dec. 16.

At stake are millions of dollars in future revenue. PacTel Cellular and GTE argue that they need high profits to maintain the quality of their service. The resellers' trade group says this is hogwash.

We believe that the PUC should stick to its original decision. Reducing cellular costs will benefit users statewide, including individuals and a growing number of companies that rely on cellular technology.

Cellular Concerns Protest Regulations Set by California

By Mary Lu Carnevale
Staff Reporter of The Wall Street Journal

Wall Street Journal
10-27-92

California's cellular telephone companies are protesting a decision by state regulators that affects pricing.

The California Public Utilities Commission, in an effort to foster competition, seeks to limit the price that cellular phone companies can charge so-called resellers, which buy phone time at wholesale prices and turn around and sell that time to phone customers at retail prices.

The commission also ordered cellular companies that operate networks to let resellers connect and operate their own computers that switch phone calls into the networks.

In their appeals to the commission, San Francisco-based **Pacific Telesis Group**'s cellular unit and **McCaw Cellular Communications Inc.**, Kirkland, Wash., warned that the new regulations could hurt the quality of cellular service by discouraging investments in their networks. The decision could also have an effect on **GTE Corp.**, **BellSouth Corp.** and others that operate cellular networks in California. The commission is expected to review the appeals and its decision.

"We view this as a serious problem," said Brian Kidney, executive director of external affairs for PacTel Corp., Pacific Telesis's cellular unit. The commission, he said, regulates the cellular carriers that operate networks as though they were monopolies, even though federal regulators issued two cellular phone licenses in each market.

The California commission, which has been viewed as a trend-setter among state regulators, quietly issued its decision two weeks ago. A spokesman said the agency is now preparing a news release to explain the decision, which was four years in the making. The decision worried some investors last week, sending shares of McCaw and Pacific Telesis south. Prices quickly stabilized, as investors realized that the decision would be challenged and doesn't go into effect until well into 1993.

"After an initial scare, investors have [understood] that this isn't a big issue financially," said Greg Sawers, an analyst at Sanford C. Bernstein & Co. "It's a narrow decision; what scares investors is the mere thought of regulators sticking their nose into the cellular business."

The commission opened its investigation in 1988 to see if changes in its regulation of the cellular phone industry were needed to meet its goal of maximum competition. Since 1984, the agency has let cellular companies charge customers whatever prices [illegible]

EHIU

OCTOBER 23, 1992

Regulators Take Aim at High Cellular Rates

■ **Utilities: Southern California's 800,000 users could see their bills drop by as much as one-third. But service providers say rate cuts would overload the airwaves.**

By CARLA LAZZARESCHI
TIMES STAFF WRITER

California's cellular telephone users, who have made the state the mobile communications capital of the nation, may soon enjoy rate reductions for the first time since service began here in 1984.

But the cuts, which could slash rates in one of the nation's most expensive cellular markets by as much as one-third, are likely to add more congestion to the already overcrowded cellular airwaves, the phone companies say.

The move by the California Public Utilities Commission to cut cellular rates is an unprecedented action that will be closely watched by regulators and cellular phone companies across the nation.

Steps toward the possible rate reduction began earlier this month when the commission ordered cellular network operators to dramatically lower the rates they charge service wholesalers.

While the PUC's action is widely viewed as a big boost for consumers, cellular companies say just the opposite is true.

"We're barely keeping pace with the existing subscriber growth," said Brian Kidney, a spokesman for PacTel Cellular, the state's largest operator. "The network couldn't handle the traffic volumes that would be generated by substantially lower prices."

The PUC ruling comes at a time of growing complaints nationally and in California about insufficient competition in the cellular industry, which got its start nearly nine years ago.

To ensure some level of competition, the federal government awarded exclusive cellular franchises to two network operators in each geographical region. But critics say that usage fees charged for air time by the two cellular franchisees in each region remain remarkably similar—at or near their 1984 level. By contrast, the cost of basic cellular handsets, available from dozens of different manufacturers, has dropped by 90% in eight years.

Cellular pricing, network operators say, has been fueled by high demand, especially in Southern California, home to an estimated 800,000 of the state's 1.1 million cellular subscribers.

"Cellular is not priced in relationship to its cost but in relationship to what the market will bear," Kidney said. "Price is the point at which the customer assigns value to a service. . . . We've had 30% subscriber growth every year. That shows customer satisfaction."

The PUC's bold move to impose regulation on the largely unregulated cellular industry could trigger similar moves elsewhere in the nation, some analysts say. Furthermore, they say, regulators could award additional cellular franchises to stimulate competition.

"California often leads the way in regulatory assaults," said Sharon Armbrust, a telecommunications analyst with Paul Kagan Associates in Carmel. "This could be something that moves to other places."

There are already some early indications that the federal government could step in to regulate the business, which it has so far treated with a hands-off policy.

The federal Government Accounting Office, in a report in July, said the current duopoly system is "unlikely to provide a product at a competitively set price."

The GAO called on the Federal Communications Commission, which issued the original cellular franchises, to begin collecting information on costs and pricing from cellular phone companies as a possible first step in determining whether additional federal regulation is necessary.

A nationwide survey by Paul Kagan Associates found that PacTel Cellular and L.A. Cellular, the two franchisees in Southern California, charge identical rates that are the fifth-highest in the nation.

Under current rates, a customer's monthly bill for 150 minutes of network usage would be $107.10 for both companies. The survey results assume that 80% of the time was billed at the companies' identical charges of 45 cents per minute for peak-time calls and the remaining 20% was billed at their off-peak rate of 27 cents per minute.

However, under fees proposed last week by Cellular Service Inc., a Glendale cellular wholesaler, the bill for this same customer would drop by a third, to $72.90, a decline that many regulators said should have occurred years ago.

"Prices were supposed to drop because there were two providers of the service in every area. But they haven't," said John Ohanian, a member of the state Public Utilities Commission. "We believe more competition would be better for everyone."

The PUC is also scheduled to consider early next month a proposal to begin a sweeping review of mobile communications prices and services in the state.

Cellular companies argue that lower rates would trigger a surge in subscribers, further overloading the already crowded network. Even now, cellular customers complain about busy signals, static and conversation interruptions. Large numbers of new customers, cellular operators say, would increase these problems until the network could be expanded to accommodate the additional subscribers.

With reduced profits looming under a lower pricing scheme, the cellular operators contend that they will have less financial incentive to invest in improvements to the system. The operators say they will appeal the ruling next week, a move that will delay indefinitely any rate cuts.

If the PUC denies the appeal, PacTel has said it will take the matter to court.

On Thursday, the shares of some cellular telephone companies dropped in active trading, possibly because of Wall Street's concern about the PUC's ruling. McCaw Cellular Communications shares dropped $2 to $21.25 a share, and the stock was the second most-actively traded on the NASDAQ composite.

On the New York Stock Exchange, GTE Corp. stock fell 12.5 cents to $34, and PacTel slumped $1.875 to $40.125. PacTel was the third most-active Big Board issue, although the company attributed the heavy trading to rumors on Wall Street that company directors will vote against a proposal to split up the company's operations. PacTel officials denied the rumor.

Even if regulators do not change the current cellular system, competition is clearly on the horizon from new mobile communication technologies.

Fleet Call, which once offered radio communications services exclusively to truckers, has been given federal permission to operate a cellular-like mobile phone system in large metropolitan areas, including Los Angeles, where service is set to begin late next year.

But the largest potential threat to cellular service may be the still-experimental "personal communication networks" that are being tested throughout the country.

Although these services offer cellular-style portable phone service, they are primarily suited to tightly limited ranges and are not considered suitable alternatives to cellular for in-motion conversations.

The FCC is studying how to award the franchises for these networks, which are not expected to be in place until at least 1994.

CALIFORNIA PUBLIC UTILITIES COMMISSION

NEWSCLIPS

Compiled by Public Affairs. For Information, Call (415) 703-2669. Date 10/21/92

S.F. Chronicle 10-21-92 Page 1

Cellular Phone Charges May Drop Sharply

PUC decision intended to encourage competition

By John Eckhouse
Chronicle Staff Writer

Cellular telephone rates could tumble by as much as 30 percent because of a little-noticed regulatory decision designed to increase competition.

Falling costs might cause a rapid expansion in the number of cellular users in the state. There are 1 million cellular subscribers now, including 250,000 in the Bay Area. Lower costs might persuade tens of thousands or even hundreds of thousands more to subscribe, cellular service providers say.

In a complex ruling in a 4-year-old case, the California Public Utility Commission decided October 6 to limit the profit the system operators get from selling service to companies known as resellers, who buy air time and resell it to cellular-telephone subscribers.

The PUC also decided to let the resellers operate their own cellular switches — computer devices that link wireless cellular phone calls to the wire-based national telephone network. The resellers can buy such switches for about $1.5 million, allowing them to cut their own expenses and expand the services they offer.

"The commission sees this whole decision as a way to make the industry more competitive," said Karen Jones, regulatory analyst at the PUC, in explaining the 3-to-0 vote of the PUC commissioners.

Although the price of cellular-telephone instruments has plunged from about $2,500 to as little as $300 in the past eight years, the cost of basic service — monthly and per-call charges — has remained unchanged. Under federal regulations, no more than two system operators are allowed in any one metropolitan area.

"We'll get some economies of scale, and our costs will go far down," said Dave Nelson, vice president of Cellular Service Inc., a Glendale reseller that petitioned the PUC in 1988 to order the changes.

Nelson predicted that the cost of establishing cellular service in the Bay Area will drop from $45 to just $18. Monthly charges could decline from $45 to $31.50, he said, and the usage cost during peak operating hours might fall from 45¢ per minute to 39¢ per minute.

PacTel Cellular, one of the two system operators in the Bay Area — GTE is the other — acknowledged that user costs might fall in the short run but warned that the PUC decision will harm consumers in the long run.

"The quality of cellular service is going to go down," said Brian Kidney, executive director of external affairs for PacTel Corp., parent of PacTel Cellular. He said operators of cellular transmission systems will not continue to invest heavily in new equipment if they face more competition and are forced to limit the profit margin on services sold to resellers to a maximum of 14.7 percent — one of the provisions in the PUC decision.

"This is a risky business, and we have a risk-based rate of return we demand," Kidney said. If their profit margins are limited, he said, California cellular operators will invest in systems outside the state.

Kidney said that PacTel Cellular — which increased its customer base by 30 percent in the past year despite the weak economy — will petition the PUC for a rehearing, which could put a temporary halt to reseller plans to purchase and operate their own switches.

GTE officials could not be reached for comment.

If the PUC decision stands, Cellular Service Inc., the Glendale reseller, expects to begin operating a switch within a year.

Comtech Mobile Telephone Co., a Hayward reseller with about 30,000 customers and annual revenues of $50 million, hopes to buy and begin operating a switch in as little as nine months.

Comtech could design all sorts of new services once it has its own switch, said company President Steve Muir. For example, it might offer limited service at a lower price to people who never need to make calls from outside a limited area, such as downtown San Francisco.

"I'm not sure what our rates will be yet, but it's clear we will be able to offer rates that will be significantly lower," Muir said. That puts pressure on the two cellular operators in each market to reduce their rates — a goal of the PUC.

The one drawback for current customers is that they will have to change their cellular phone numbers if they want to take advantage of the lower rates offered by the resellers. That is because each cellular switch controls a batch of phone numbers, and an individual number cannot be moved from one company's switch to another.

PUC targets cellular phones

18-month probe looks at high rates, competition

By Michelle Vranizan
The Register

Amid crescendoing complaints of unfair rates and lack of competition in cellular phone service, a state agency is preparing a report that could result in stricter controls for the industry and lower prices for consumers.

The report, to be issued by the Public Utilities Commission, will end an 18-month investigation of the state's cellular network, the largest in the nation.

The controversy goes beyond the PUC. Claims of excessive rates and profits by cellular carriers and illegal practices by retailers also have prompted lawsuits — including two filed in Orange County. And a bill has been introduced in Sacramento to protect cellular consumer's rights.

At the crux of the issue are rates, which result in average monthly cellular phone bills of $140 in the Orange County area, according to the PUC.

Regulators and retailers claim rates are artificially high because there is little competition among carriers. They say higher rates keep cellular a rich man's toy rather than a utility open to everyone, no different from gas, electricity or the standard telephone.

At the same time, competition is scorching among stores that market phones and sign up customers for cellular phone numbers. Some retailers accuse others of illegally selling equipment below cost to grab customers then making up the loss with fat commissions paid by carriers. Other stores, retailers maintain, "bundle" phone sales with phone numbers, another unlawful practice.

Retailers hope the PUC's guidelines will give cellular customers a price break and make it easier for them to do business.

"We need fair competition on all levels to open it up to the 98 percent of the population who don't have cellular," said Stan Fasack, owner of Allstate Cellular in Anaheim.

One of the commission's biggest concerns has been lack of competitive pricing among carriers. The Federal Communications Commission licenses two companies to run cellular networks in each of its service areas. California has 30 of these areas, either large urban centers or rural tracts.

The five-county region including Orange County is the largest in the state, with more than 300,000 cellular users. The region's two carriers are PacTel Cellular and LA Cellular.

PacTel, based in Irvine and controlled by Pacific Telesis, is one of the country's largest cellular operators. LA Cellular in Commerce had been controlled by Lin Broadcasting and Bell South until McCaw Cellular Communications acquired controlling interest in Lin in a $3.4 billion buyout.

In Orange County, PacTel Cellular's and LA Cellular's most popular rates are identical: $45 a month for each carrier's basic business package, plus 45 cents a minute for incoming and outgoing calls during peak weekday hours.

For some local executives, cellular phones have become as essential as copy machines. They think nothing of paying hundreds of dollars a month in cellular bills.

"My business couldn't function without the ability to get back to people," said Wayne Wedin, a La Habra consultant who spends most of his time on the road and about $1,000 a month in cellular car phone bills.

Not everyone shares the sentiment.

Toward Utility Rate Normalization, an independent watchdog group in San Francisco, does not follow the cellular industry because mobile phones are too expensive for the average Joe, said TURN attorney Mark Barmore.

Justin Jaschke, a PacTel Cellular vice president, argues that competition is the very reason prices are so even.

"It's like Coke and Pepsi," he said.

Some rates are different, he added, such as corporate rates and low-volume personal rates.

Officials for LA Cellular could not be reached for comment.

Rates carriers charge resellers, set *before* cellular networks were operating, also have been criticized for contributing to the lack of competition.

Under current rules, PacTel Cellular and LA Cellular can sell cellular "air time" on a wholesale basis to resellers, who compete with carriers to sign up retailers and subscribers. The arrangement is similar to AT&T selling time on its trunk lines to MCI and US Sprint.

But resellers complain the current wholesale rate of 37 cents a minute is too high, creating outrageous profits for carriers and leaving resellers to squeak by.

"I earn less than 1 percent profit," said Dave Nelson, vice president of Cellular Service Inc. in Glendale, a reseller with business in Orange County.

Today the Public Utilities Commission has no authority to limit what wholesale or retail prices carriers can charge or how much profit they can make. However, carriers must get rate hikes or cuts approved, a process carriers complain is lengthy and cumbersome.

A PUC consumer watchdog division agrees with resellers that rates are too high, given growth in carrier's customers, revenues and profits.

"Compared with industries having similar risks, cellular carriers are generally earning excessive returns," states a August 1989 report by the PUC's Division of Ratepayer Avocates.

PacTel Cellular's Jaschke said if anything, cellular carriers' profits are low.

"PacTel Cellular does well compared to other cellular companies. But just our California operations haven't earned what would be considered a fair rate of return."

The PUC's ratepayer division has suggested a number of solutions to the industry's ills. Its prescription includes putting a cap on carriers' wholesale prices, creating a third rate that would increase profits for resellers and completely deregulating retail rates.

In general, resellers and retailers favor most of the division's proposals.

Jaschke said PacTel Cellular would like more flexibility in setting wholesale and retail prices, but does not favor immediately changing wholesale rates.

Carl Danner, a PUC spokesman in San Francisco, would not indicate what specific changes the commission will include in its report. However, he said most of the commissioners agree cellular rates are too high.

Danner said the report, written by PUC administrative law judge Mike Galvin, could be published as early as this week. It will be circulated in the industry for 30 days before PUC commissioners approve a final version. Any new regulations would take effect later.

Some problems may not be solved by regulation.

One that frustrates some retailers is carriers' practice of paying commissions for signing on new subscribers, a practice that is legal and not regulated.

The going rate for commissions in the Los Angeles area is $175 to $250 per new phone number.

Carriers use commissions as carrots to gain subscribers. But some retailers lure customers by selling phones below cost, then use commissions on the phone numbers to make up the loss. The practice of tying the sale of unregulated phone equiment to regulated phone numbers, called bundling, is illegal.

In competitive markets such as Orange County, some small cellular companies have gone out of business because larger competitors bundle equipment and numbers, said Jerry Kaufman, owner of the Just Phones cellular franchise in Fullerton.

Last fall, Kaufman and nine other retailers filed suit against Leo's Stereo and Pack-Cell, alleging that the two were guilty of bundling.

Pack-Cell and Leo's claim not to have broken any laws and that retailers failed to present enough facts to support their case.

As of last week, no further action has been taken on the suit.

In a separate lawsuit filed last December, Allstate Cellular and three other cellular dealers in Orange County and Los Angeles filed suit against PacTel Cellular, LA Cellular and two manufacturers of phone equipment.

The suit alleges the carriers and manufacturers fixed prices and committed fraud in selling cellular service and phone equipment.

Retailers claim they should be allowed to buy phone equipment directly from manufacturers, Allstate's Fasack said. Now retailers in some cases must buy equipment through carriers, he said.

PacTel Cellular's Jaschke said he was not familiar with the suit.

To help people make more informed decisions about cellular rates, state Sen. Herschel Rosenthal, D-Los Angeles, has introduced a cellular consumer protection bill.

The bill was introduced but not acted on last year and is scheduled to be reintroduced this session, said Paul Fadelli, a consultant for Rosenthal.

If passed, the bill would allow retailers to sign up new customers for both carriers in an area. Now, retailers can sign up customers for only one carrier.

"Retailers like (the bill) because it gives them more choice," Fadelli said.

PacTel Cellular opposes all aspects of the bill, Jaschke said. Carriers need exclusive agents to provide quality service to customers, and posting rates and maps "seems a little unprecedented."

Cellular phone definitions

■ **Agent:** Independent cellular phone company, often a store front, that sells equipment and service for one of an area's carriers. Carriers give agents hefty commissions ($175 to $350) for signing on new customers. Some critics claim agents sell phones under cost, making up for it with commissions.

■ **Carriers:** Refers to companies with FCC licenses to provide cellular service in a given city or rural area. Each area has two carriers, one affiliated with the local Bell operating company, and one unaffiliated, or non-wireline, company. In Orange County, carriers are PacTel Cellular and LA Cellular.

■ **Churn:** Number of customers who stop cellular service in a period. Nationally, 3 percent drop out each month; in California, rate ranges 2.5 percent to 3.6 percent a month.

■ **Dead spots:** Locations in a service area where cellular transmission is not available because of the terrain, or lack of cell sites.

■ **Reseller:** A company that buys cellular "air time" from carriers in bulk, reselling it to consumers with services such as operators and call waiting.

■ **Roaming:** Ability to make and receive calls from a cellular phone outside one's "home" area. Carriers typically charge a few dollars a month for the service.

Sources: California Public Utilities Commission, Division of Ratepayer Advocates, The Register

PUC report targets rates, service

Cellular phone facts

Key statistics on the market

■ The number of cellular phones in the United States will ring in at 4 million by the end of 1990, increasing from 1.7 million last year.

■ California accounts for 17 percent of the country's cellular phones. Southern California's density is about one for every 40 people.

■ The typical California user is male, 39 to 55 years old, owns or manages a small business or works in sales, makes $45,000 to $80,000 a year and spends one to five hours a day in his car.

■ Making a call costs a lot in Southern California — there's a $45 monthly fee plus 45 cents a minute for both incoming and outgoing calls — and prices haven't dropped since 1983. In other parts of the country, monthly fees range from $29 to $45, and minute charges run between 29 and 43 cents.

Sources: California Public Utilities Commission, Division of Ratepayer Advocates, The Register

CHAIRMAN HERSCHEL ROSENTHAL: First of all, does any member of the Committee object to TV news cameras covering the Committee? Without objection, TV coverage is approved.

This is an informational hearing on cellular telephone rates. I want to welcome everyone here today to the first hearing of the Senate Energy and Public Utilities Committee in the new legislative session.

I want to welcome back Members, Senator Alquist and Senator Killea. Just for those who don't know, the Committee staff is, Michael Shapiro, Committee Secretary is Patti Stearns and the new Senate fellow is Kevin Parikh.

Today we are holding a hearing on high cellular telephone rates in California. And we're asking the question - how should the state regulate the cellular industry to help lower rates?

My goals as Committee Chair have been to protect consumer interests and promote fair competition. At the moment, I don't think either of these goals is being realized in California with respect to the cellular telephone industry.

California has more cellular telephone customers than any other state in the nation, with most of those customers in Southern California, the area I represent. Yet despite this huge demand, our rates are among the highest in the country. And although cellular telephone service started in California in 1984, basic rates to consumers have not come down since this service began.

We come here today to ask why rates are still so high, and why there is so little difference in the rates and services offered by the competing cellular companies. I think the answer is lack of effective competition.

We are also here today to hear what the California Public Utilities Commission has done, or will do, to wrestle with the issue of cellular telephone regulation. In particular, I want to hear the Commission's recommendations on what can and should be done to lower rates.

In addition, I want to know whether it is time for new state legislation, either to further regulate or deregulate the cellular industry to promote competition and lower rates. At this moment, I am leaning against deregulation.

As an alternative to new legislation this year, should the Legislature during this time of dynamic technological change and market restructuring step back and await further developments before taking action?

Finally, we may be barking up the wrong tree entirely in thinking that state action is the answer. We may be trying to change something in California which can only be properly reshaped in Washington. The answer to our concerns may be to send a strong message to Congress, to the new President, and the FCC that the federally mandated duopoly cellular telephone system isn't providing the competitive environment that the wireless communication marketplace really needs.

Today we stand at a cross-roads. The direction we go with cellular telephone service in California will be determined by a combination of federal government and PUC decisions, new technologies, new competitors, consumer action and, possibly, state legislation. The road that I prefer to travel is the one that leads to aggressive competition and lower customer rates.

We have with us today a prestigious group of witnesses to help lead us along the right path. They include the U.S. General Accounting Office, the Public Utilities Commission, the cellular industry, industry competitors and consumer groups. I regret that the Federal Communications Commission, the FCC, declined to attend. However, the FCC indicated it would be sending the Committee written testimony for the record.

I look forward to the witnesses' testimony today, and I would ask the witnesses, each one of them, each as a group, to limit their remarks to about fifteen minutes and I will not be bashful about holding you to that so we have time for all the witnesses to speak and for questions.

Let's begin first with GAO, the investigative arm of the U.S. Congress, which recently studied the status of competition in the cellular telephone industry. Welcome to California.

At the outset I'd like to express my deep appreciation for your agreeing to come to California to testify today. I only wish your federal colleagues at the FCC had been able to attend as well. Also, I understand that your testimony is confined to the findings in your report to Congress on cellular telephone competition, and that you're not prepared to comment on the specifics of California regulatory decisions and that's fine as far as I'm concerned. With that in mind, please proceed.

MR. JOHN ANDERSON: Thank you, Mr. Chairman, for the warm welcome.

CHAIRMAN ROSENTHAL: I'd like to welcome, before we begin, the Vice Chair of the Committee, Senator Russell. Okay, sir.

MR. ANDERSON: All right, thank you again.

With me today is Paul O'Neil who is responsible for GAO's reviews of the Federal Communications Commission. And with your concurrence I'll summarize my statement and I ask that the entire statement be submitted for the record.

CHAIRMAN ROSENTHAL: That's approved.

MR. ANDERSON: We appreciate this opportunity to discuss GAO's July, 1992 report on the competitiveness of the cellular telephone industry. Cellular is one of the fastest growing segments of the telecommunications industry. From its fledging years, late 1983 and '84, cellular has grown to nearly $7 billion in annual revenues with over 10 million subscribers paying over $68 per month for service. This afternoon I'd like to discuss the development of the industry, it's competitive structure and profitability and the impact of emerging technologies on industry competitiveness.

In brief, the FCC authorized the licensing and allocated spectrum to two carriers in each market. One license went to the existing local telephone company and one to an applicant not affiliated with the local telephone company. The carriers, in turn, made the capital investment to build, operate and maintain cellular systems. Currently, license carriers operate in all 734 geographic market areas designated by the FCC and there are 30 such market areas in California.

Licensed carriers sell cellular services directly to consumers, or hire independent agents to obtain subscribers on a commission basis. Also, the FCC allows an unlimited number of firms, called resellers, to buy blocks of cellular phone numbers from the carriers at wholesale prices to sell at retail to consumers. Resellers become, in effect, their customers' cellular phone company, handling billing and services, while the licensed carrier operates and maintains the system.

At the request of Senator Harry Reid of Nevada we examined the competitive structure of the industry and whether the FCC's policies ensure the availability of cellular service at competitive prices. In our report we made recommendations to the FCC that were designed to, one, enhance competition in the industry and, two, facilitate an evaluation of industry competitiveness if increased competition is not forthcoming. I would now like to elaborate on cellular's current market structure.

According to economic theory, in any duopoly market, adequate competition is a concern because producers can recognize their interdependence and may maintain their prices above competitive levels. In general, the fewer the number of producers, the less likely that they will price competitively.

In addition, several characteristics of the cellular market may reduce the likelihood of competition. First, few significant quality differences exist among cellular carriers. Similarity in product quality may facilitate noncompetitive behavior.

Second, cellular's duopoly structure resulted not because of market forces but because the FCC restricted market entry. If new firms can enter a market freely it is more difficult to maintain prices above a competitive level.

Third, the pattern of ownership for cellular service may be conducive to noncompetitive behavior. A carrier may find that its competitor in one market is also its competitor in several other markets. In still other markets, that competitor might be the carrier's partner.

And fourth, when no good substitutes exist, which is the current situation in the cellular industry, it is easier for firms to maintain prices above the competitive level because consumers have no alternatives. Taken together, these factors increase the likelihood that cellular prices will be above the competitive level.

Resellers have been active in bringing the issue of industry competitiveness to the forefront. Although the FCC recognized the resellers' potential to enhance competition at the retail level, it was uncertain whether a market structure that included resellers would lead to a greater diversity of service or lower prices. This is because the reseller must buy the service from the cellular carrier and the carrier is itself in the business of selling retail to customers. The resellers' presence in a market does not alter a market's duopoly structure, deter market power by licensed carriers, or generally lead to lower rates to consumers.

I'd now like to spend a moment discussing profitability in the cellular industry. Profitability is a critical component in evaluating whether an industry's prices are set at or near competitive levels. Neither the FCC nor the states require the collection of revenue, cost and other data from cellular carriers that would be needed to begin assessing industry profitability. Although cash flows have been negative for many cellular carriers because of large initial capital outlays, the FCC and others contend that the industry will be very profitable in the future. These views are based on the average rates of return carriers are reportedly realizing and on the high prices at which cellular licenses have been selling, some for more than $200 per person in some markets and some higher. That translates to tens of millions of dollars for a license, even more in the very largest markets.

In our report we noted that, according to a 1989 study by the California Public Utilities Commission which analyzed 1988 data for fourteen of its licensed cellular carriers, the average return on equity reported by these carriers was a very healthy 24.5 percent. The California-based Cellular Resellers' Association analysis of financial performance of the cellular carriers in Los Angeles, San Diego, and San Francisco/San Jose showed wholesale investment returns of between 25.3 and 123.1 percent in 1988.

As part of our review, we examined retail prices charged between 1985 and 1991 by licensed carriers in 30 of the largest cellular phone markets, including Los Angeles, San Francisco, San Diego and San Jose. We found that average prices were fairly constant over the period. When inflation was taken into account prices actually decreased about 27 percent. However, on average, California prices were about 31 percent above the other markets. We also found that in about two-thirds of the markets, the best available prices between the two carriers were very close and often nearly identical. In California our data showed that the average price difference, if any, varied no more than about three percent between the two carriers.

However, as the California Public Utilities Commission has recognized, additional information on cost and profitability, which has not been routinely collected, would be needed to determine whether prices were competitive. The Commission has issued an order which is currently stayed pending a rehearing requiring the collection of financial data on a semiannual basis.

Finally, I would like to discuss the impact of emerging technologies on the industry's competitiveness. The FCC is relying on new services from new sources to resolve concerns over the competitive condition in the cellular marketplace. While these technologies have the potential to improve competition, significant questions remain about how and when this will occur and who will get the licenses, new entrants or the incumbent carriers. New services, referred to as personal communication services, share certain characteristics with cellular and use both existing and new technologies.

Since our report was issued in July, the FCC has issued notices of proposed rulemakings in an order allocating spectrum to the new technologies. The FCC has asked for comments on restricting licenses to new carriers in the existing markets. We support a policy that favors granting licenses to new firms that are not current cellular providers in a given market area in order to increase the options available to consumers, thus encouraging carriers to lower their prices.

As technologies advance and new personal communication services are brought to the marketplace that provide a function similar to cellular, competitiveness in the industry may improve. The FCC expects new services with new providers to begin competing in the marketplace in the not too distant future, beginning this year with Fleet Call's specialized mobile radio system.

Officials of Fleet Call see this as an opportunity to be the third major provider of mobile phone services in six markets, including Los Angeles and San Francisco, which, as Fleet Call defines them, represent 82 percent of California's population. Although the FCC has already assigned spectrum for Fleet Call, virtually all of the spectrum that is suitable for additional new services has been allocated. The FCC must reallocate spectrum from current users to make it available for the new services. These users, railroads, electric cooperatives and others, have expressed strong concern about the potential disruption to safe and reliable transportation and electrical power services that may result.

Also, Members of Congress have proposed auctioning spectrum for the new services to the highest bidder rather than allocate it without charge. While the FCC is making progress in its efforts to reallocate the spectrum, these controversies could delay the introduction of new services, thus delaying new competition to cellular.

In conclusion, Mr. Chairman, the FCC has not routinely gathered the data needed to determine whether cellular service prices are competitive. Emerging developments in cellular and similar technologies may solve some of the concerns with the existing market structure. However, the FCC must first overcome obstacles which could significantly delay introduction of the new services. In the event such delays occur, other actions may be needed to protect consumers' interests. Therefore, our report recommended that if the new services are not available within the time frames the FCC currently envisions, the FCC should begin evaluating the status and development of competition in the cellular industry. As a first step, the FCC should obtain revenue, cost and other financial data needed to assess the profitability of carriers in the 30 largest markets. It would then be in a position to judge whether consumers' interests are adequately safeguarded.

In responding to this recommendation, the Chairman of the FCC acknowledged that it is difficult to conclude that the cellular market is fully competitive. He added that, at a later time, depending on the outcome of the FCC's personal communication services rulemaking, and the emergence of other competitive services, obtaining revenue, cost and other data, as we had recommended, could be beneficial in evaluating the competitiveness of the industry.

The FCC's approval of Fleet Call in six frequency congested markets, including San Francisco and Los Angeles, should guarantee a new competitor in these markets. However, it is not yet known whether additional carriers or the existing cellular carriers will provide new services in most of the markets across the country. Our report further recommended that, in allocating spectrum and granting licenses for the new services, the FCC should establish a policy that gives first preference to firms that are not current cellular providers, particularly if only one new license is granted in that market.

Mr. Chairman, this concludes my prepared remarks and I would be glad to answer any questions.

CHAIRMAN ROSENTHAL: Let me ask you a couple of questions. Do you believe that the FCC mandated duopoly structure is the cause for most of the competitive constraints that you have found?

MR. ANDERSON: I believe it is but I also believe that it's the nature of the industry itself that causes some of the problems, the fact that you have few competitors right now and that there isn't anything new on the market, although it looks like there's some products that are about to emerge.

CHAIRMAN ROSENTHAL: In your report you suggest that it may be appropriate for the FCC and states to investigate cellular industry costs and profits. How would that help promote competition and lower rates?

MR. ANDERSON: Well, I think that we would agree with the FCC that the first thing should be to try to get some more competition into the industry. If they were to evaluate cost and pricing data, however, if the additional competition is not forthcoming, at least it would shed some light, some sunshine if you will, on whether or not there truly is competition in the industry. Right now we're relying pretty much on some anecdotal data and some old data, some 1988 data collected by your Public Utilities Commission, and relying on analysis of prices. That's not enough. You need to have information on costs, as well.

CHAIRMAN ROSENTHAL: It's my understanding that there are going to be some FCC licenses for new mobile communication technologies. Do you have a concern that this might give the existing cellular carriers a first preference call on those new technologies?

MR. ANDERSON: Yes, Mr. Chairman, we do have some concern about that and that's why we recommended that the FCC consider a policy that would give first preference to carriers other than the current carriers in the market.

CHAIRMAN ROSENTHAL: Some of the press that I've been reading lately suggests that Congress may examine the cellular telephone industry this session. Do you think that's likely this year?

MR. ANDERSON: I think that's very possible and the question of whether or not the spectrum should be given out at no charge or there should be some sort of a fee could come up, as well.

CHAIRMAN ROSENTHAL: Any further questions? Senator Killea.

SENATOR LUCY KILLEA: Yes. Mr. Anderson, I agree that the 1988 data is terribly out of date. Wouldn't this industry have grown by a fourth or a third since then?

MR. ANDERSON: I'm not real sure. I know that it's grown over that time, yes.

SENATOR KILLEA: Tremendously, in that time. I knew very few people who had cellular phones in '88 and, you know, two out of three people I know do now, so there's been a tremendous change in that. Seems to me that that's something that would be necessary to make some judgments on this to have some more up-to-date information.

MR. ANDERSON: Oh, yes.

SENATOR KILLEA: Are you planning to gather that?

MR. ANDERSON: Yes. I believe that that even makes it more important that the competitiveness of the industry be monitored because when cellular first started out there weren't that many people that were using cellular phones and it's growing in leaps and bounds, like you've indicated, and I think that that means that we need to pay more attention to make sure consumers' interests are being protected.

SENATOR KILLEA: And I think - what do you see in terms of - this is a question that I shouldn't ask you, I guess, but what do you see in terms of some actual possibility of Congress coming up with something during the course of this year or - what do you see?

MR. ANDERSON: I really can't predict. I don't know. There's going to be a lot...

SENATOR KILLEA: No, I know you can't.

MR. ANDERSON: ...on the legislative agenda this year, budget deficits and other things, and I really can't predict but I do know that in the last Congress there was a lot of activity, especially toward the end, they just didn't get around to resolving anything.

SENATOR KILLEA: I guess, you know, we go through this sometimes, should we go ahead and do something and then Congress will do something contrary to that or, if we wait forever, you know, sometimes we go ahead and it turns out that whatever is done fits right in with what we've done. So, I guess that's the chicken and egg kind of thing that we're always faced with. Thank you.

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR NEWTON RUSSELL: My understanding is that, in certain population areas, such as Southern California, Los Angeles, maybe the San Francisco Bay Area, that the availability of additional units, or whatever you call them, additional phones or additional customers, without going to digital type of work is very limited. That being the case, how can you get more competition in an area that's already saturated?

MR. ANDERSON: I think under the current structure, with the analog system, that's true but, hopefully, digitalization is going to increase it four, six, ten-fold eventually, which will deal with the problem in the long run.

SENATOR RUSSELL: Doesn't that require a great deal of capital investment?

MR. ANDERSON: I would imagine it would, yes.

SENATOR RUSSELL: And to attract capital investment need there not be a reasonably fair return, at least a good return initially, to get the system up and to get a return, an early return, on that money?. If the heavy hand of government comes down in a regulatory mode and restricts that, by whatever regulations, wouldn't that diminish to some degree the ability to attract investment and, therefore, expand this market as much as we hope it will expand it?

MR. ANDERSON: You're making a good point, one that, you know, if you take some action to try to improve things and in essence sometimes it could have the reverse effect. That's a possibility here. I think that the reason we supported the position we did in our report is that we think the best thing is to try to get more competition. Competition will spur innovation and, hopefully, the consumers will benefit from that. And we would not be in favor of, you know, just regulating for regulation sake, but we think that if the competition is not forthcoming in the near future, and I would say in the next two years, we don't see competition for the other two carriers in that particular market, that it's time then to start taking some action to gather some data and look closer at the industry.

SENATOR RUSSELL: What factors do you consider that relate to the cost of capital in terms of the return? You have an industry that's, say, reasonably maxed out in California and in certain areas, and to change to digital as we indicated requires an investment of capital. Capital will go where it's most profitable. And if, do you take that into consideration in your recommendations for regulation as to how you can attract the capital into this industry, be it competitiveness, additional players or just the duopoly, for now? How do you relate that?

MR. ANDERSON: I think that the American industry has been very, very innovative in the past and has been able to come up with solutions to problems that have been presented and I think that there could be some solutions here. I think what we're talking about also with these new personal communication services are a totally different type of thing. I think the state of the art is moving so fast that we're not real sure what's going to be needed necessarily in the way of capital investment and that sort of thing in the future.

SENATOR RUSSELL: These new types of communications, they use a spectrum also? I thought that was all used up, all allocated.

MR. ANDERSON: Yes. That's right and that's part of the problem. That's part of our concern is that some of this has to be taken away from existing users and those existing users are objecting and whether or not that will delay the introduction of new competing services remains to be seen.

SENATOR RUSSELL: The hand of government giveth and the hand of government taketh away, is that what we're saying?

MR. ANDERSON: This is a difficult problem that, you know, there are no easy solutions to.

SENATOR RUSSELL: Well, if - what has been the impediment towards the development of new competitive products? Is it just the technology hasn't moved that far ahead?

MR. ANDERSON: That's my understanding. I think just recently, you know, I guess cellular got started in the '83-84 time frame in earnest and just recently over the last year or two have some of these new technologies been emerging and then they seem to be like growing in leaps and bounds if you read the articles and the reports about them.

SENATOR RUSSELL: Are they capital intensive type?

MR. ANDERSON: I would imagine they have some capital intensity but I don't know enough - Paul, do you have anything you would add?

MR. PAUL O'NEIL: Well, they certainly are capital intensive but just recently Fleet Call announced a merger with DisCom and there's a lot of money out there...

SENATOR RUSSELL: How does that differ from the regular Cellular One and

Pac Bell Cellular? I mean, why would I go to Fleet Call or one of the others?

MR. O'NEIL: Well, they may be able to offer a cheaper price than Cellular...

SENATOR RUSSELL: It's the same concept, is it?

MR. O'NEIL: Basically. The way it was explained to me is that this is based more on the principal of the dispatch radio services that used to exist in the past but much enhanced with digitalization and that sort of thing.

SENATOR RUSSELL: Doesn't it seem to you that the best thing we can do, while keeping an eye on the industry, is to allow them to have this return for a period of time to build up the industry, to bring in the new competitors with a potential for a return, and then once everything is fairly settled then look at it and talk about the potential regulations, keeping an eye on the fact that it costs so much in terms in capital investment and there has to be a return on that.

MR. ANDERSON: That would not be an unreasonable approach. I think the introduction of Fleet Call, as soon as it is coming down the road, the emergence of other personal communication services, is going to change the structure of this market and a go cautiously approach would be considered by some to be a prudent one.

SENATOR RUSSELL: Well, most regulation is done with the best of intentions, designed to do something good for the people, but my concern is that we don't want to do anything that's going to stall this fledging industry, and I suspect that, possibly, if we get in too heavy handed it may do that. Thank you, Mr. Chairman.

CHAIRMAN ROSENTHAL: Any further questions? Thank you very much.

Our next witness is the Honorable Daniel Fessler, President of the California Public Utilities Commission.

Let me begin by expressing my appreciation for your attendance. As you know, I asked you to provide the Committee with an historical overview of PUC regulation of cellular carriers with the understanding that we would not ask you to comment on any substantive issues which are now pending on rehearings. Also, I want to publicly commend you and your colleagues for your recent decision on cellular telephone service. While I don't necessarily embrace or even fully understand all the details, I believe it is pro-competitive and pro-consumer and I hope that the public will soon realize the benefits of your deliberations. Please begin.

PRESIDENT DANIEL FESSLER: Thank you, Mr. Chairman, members of the

Committee. I do not have a prepared statement, as such. I have attempted to react to questions which were posed to me by the Chair and so, if I may, I will comment on those areas and then engage in such answering of questions as I'm able for members of the Committee.

The basic history of the industry which you heard from the federal officials who proceeded me is one with which I would take no exception and I would not find it the most useful expenditure of your valuable time to repeat it.

In California the Commission became pro-active in the area of cellular communications in the early 1980's, with the initial deployment. The attitude adopted by the Commission at that time, in which the Legislature seems to be in full concurrence, is that the cellular carrier licensed duopolies were clearly telephone utilities within the statutory mandate of the Public Utilities Commission and, therefore, a regulatory oversight responsibility is ours. As the questions from Senator Russell anticipated, the exact dimension of that regulatory responsibility and the optimal way to go about it is one that we have been attempting to cope with and with which we are still at it, as it were.

The first thing the Commission had to do was to adopt rates for what was truly an infant industry. The rates which were adopted and approved by the Commission were rates which, of necessity, had to amount to guesstimates as to a stream of income which would be sufficient to do two things. First, to allow the industry to grow and that required that it have an access to capital and a fair return so that investors would be induced to build the facilities that we needed. Second, to have some knowledge that those rates were not beyond what was necessary to produce that result, else the high rates would themselves discourage people from being able to afford or willing to make the outlays to become subscribers to the system. And so, there is this balance of a concern about rates which includes the concern about the health and vitality of the industry, as well as a concern about the industry, itself. In my mind they are intertwined and the link in inextricable.

What is extraordinary today is that, as the Chair indicated, if you work with Chairman Rosenthal's figures, slightly more than one in ten cellular telephone users in the United States is a Californian. And so the industry is not small in our state, either in terms of gross numbers of subscribers nor gross numbers of dollars that are being involved in this marketplace. And yet, today, it is a fact that basic rates in California are where they were when the Commission first established them.

It is a matter passing strange and worthy of the concern of this body, that a decade later and a million subscribers later, the economies of scale, which one would have anticipated, might have been reflected in decreasing rates have, in point of fact, on the surface, not been there.

Now, in fairness, there are two matters that require greater explanation. First, there is the factor that rates today, being what they were ten years ago, have actually decreased because of the ravages of inflation and so that must be conceded and that works about a 20 to 28 percent actual decrease in the expendable value of current dollars. And, the second issue which must be conceded is that, while basic rates are as I have indicated, the cellular carriers and resellers have been very inventive in developing what we could call "affinity plans" that seek to channel the demand for this service to various interest groups and there is substantial competition at the retail level for these affinity groups. For us, and especially for one vested by you with my responsibilities, that poses a number of issues, because, do we want to see this industry grow and be nurtured in that manner or do we want the industry to grow and be nurtured in a manner that is more like basic telephone service, in which we have sought to provide an extension to the broadest number of people of the utility of the instrument and not simply to attract them by the issue of whether or not they happen to be a lawyer or they happen to be in real estate sales or some other affinity group.

And then, finally, complicating the matter, is the point that Senator Russell raises, because the million people in California, and more, who are currently using cellular devices have, most especially in the Los Angeles area, the constituencies represented by two of the distinguished members of this panel, resulted in circumstances where the analog system is reaching the limits of its physical capacity to handle calls. This requires significant investment to bring about the replacement of these analog switching devices with digital switching. And so, we are caught on a circumstance in which the industry has legitimate arguments to make in certain of its markets that it is facing intense capital demands and yet, when all of this is said and done, there is the haunting fact of concern to me that we have in California some of the highest rates in the United States. And, those rates are high when they are compared to other impacted markets such as Houston or Atlanta, and why is that so?

Perhaps, my Commission has some responsibility here. A complaint, which I have heard from the industry, and which I have begun to examine, and which I am here to tell you I think may have some validity, is that when the Commission adopted its initial rate structure, it added as a companion the notion that the Commission would not try to come back and every so often re-determine rates. That type of rather heavy handed regulation has been the traditional way in which the Commission has interacted, let us say, with the field of energy in which we appear to be called upon constantly to be adjusting rates. Rather, the effort was made to say that the industry participants could be the source of the rate adjustments and we put in place a mechanism that made it easy for industry participants to lower rates, more difficult for industry participants to raise rates.

The reason for that has to be taken in its historical context and then re-examined as to whether the history counsels the continuation of this policy and that was we were, at one and the same time, attempting to nurture the presence of these resellers. Remember that the duopolist is allowed to be, by federal decision, in the business of retailing the product. The retailer is not allowed by federal decision to be in the business of competing in generating the basic product - as you said, Senator, the band width has been allocated and that is a decision over which neither my Commission nor, indeed, the government of California, has any direct control.

And so, the question was to worry about a competitor in this circumstance who might lower its rates for a brief period of time so as to forestall the emergence of a reseller as a potential competitor or to drive the fledgling reseller essentially out of business and then turn around and raise the rates. That was the historical reason if you go back and read Commission decisions in the late 1980's, the concern that it should be easier to lower rates and more difficult to raise them.

Now, you will be told, and I think there is an element of agreement, and one has to try and put oneself in the position of men and women who are in the marketplace here, that there is a fear. There is a fear to lower rates if it appears that the door slams behind you with the Commission and that you have exited a room from which there is no possibility of re-entry. Well, in truth, of course, there is a possibility of re-entry but that possibility of re-entry includes the ability of your competitors to come before the Commission and to protest what it is that you are seeking to do, to raise rates, for instance.

And, so we have a fourth dimension, Senator Russell, Senator Killea, Senator Alquist and Senator Rosenthal, which you have all been interested in over the years and that is the fairness of the process. The competitors will frequently use the processes of the Public Utilities Commission, not only to make their own case, but to comment very vociferously on the cases that are being made by others. Time is money, and the ability to delay or forestall something that you do not wish to happen is something that I must constantly worry about and fight against at the Commission.

As the Senator has indicated, in October of this year, the Commission took a step. The step is lucidly summarized in the position paper presented to you by your Committee staff. The step was to attempt to give the resellers a greater opportunity to have some potential dominion over the basic physics of the circumstance of the service they were offering by allowing them to introduce their own switches and forcing the duopolist to, in effect, unbundle that aspect of the operation so as to provide a greater margin in which the resellers could effectively compete. That opinion of the Commission is currently before the body on a petition for rehearing and the Chair has graciously indicated his indisposition to have me comment on it since I am one of the individuals under our Constitutional system that is judged with making a determination of the merits of the petition for the rehearing.

But the goal of the Commission is the goal of working within the existing structure, to attempt, if possible, to facilitate competition. That was our understanding of our mission and the fact that rates are has high as they are suggests that we have not been successful. The tactic that the Commission has now taken in its October order is but another one of the techniques that we would try to bring those rates down. The question whether we have chosen a propitious time, given the needs for digitalization. Whether this sends the wrong message to investors that, don't come to California. I believe that we must always be concerned about making California an attractive place in which to invest money.

I do not accept it as self-evident that California should pay what amounts to about a 30 percent premium, or what other markets are finding necessary to pay, in order to attract a vigorous cellular industry in their states. And that, if the figures you heard today from federal officials are correct, is the premium that we are paying and that is a matter of concern to me. And, I will make available to each of you, for whatever advantage you may or may not find in it, a speech that I gave to the cellular industry in June of this year, for I found it useful to engage the industry and to warn them that, having been on the job for some 16 months at that point, I was concerned about cellular rates. I was depressed that they seemed to be stuck, as I put it, like a bug frozen in amber, and I invited the industry to engage in a dialogue with me as one of the individuals who is vested with responsibility here.

For a considerable period of time I heard nothing. And then came the decision which was uttered in August - excuse me, in October. Since then I have heard a great deal. I've heard a large number of what I take it to be good faith overtures that, yes, there is a problem with rates and, yes, perhaps something can be done with it. I will say to you that I am open to any reform including the reforms in the tactics that my Commission pursues. The Co-Chair has asked for my advice as to whether I believe you need legislation. At this point my belief is that you do not. I believe that it would be wise to allow us to attempt to work our way through the order which is pending before us on rehearing. I believe it would be useful from the Legislature's perspective to determine whether Fleet Call actually does deploy in Southern California in the fall of this year, as we are hoping that it does, and to monitor with interest to see what effects what amounts to a third competitor begins to have on this industry.

My Commission is very interested in having the support of the Legislature if you deem it to be merited, that California resist the notion and advise the new administration of its resistance of the notion, that we should attempt to approach this matter by essentially federal preemption and for that reason that we continue to insist that the fifty states have legitimate interests here. California, as we have frequently told the world, is the eighth largest economy in the world. I believe that it is a useful thing that in California the Legislature, the Public Utilities Commission and the interested segments of the market, the duopolist, the existing resellers, those who are interested in providing Fleet Call and those who are interested in providing personal communication services, be brought to a forum. That forum is one that you have created. It is the Public Utilities Commission and see what we can make out of this. We have to do better, all of us, than we have done. And so that - if there are questions, I would be happy to attempt to...

CHAIRMAN ROSENTHAL: What - at the present, what action, if any, has the PUC taken before the FCC to further cellular competition?

PRESIDENT FESSLER: We've done two things. First, we have suggested that the FCC not proceed any further in efforts to usurp the authority of the several states by preemption. With regard to personal communication services, we have filed our preference that that new band width be allocated among providers who are not currently in the cellular business in the markets where they would become operating. It is a strong matter of opinion on our part that that would not be in consumer interest to have, in essence, the same economic interests that are now using the mode of cellular as a means of making a livelihood, suddenly become, on the ground, making a livelihood competing with themselves.

CHAIRMAN ROSENTHAL: One of the things that's become apparent is that many - for some of the cellular carriers that are competitors in one California market are partners in another.

PRESIDENT FESSLER: Yes.

CHAIRMAN ROSENTHAL: In other words, how can you expect - how can we expect competition with these types of arrangements where, you know, whatever you do may effect your partnership in another part of the state?

PRESIDENT FESSLER: Well, Senator, this is a matter of concern and you have refrained from giving the most obvious example. The competitors in San Francisco are exactly reversed in position and are the partners in the Los Angeles market. It would, at surface, begin to remind one of professional wrestling, that it would be difficult to expect that there is going to be vigorous competition here or significant injury.

What we have done, and I detect no great problem in terms of compliance with this, is to insist that these markets be effectively segregated, but that isn't really in the nature of the matter. One worries, one worries about the consequence of business decisions that are made by individuals who are called upon to think of themselves, as in high positions in these industries, as competitors in one market and partners in another. I find it problematic. Again, there is an issue of information gathering. Our success in gathering information has, and we have complained publicly in a report that was issued to the Commissioners in June of this year, has not been as great as we would like in gaining cooperation from the industry and providing us with information.

Again, one strives to play a balancing role between asking questions which are costly to answer for the sake of gathering information and having a purpose about gathering information. But, this is a matter of concern to me. I think it's a matter of concern to everyone in this room.

CHAIRMAN ROSENTHAL: In the mid-1992 PUC staff cellular report, the telephone report,...

PRESIDENT FESSLER: Yes.

CHAIRMAN ROSENTHAL: ...your staff complained that its ability to perform its duties had been severely hampered due to the carriers' failure to report financial information as required by PUC orders. Is this still a problem?

PRESIDENT FESSLER: Yes, it is a problem and it is a problem of a number of facets. Let me tell you that sometimes carriers will come and say to me, "Look, we're being asked excessively general questions and it becomes incredibly and inordinately burdensome for us to be trying to answer these questions. Couldn't the staff be more precise?" To the extent that is possible, I will seek to make our questions and our information gathering as targeted but, of necessity, with a market of this nature, we cannot be dead-on precise knowing the answer to a question before we ask it.

Fishing expeditions that burden the private sector are not to be encouraged but I do not believe we have been guilty of such things. I would not wish to have it demonstrated that we were and would take corrective measures were that the case. But we have encountered problems from our perspective in receiving a cooperative response and if later witnesses wish to elaborate on this from their perspective we will be very attentive.

CHAIRMAN ROSENTHAL: I might very well ask questions later. Yes, Senator Russell.

SENATOR RUSSELL: I'm wondering if you could share with us your knowledge about these other markets that are fairly similar in terms of geographics or dynamics, size and so forth, as to what the difference is between, say, New York City's duopoly and Los Angeles' duopoly, if those are good examples. Why are the rates lower there than here? I presume that the, it's same concept of attracting capital in both places or does the Eastern Seaboard get leg up in capital markets that we don't have?

PRESIDENT FESSLER: I think there is some validity in the last statement that you made. I mean, we can be demonstrated to, in many areas, pay a small premium but the premium is too large here; that cannot be the explanation. Part of the explanation may be the one that I was adverting to when I said that you would hear complaints in the industry that in California the California Public Utilities Commission took a greater interest in the cellular industry than was the case in most other states. That is a fact, Senator. And the statement was, well, in these other states which essentially adopted an almost totally hands-off attitude we were free to raise and lower prices as we would; you had this great concern about fostering the presence of resellers in the market and, therefore, prohibited steps which you felt were, meaning the Public Utilities, were aimed at precluding predatory pricing and look where you are, you have 30 percent higher rates than is true in Atlanta.

And, I can't dismiss that criticism out-of-hand and I don't but I do not think that there is a structural difference between the duopolies, let us say, who are in the Atlanta market and a structural difference between the duopolies who are in our market, because one of the interesting things is that while the original FCC scheme was that you would have the local telephone carrier with one license and somebody who got real lucky with the other, those license long ago have, by and large, been sold and those licenses are now concentrated in the hands of a number of firms that have done, have certainly done great things for society in spreading the service. But, that means that they are in multiple markets and so many of the duopolies that we face here are, in their corporate persona, found in these other markets, and I'd be very interested in the responses you get from their witnesses on this point.

SENATOR RUSSELL: Well one, I think then from what you said, could make the argument that the only difference between California, say Los Angeles and Atlanta, is the involvement of the PUC.

PRESIDENT FESSLER: One could attempt that argument and, as I said, I don't - I didn't come on this job with the notion that everything that the Public Utilities Commission had done before I arrived or since I've been there must absolutely be correct. I think that the Public Utilities Commission in the state of California, if we turn out to be part of the problem, then it is within your prerogative to remove us from this, but I can assure you that I will be competing with you to be one step ahead of correcting that problem. But, I frankly do not believe that one can sustain the case for the notion that the requirement of giving the basic information which we have sought, and some states have expressed total disinterest in, in the nature of the industry, in its financial returns, and fostering resellers, is the reason why rates in California are at the level that they are.

SENATOR RUSSELL: Resellers are not particularly fostered, say, in Atlanta?

PRESIDENT FESSLER: To a much lesser extent. And you will hear from the resellers what they perceive to be the problems of the industry.

SENATOR RUSSELL: Thank you.

PRESIDENT FESSLER: Yes.

CHAIRMAN ROSENTHAL: Dan, one final question, completely off the subject but while I have you here. You know about my concerns about competition and fair rates go beyond telecommunications.

PRESIDENT FESSLER: Yes.

CHAIRMAN ROSENTHAL: In particular I share your concerns about persuading the Canadian government to cooperate with California to foster a competitive natural gas system. While I have you here, could you, in a minute, briefly tell me about the progress of your Canadian negotiations?

PRESIDENT FESSLER: Yes. We have been engaged in negotiations with the province of Alberta, with the Canadian federal government and, to a lesser extent, with the problems of British Columbia, because, as you are all aware, PG&E customers annually are buying $1 billion a year in natural gas from Canada and, again, we find ourselves in the non-enviable position of paying on balance the highest prices for that natural gas in North America. It strikes me as exceedingly strange that your oldest and largest customer would be singled out for the highest charges and so we have been aggressively engaged in dialogue, and I can tell you that there has been a significant change in the government of Alberta recently. The Premier has resigned. The Premier has now been replaced through their constitutional process. A new Minister for Energy Affairs has been appointed, Mrs. Black, and I am engaged in negotiations with them in which I think that I can report to the Senate that there is now a strong, affirmative indication in Canada that they recognize that this type of treatment in California simply is not to continue and that we are moving in the direction of being able to buy gas under the same circumstances that others are. And that's quite simple. There's no mystery that the Senate is supporting us and we desire a circumstance in which any California customer for natural gas can buy gas in Canada from any willing seller on terms the two find congenial and then find in transportation open access.

CHAIRMAN ROSENTHAL: Thank you very much and Members, this will eliminate another hearing. Thank you very much.

PRESIDENT FESSLER: Thank you very much, Mr. Chairman.

SENATOR RUSSELL: Mr. Chairman.

CHAIRMAN ROSENTHAL: Yes.

SENATOR RUSSELL: But you know, it's interesting, the parallelism here, that here we're talking about 50 different states and what they're doing regarding cellular, you know. And then here we find the state of California has complained that the gas it's getting down from Alberta costs more in California than it does in other states. There is a interesting parallelism, at least in my mind, as to what's going here. I would wonder some, Mr. Chairman, as to, what do we know about what goes on in the several states. We know that some are, California is perhaps as heavily regulated as any state and has a very high cost level. Are there any states as costly as California? Are we the highest cost state around or are there others?

We know there are other states that practically don't regulate at all. Well, what do we find as a rate structure there? Are there more important things than rate as the quality of service, coverage, and so and so forth. You know, do we have any background on that? I see we have some background material but does it cover such items?

CHAIRMAN ROSENTHAL: Well, we have some information and more will be available as the PUC and Senate...

SENATOR RUSSELL: One of the things that bothers me about the agencies of government, and in this case we're talking about PUC, but I don't particularly care to pick on them as opposed to any other, but there's a common problem with all agencies of government and that is, regulatory agencies are not investors, they have no money on the table, there is no gain or loss to them in outcomes. There are other people who have sums of money at risk, you know, have businesses at risk, have jobs at risk and so on. Never is that the case for the agency that is supervising. And so, one wonders about the sensitivity of such agencies as, for example, here we heard just from the last witness that here the cellular people are saying, "Can't you give us a narrower question? This question is so broad you're taking up all kinds of time and effort to answer it." And, I think he's saying, "We don't even know if you want all that information." But again, he talked about a fishing expedition, okay.

Well, these are the things that are going to be very costly on the private sector. These are the kinds of things that seemingly the Governor and the Legislature are becoming more sensitive to with the passage of time because of the high cost of government, because of the high cost of doing business in the state of California and, perhaps, for a Committee under the Legislature such as this one, maybe we have to concentrate an awful lot of attention on what it costs to do business in the state of California.

CHAIRMAN ROSENTHAL: I understand your concerns. The thing that - in answer, and I don't have all the answers in terms of regulation or deregulation or non-regulation. The only thing that I can say is that I am concerned that California consumers are paying more for their service than anyplace else. Now, I don't know if that's the fault of regulation or the fault of the business that's working in California, which is one of the reasons...

SENATOR RUSSELL: Yeah, but it also means that any business operating in California that uses cellular phones is paying more than if they were conducting their same business elsewhere.

CHAIRMAN ROSENTHAL: Well, that's true. But it also affects your homeowner.

SENATOR RUSSELL: Yes.

SENATOR LEROY GREENE: Mr. Chairman.

CHAIRMAN ROSENTHAL: Yes, Senator.

SENATOR GREENE: I was wondering, we have the PUC and we have the utility regulation and monopoly to provide a service to the broad spectrum of the public, heating homes and businesses, basically, basic communications. Is the cellular telephone in that same category or is it in the category - some other category of other business devices that people use that are in business? If, it would seem to me, that if this is unfairly expensive, that businesses would not flock to it as apparently they have and saturate the market. Do we need to make or think of, and I should have asked Mr. Fessler this, do we need to think about, even though this has been considered a regulatory arena, do we need to consider it as a sort of a secondary arena for regulations? Because this is, at least not now, this is not a universally, a device that's going to be universally used by every household like the telephone is.

CHAIRMAN ROSENTHAL: We don't know that yet. It may, in fact, if it is reasonably priced, be the substitute for the telephone.

SENATOR GREENE: Apparently even with the digital approach will not...

CHAIRMAN ROSENTHAL: Or you could go say six, ten times the volume.

SENATOR GREENE: Yeah, but we have only have what, a million in Los Angeles now?

CHAIRMAN ROSENTHAL: But, how many did you have five years ago? How many did you have four years go? How many did you have last year?

SENATOR GREENE: But, the thing is, the total market is a potential 31 million people in California and growing and you have a limited ban which can't be addressed by three or six or ten times more by digital but, I don't know, is it in the same category?

CHAIRMAN ROSENTHAL: President Fessler, would you have a comment?

PRESIDENT FESSLER: I have, if I might also briefly respond to some of the comments made by Senator Greene. I absolutely agree with you, Senator Russell, that the cellular device as we now know it is not in the same league and ought not be regarded in the same league as, as the basic telephone instrument.

I would caution against drawing the conclusion that it could not play that role. One of the areas identified in the recent study that the FCC, excuse me, the Office of the Congressional General Accounting Office I'm trying to say, identified is that the largest new area for growth, for cellular, is by families desiring to have this essentially as a security device in order to be able to be in contact with family members. The largest barrier that these individuals see to achieving a means of carrying that through is cost. So, I was impressed, being a few minutes early, walking down the hall and looking at the then Governor's office in 1906; the telephone instruments that one sees there were far less frequent in terms of their impact on California in 1906 than the cellular instrument already is in California, in a small town like I live in in Davis, to say nothing of the large constituencies that you all represent where, as Senator Killea says, most of her friends are finding these things very useful.

So, I think it is an instrument of tremendous interest and that I would say that it is a business that, clearly, in the classical sense, is affected with the public interest, one which doesn't justify any form of regulation. It doesn't justify a form of regulation that is destructive or counterproductive, nothing would ever do that. But I think it legitimates the interest of business because it is the means to get to, in circumstances where one otherwise couldn't, the basic telephone network that we all depend upon.

And Senator, I hope - I'm sorry that, if I did not speak with sufficient clarity. My interest, Senator Greene, is in seeing that the Public Utilities Commission is not and never would become, and if it has in the past, that it would cease to be, the source of fishing expeditions or overly broad inquires.

SENATOR GREENE: Well, I've not been here at the beginning of the meeting. For me there is simply a basic question, why does it cost more for cellular service in the state of California than it costs in most other locations, if not all of the locations? There's an answer there someplace and I'd like to know what it is.

PRESIDENT FESSLER: And that same question, now that I've been here in this job for two years, is a matter of great interest to me and I'm striving to find it out and I am suggesting that one thing that you might wish to do is to keep a sharp eye on me and my colleagues in the next ten months as we try to...

SENATOR GREENE: Well, what I would note about the cellular business and even, for that matter, the telephone business, as a generalization in economics you would assume that as the volume goes up, the cost goes down. That does not seem to have been the case either in the telephone company or cellular.

PRESIDENT FESSLER: Yeah. Well, actually, in the telephone industry the cost has, in some instances, come down quite remarkably for long distance service, for instance. The forces of competition there seem to have brought about very, very significant reductions in pricing. In California, interestingly, for basic telephone service, we have about the lowest cost for the basic instrument in the home in the United States. And, that's, it is remarkable that in one area of telephony we are, as you say, you are very legitimately concerned about why are we at this level of cost. We don't want to be. For the basic instrument we have one of the lowest cost profiles in the United States with the economies of scale. That's what bothered me. You would think that an infant industry would not require the same nurturing as it enters adolescence that it did when it was an infant. Surely, were that true in any mammal, we would think it passing strange.

SENATOR GREENE: Thank you.

PRESIDENT FESSLER: Thank you.

CHAIRMAN ROSENTHAL: Yes. Senator Mello.

SENATOR HENRY MELLO: I have a question. You said the next ten months you're going to be looking at these rates?

PRESIDENT FESSLER: Yes.

SENATOR MELLO: Would you kindly look at the level of service too? Now, this drawing shows a nice flat area that, no doubt, communication is fairly standard. Where I live, in the Monterey Bay area, and I have three different cellular phones, myself, and I make an average of two to three to four phone calls to complete one message, mainly because the level of service is so poor. You go by a tree and you get cut off. You go up by some buildings or some mountains - and the service in the rural areas, believe me - we're getting the shaft. We're paying these high prices and we're getting nothing. I don't even take the time to call them back and say I got cut off. That call should not be charged as another call.

PRESIDENT FESSLER: You most certainly should not.

SENATOR MELLO: But, it's because they space out these cells probably thirty, forty miles apart, and they don't take into consideration - I guess what they do, they take the Department of Transportation's traffic studies and see how much traffic is on the road which relates to how much potential business there might be there - then they put the sparest level of service there. When they get into a congested area where there is a lot of traffic they probably put a lot more.

Another thing that happens to me is I get encroachment of other signals from other carriers and I listen to them and they, no doubt, listen to me, you know, and, I mean we're paying much too much in the way of service, but if the quality could increase it would lessen the hardship we have in paying these high costs.

PRESIDENT FESSLER: Well, and again, the level of service throughout the state is a matter of concern to the Commission and, on balance, I think the utilities - excuse me - the industry, is to be commended for the job it has done in certain segments of the California market. And, from what you are reporting, and I have heard other similar comments, and I, myself, driving from Davis to San Francisco have, at times, encountered problems with dropped out calls and blocked calls. The difficulty is, of course, inherent in the limited range of the cellular instrument itself and the necessity of putting up these towers and the costs that are involved in the towers, the degree to which local governments will be cooperative in permitting the towers - there are many factors here, but, certainly there ought to be a legitimate and usable service.

SENATOR MELLO: We're not being, in other words, they might say, you know, we have a shabby level of service. They ought to charge me a lot less to put up with it...

PRESIDENT FESSLER: Yes.

SENATOR MELLO: ...but we're paying the same high rate as anybody else and we're getting interruptable service throughout the whole area.

PRESIDENT FESSLER: Yes. I appreciate the comment and I will take it back with me. Senator Alquist.

CHAIRMAN ROSENTHAL: Yes. Senator Alquist.

SENATOR ALFRED ALQUIST: Yeah. But, isn't this a rather capital intensive, rapidly expanding industry with a need to expand service that's going to need an adequate rate of return to attract capital?

PRESIDENT FESSLER: I completely agree, Senator, that it will need and has needed in the past ten years, an adequate rate of return in order to attract capital. I guess the question which you are focused on and which I am focused on is whether there is something inherent in California, as opposed to other areas, both rural and metropolitan, in which the industry seems to be growing, seems to be responding to the needs to digitize and to build towers, but it is doing so at rates that are lower than are being borne by the ratepayers of the state of California.

SENATOR ALQUIST: You're convinced then from the studies you've made so far that the rate they are being charged is more than adequate, that you should order a reduction?

PRESIDENT FESSLER: I have not ordered a reduction, Senator, and I am not convinced that that is the case.

SENATOR ALQUIST: You're not even thinking about it at the moment?

PRESIDENT FESSLER: I am thinking about it. I want you to understand that I'm thinking about it but I am not convinced that ordering reductions would be an appropriate thing and that that type of rate regulation would be one that you would want to encourage me in, but it certainly is a matter that I hold out as one of society's responsibilities, excuse me, responses, if it were pushed to that.

SENATOR ALQUIST: You don't see any need at the present for any further legislation, any action by this Committee?

PRESIDENT FESSLER: I would like to encourage the Committee to continue its vigorous oversight of this industry and of the Commission but I do not suggest that this, that we have enough returns in, Senator, that we would want to put it in the form of legislation. That would be my feeling. Thank you.

SENATOR ALQUIST: I am quite confident that Senator Rosenthal has that oversight in mind.

PRESIDENT FESSLER: I share that confidence from experience, Senator.

CHAIRMAN ROSENTHAL: Senator Russell. Okay. Thank you very much.

PRESIDENT FESSLER: Very good. Thank you, gentlemen.

CHAIRMAN ROSENTHAL: We are going to move on and I have to tell you that we're going to be a little more strict about the time since many of the issues will be duplicative. Wayne Perry, Vice Chairman of McCaw Cellular Communications. Welcome.

MR. WAYNE PERRY: Thank you very much. We will be passing out my remarks that I hopefully will be able to, I have some charts and things that I think will be useful. First, thank you very much for the opportunity to testify. My name is Wayne Perry. I am Vice Chairman of McCaw Cellular Communications. McCaw is the largest cellular company in the United States. In fact, it is the largest wireless company in the world. We operate in Sacramento, Stockton, Fresno, Yuba City, Modesto, Visalia, a number of California markets, including significant interests in the Los Angeles and Bay Area systems.

Wireless is our only business. Our goal is to provide high quality and affordable cellular service and we think we have made an excellent start on that process but one that we must continue. Wireless is something that our customers, we think, are feeling they get a good value. There are exceptions. I'm glad, Senator, you're not on our system. But, last year we grew 35 percent in a recession environment. Our customers do believe, according to our customer satisfaction surveys, that we are, in fact, giving them good value.

We hope to introduce new technologies that will give us the opportunity to introduce more services and reduce prices. But, it is important for us to do that, that we have a regulatory environment and a partnership with government that gives us the predictability and stability that we need to move forward.

I think there are three fundamental points about cellular pricing and cellular rates that I would like to make today. First, to reiterate, our customers demand quality. It is the clear reception, the broad coverage and the substantial network investment that they demand from us, primarily above all. The very first thing that our customers demand is a quality network. They are very concerned about price but quality is number one.

McCaw invested over $200 million in cellular in the state of California, not including our investments in Los Angeles and the Bay Area. Attachment A of my handout shows you the coverage maps that shows that we have increased our coverage over three times in the five and a half years that we have been in operation in the state of California. Those maps don't quite cover it all because they don't tell you that we have now had to go to portable coverage. We used to have to exist with just mobile coverage and now our customers are demanding portable coverage, so that we've had to fill in a lot more cell sites within those areas as we've expanded our coverage. We've not, if you look at Attachment B you will see that we've not returned our investment in that state, in the state of California, yet. Every year we've invested more money than we've made and what we show you there on Attachment B is from 1988 through 1991. We would have included our results for the years before 1988 but we lost so much money we didn't think you would give us credence for it, but they were very dismal.

Second, I think the point we like to point out about cellular rates is that the cellular carriers are introducing discount rate plans today. It's true that the basic rates have oftentimes not changes significantly. But, to attract new customers and to keep our customers from going over to the competition we have been introducing alternative rate plans and oftentimes a great number of our customers are on those alternative rate plans. These are in addition to the basic rate plans. Attachment C and D shows you some of those rate plans that we have in some of our markets, including this market here in Sacramento. A typical customer gets about a seven percent price reduction in nominal terms off of the basic rate using one of those plans. Now, in real terms, President Fessler mentioned how the true rates in cellular considering inflation have reduced even more. I think that the reason these cellular prices are going down is the competition that we have with, not only our other carrier, but the new carriers that we feel are going to be coming into our business.

The third point we would like to make about the cellular rates, which is one that has clearly been on the Committee's mind today, deals with the fact that we believe that cellular regulation discourages price reduction. California is the most regulated state when it comes to cellular in the United States. We believe that cellular prices would be less if we were not so heavily regulated.

CHAIRMAN ROSENTHAL: Excuse me. How does the regulation prevent you from reducing your price?

MR. PERRY: That's a good question. For example, we have to give a 30 day notice to all of our competitors when we want to reduce rates.

CHAIRMAN ROSENTHAL: What's the problem with that?

MR. PERRY: The problem with that is that you don't get any competitive advantage. Your competitor will know about it.

CHAIRMAN ROSENTHAL: Well, who cares, who cares?

MR. PERRY: Well, people do things to get a competitive advantage.

CHAIRMAN ROSENTHAL: No, I mean the companies may be concerned about that but if you decided that you wanted to reduce my rate, I wouldn't care whether the other company knew about that or not - reduce my rate.

MR. PERRY: Well, that's true. It's just that it hinders the...

SENATOR RUSSELL: Yeah, but he wants to get business from the other, that the other company might otherwise get.

CHAIRMAN ROSENTHAL: Well, but, if the other company is then forced to reduce their rates, as well, that's fine for the consumer.

MR. PERRY: But it rarely works that way, Senator. What happens...

CHAIRMAN ROSENTHAL: Try it.

MR. PERRY: Senator, we tried, oftentimes we tried, but there are delays that inhibit our ability to reduce rates. Oftentimes we are required to put in place a reseller clone, tariff reduction or the resellers protested the rate reduction. This simplified tariff proceeding that we've been under the last two years hasn't resulted in rates going down.

SENATOR GREENE: Let me ask a question on that point, what you were talking about, Mr. Chairman. The reasons you would want to reduce your rate is to attract business to your company from your competitors. Is that not correct?

MR. PERRY: That is a major reason you would, yes.

SENATOR GREENE: And, to do that, if you signal this 30 days in advance of any reduction, does it not give your competitor an opportunity to look at the facts, the lay of the land, and reduce their rates a similar amount, if you have to announce ahead of time?

MR. PERRY: Especially since it is never 30 days. The process always takes longer. Absolutely.

SENATOR GREENE: So, there's no competitive surprise which enables you to wean away other customers who are, since most of them are business people, they are looking at the bottom line.

MR. PERRY: That's correct. I would also ask...

CHAIRMAN ROSENTHAL: Okay, let me ask you a question, follow-up. Have you asked the PUC - my question is - have you asked the PUC to change that rule? An official request?

MR. PERRY: We have been in discussions - have we made an official request?

CHAIRMAN ROSENTHAL: You have not made an official request? Why not?

MR. PERRY: Considering an official request, we asked, we talked to the CPUC and said, "The best system that we feel is one that we can raise and lower rates without notice and without opportunity for other people to comment."

CHAIRMAN ROSENTHAL: And, you've asked specifically of the PUC to take a look at that?

MR. PERRY: Yes.

SENATOR GREENE: Well, if I may, Mr. Chairman, there must be more to it than this. Simply notifying the PUC is notifying PUC. What is the result of that notification? Do they then step in?

MR. PERRY: Yes, they oftentimes, it's a long process that...

SENATOR GREENE: So, what you're suggesting to us is you have to notify the PUC 30 days in advance of lowering or raising a price?

MR. PERRY: That's correct.

SENATOR GREENE: That might, in turn, wind up with some hearing before the PUC or what?

MR. PERRY: It usually gets involved in protests and requests for additional information and just process delay.

SENATOR GREENE: All right, but, even if you're just, let's say that you want to lower your rates ten percent, okay, and you, "Dear PUC, I intend to lower my rate ten percent." And, the PUC can say to you, "Now, wait a minute. Before you do that there are certain things I want to know."

MR. PERRY: That's correct. More often that not the resellers will ask for us to protect their margins in that instance or even our other competitor might protest. There is just an opportunity to slow the process down in that instance.

SENATOR GREENE: Well, there's an opportunity. Does it happen, is it usual?

MR. PERRY: Yes. Yes.

SENATOR GREENE: It's usual and customary that 30 days is not 30 days. It's an extended period of time.

MR. PERRY: Yes. If you give sodium pentothal to every cellular carrier in the state of California he will tell you he does not feel he has the ability to reduce rates or increase rates, especially increase rates. We don't think we can increase rates.

SENATOR GREENE: Well, but if we were to do that then we could reduce the price of sodium pentothal.

MR. PERRY: Senator. I suggest you, let's take a look at Exhibit, Attachment E to my presentations. I think what that shows is that cellular rates are anywhere from ten to fifty percent lower in states without rate regulation than they are in Los Angeles or the Bay Area.

CHAIRMAN ROSENTHAL: Basic rates?

MR. PERRY: Yes. If you will look at how we calculated this assumption, we just took a plan for a number of minutes and made fair assumptions - we believe these are fair assumptions - and you can see that there is almost a perfect correlation between high rates and regulation. Now, I think that this is an instance where we believe that competition is good, we believe that rates can come down and will come down.

SENATOR GREENE: But, isn't it interesting though that, in terms of your investment, okay, in dollars, so much money is put into leasing property, putting up towers, buying equipment of various kinds and so on and so forth. Doesn't it become a little difficult to think of the millions of dollars that are invested that these actions by the PUC can have that much effect on the price? Isn't the price in relation to what it is costing you to do business, of which this can't be a very big part?

MR. PERRY: It's true that one can argue that regulation, in and of itself, is not a huge cost versus the capital investment that we have made, but it ends up being a stifling process in which true competition just doesn't really happen as vibrantly as it does in markets where we don't have the kind of...

SENATOR GREENE: Well, you were showing, for example, that in Chicago, Illinois, okay, that the cost for 60 minutes, it's 54 percent lower in Chicago than here - so it's roughly half - and you show for 120 minutes and you go to 185 minutes and you say it's 85 percent cheaper in Chicago than it is in California, and so on. Now, why would the number of minutes that you are on the phone make the difference?

MR. PERRY: Those might be benefited from particular rate plan competition. One of the things about cellular competition in unregulated markets is that it takes many forms. It takes the form of package plans. People compete on various package plans. They compete on...

SENATOR GREENE: Then, are you basically saying that regulation stifles competition?

MR. PERRY: I believe that we would have more vibrant competition in the state of California if we were not subject to such stringent regulations.

SENATOR GREENE: Well, you gave an illustration, for example, of saying, if I may, Mr. Chairman, that, you know, the 30 day notice thing and then you're saying, "No fair. My opposition, my opponent, my competitor understands that in 30 days I wish to lower my rates by ten percent." So, he's going to turn around and notify the PUC that he's going to lower his in the 30 days, which is probably a couple of days off of yours. Is that the nature of what happens?

MR. PERRY: Yes. If, in fact, they thought it was going to be implemented in 30 days.

SENATOR GREENE: Now, let us assume that this is an unregulated market and so, in that case, you're not going to notify any PUC because they are not going to be there to notify. You're simply going to say that we've reached an internal decision. As of next Monday the rates are lower by ten percent. Now, this is going to be found out very quickly by your competitor who'll say, "Gosh, they're going down ten percent. I guess we have to match them or lose business because we are all competing over customers." And we're talking about somebody who, let's say, is not a customer now but we want to buy him up tomorrow. You're trying to get to a lower price than they are so you can say to this potential customer, "Come with us. It costs you ten percent less than if you go with them." They turn around and do the same thing. What I'm getting at is I don't, in this instance, maybe others, but in this instance I don't see the difference between being regulated and being non-regulated.

MR. PERRY: One can argue why people behave the way they do in an unregulated environment but I think the facts speak very clearly that the rates are less in an unregulated environment...

SENATOR GREENE: Yeah, a duopoly structure.

MR. PERRY: The same participant.

SENATOR GREENE: Well, again, my problem is that what you state I will assume is the truth, but I can't find out thus far why it's true.

CHAIRMAN ROSENTHAL: One of the other things as part of the PUC's concern, you see, we have those who are providing this service and then we have the resellers who are selling it to you. Okay? Now, if they did what they might want to do, it might be considered predatory pricing. In other words, if they reduced their rates 25 percent but the reseller couldn't stay in business as a result of that reduction, then where are we? And so, the PUC has the duplicate concern...

SENATOR GREENE: Well, what we note here, assuming that this table is accurate and not knowing whether it is or not, assuming that, and we are talking about the back page in the book there, we are shown three regulated markets, Los Angeles, New York and San Francisco. Okay?

CHAIRMAN ROSENTHAL: Yes.

SENATOR GREENE: Let's take the first item there, the 60 minutes, the difference. In Los Angeles it's $69 plus. Okay? In New York it's $60 and in San Francisco it's $69. All of those charges are higher than the unregulated markets where we see one, two, three, four, five, six, seven, eight, nine, ten, unregulated markets which vary between $31.90 in Chicago as the low and

$60.00 in Miami - all of which are under the $69.84 of California, Los Angeles, and the $60.00 in New York and the $69.00 in San Francisco. So, there is something about this table that says there is a difference between regulated and unregulated, but is the difference the question of regulation or is it something else? Is it, for example, the volume of business? Is it that the city of Chicago is a more intensely covered area? And let's say that, because one of the things that we don't have here is, how many phones are there, you know.

MR. PERRY: I will tell you that within that array of unregulated markets are markets that are less penetrated and even more penetrated than markets...

SENATOR GREENE: So they are both less and more?

MR. PERRY: Less and more.

SENATOR GREENE: Then is that something to do about the middle man and what his costs are? Would that be a big part of what's going on here?

MR. PERRY: I think that would be a big factor in a competitive environment maybe that we do whatever we can to wring out every dollar cost out of the process and there are certainly costs in the distribution that might be more efficient in those markets, that can be a factor.

CHAIRMAN ROSENTHAL: See, we have a different, they don't have the same kind of system.

SENATOR GREENE: But, Mr. Chairman, that's all true. The basic information is, the basic need is to know what the reason is for the difference in cost and what we have is verbal commentary, not hard figures.

CHAIRMAN ROSENTHAL: I understand. I understand. Let's move on.

MR. PERRY: I think there are two new important developments which will affect cellular rates in California in 1993 and which should shape the regulatory policies in the state of California. One is competition. I think that we are going to hear later this afternoon - we've heard a lot about Fleet Call, which is an unregulated all digital, national company that's going to begin operating in Los Angeles, they state, in August and in the rest of California by mid-94. California, I mean Fleet Call will explain that they actually reach a greater footprint in the United States, serve more potential customers than we do as the largest cellular carrier, so they're quite large. And, I think that that is something that will increase the competitive outlook in the state of California. They are an unregulated carrier. They can reduce rates and raise rates and not have to worry about protests by the resellers or delays or signaling their competitors or whatever. That's a very different thing than we face.

The second issue, or the second event that will, I think, effect cellular pricing in California in 1993 is the transition from analog to digital. Digital expands capacity. It gives us new opportunity for new services. It helps us with fraud. It helps us with privacy. It's really very, very important but, most important, it takes the $1,200 per subscriber that we currently invest in the analog environment and drops it significantly. For the first time it really gives us economies of scale. We intend to pass on those opportunities, or those savings, to our customers. You mentioned the problem of how can you compete with somebody who is your partner. Let me give you an example. In Florida we recently introduced digital service, the first digital commercial service in the United States. We reduced digital air time fifteen to twenty percent. The competition in Florida who we hit with this is our partner in Los Angeles, so I tell you that Hulk Hogan has a broken jaw and that there is true competition against people who are competitors and partners in another area. And that, those savings we intend and will pass on to our customers because we need to continue to expand the breadth of people who we reach in the consumer market which is much more price sensitive. We think we can really benefit from the introduction of digital...

SENATOR RUSSELL: Do you have resellers in these other markets that you're involved in?

MR. PERRY: Resellers are primarily a function of high rate markets.

SENATOR RUSSELL: So, as you reduce the rate you squeeze out the resellers?

MR. PERRY: Most of the time they don't go to markets that have high rates, or, low rates.

SENATOR RUSSELL: What is the advantage or disadvantage of a reseller area or a nonreseller area? Do you sell it direct then?

MR. PERRY: Yes, absolutely. Resellers, remember, they don't have any cell sites, they don't build any networks. They just take whatever we have and resell it.

SENATOR RUSSELL: They are the middle men?

MR. PERRY: Yes.

SENATOR RUSSELL: You cut out the middle men, you save money.

MR. PERRY: They are not a factor in markets that have low rates.

SENATOR RUSSELL: I think basically that's true. We all agree. You cut out the middle man, you save money. Does California require these resellers?

MR. PERRY: A significant part of California, the policy of the California Public Utilities Commission has been to foster the help of the resellers as a way of introducing competition to the marketplace.

SENATOR RUSSELL: Well, apparently it hasn't succeeded, Mr. Fessler.

SENATOR GREENE: On this same point, Mr. Chairman. New York, Los Angeles, San Francisco, San Jose are all regulated markets and in those markets are there resellers?

MR. PERRY: Yes.

SENATOR GREENE: All right. What about the unregulated markets?

MR. PERRY: Well, my home town is Seattle and if there is a reseller there, I don't know where he is.

SENATOR GREENE: Where? In Seattle?

MR. PERRY: Yes.

SENATOR GREENE: What about the rest of them?

MR. PERRY: I think there are resellers in some of those markets. Certainly, I believe, in Washington, Baltimore and in, despite its lower rates, and in Chicago.

SENATOR GREENE: All right, but then, they are not, there is nothing generic here about saying that, under the case of being regulated you have resellers and unregulated, you don't. That's not the case.

MR. PERRY: They exist in the lower markets. They do not have near the...

SENATOR GREENE: Is there something in the PUC rules and regulations that requires you to deal with resellers? Can you say no, we won't deal with any resellers?

MR. PERRY: Oh, absolutely not. We encourage, we have a very good relationship with resellers. They are a part of our distribution. The problem comes when...

SENATOR GREENE: So then, what you're telling us, in a sense, is that under some circumstances you would find it cheaper to use a reseller than set up your own sales organization.

MR. PERRY: No. That's not what I said.

SENATOR GREENE: That's not what you said? Then why would you ever want a reseller if you can sell less costly than through a reseller?

MR. PERRY: As a businessperson who has the ability to sell to a lot of different entities, we would not cut off one of the entities that would buy our product from us. And, if they want to buy our product, we would be happy to have them as we would other customers, large corporate accounts, government accounts, retail accounts...

SENATOR GREENE: Then these figures here that you've given us are the costs to you? But, the reseller is in there someplace, so there is some other factor in here. Above these numbers in those cases?

MR. PERRY: You cannot explain the difference in pricing as a result of just the absence and presence of resellers.

SENATOR GREENE: All right, but that's a different sum of money. It's a one time unit cost of money? You know, if I come to you and I said, "Give me a thousand of your phones. I'm going to sell them." You know, and you say, "Okay, I'm charging you the same as I charge anybody else." All right? You may have some volume discount or something the other. Now I, as a reseller, in selling that, isn't this a one time sale? I want "x" dollars for this piece of merchandise, or it's...

MR. PERRY: No. No.

SENATOR GREENE: ...something that's a continuing cost. It's a continuing cost?

MR. PERRY: Yes. Continuing cost based on usage.

SENATOR GREENE: Then these tables ignore that reseller?

MR. PERRY: Yes.

SENATOR GREENE: And, if the table ignores the reseller, we do not know what the buyer of the product is paying for the use of it.

MR. PERRY: Well, I will tell you in markets that we have listed here, this is what the public pays. This is what, this is probably what 95 percent of the public would pay in those unregulated markets, would be within these issues here. Resellers are not a factor in these markets with lower rates. They exist but they are not nearly as pervasive as they are in the three regulated markets of Los Angeles, San Francisco and New York.

CHAIRMAN ROSENTHAL: Let me tell you, Senator Greene...

SENATOR GREENE: I'm getting (INAUDIBLE) because we're not closer to it.

CHAIRMAN ROSENTHAL: I understand, and I'm going to make this statement and we're going to move on. One of the problems, and I tried to deal with this with legislation, and it's interesting that they opposed my legislation. I tried to eliminate the concept of where they paid a reseller $500 for selling that to you. Okay? That's part of the cost of doing business, according to them.

SENATOR GREENE: Well, but, they're saying that I'd rather pay the reseller $500 than to hire you as being my salesman and having to pay you.

CHAIRMAN ROSENTHAL: Okay. In addition, they opposed, which I wanted, when you walk into a store, legislation to say that you ought to be able to buy either one of those services, but you can't. You can only buy the one that has signed up with them, which is another problem of competition which could have reduced the rates. Anyway, we're talking about apples and bananas here when we look at this chart and I don't blame him for presenting it that way, but it's not measuring apples against apples.

SENATOR RUSSELL: Are you saying, Mr. Chairman, that if I lived in Chicago and used 60 minutes of their service, it would cost me something other than $31.90?

CHAIRMAN ROSENTHAL: Yes.

MR. PERRY: No. It would cost you $31.90.

SENATOR GREENE: Well, if you have resellers in there it still costs you $31.90?

MR. PERRY: I mean, well, the resellers could have their own, remember, they set their own pricing, but rarely do they price it as anything different than the cellular carrier.

SENATOR RUSSELL: Resellers are in competition with your direct sales?

MR. PERRY: That's correct.

CHAIRMAN ROSENTHAL: There's two different prices in cellular. We're only looking at one here. There's a price for the wholesale and there's a price for the retail. Okay? In California you pay $45 a month from the duopoly and 45 cents a minute for the use of the telephone. Now, what is this?

MR. PERRY: This is the retail price.

CHAIRMAN ROSENTHAL: All I'm interested in is what I have to pay.

MR. PERRY: This is what the consumer cares about. Attachment E is what the consumer sees and you can see from Attachment E, the consumer is better off living in an unregulated state.

CHAIRMAN ROSENTHAL: All right. Let's move on.

MR. PERRY: All right. I mean, I've taken far more than I should in time.

CHAIRMAN ROSENTHAL: Yes, well, we created the problem.

MR. PERRY: I think that we sit at a crossroads, to use your phrase. We can either go down the road of an unregulated but with oversight environment, or we can go down and attempt to go through some kind of complicated regulatory scheme where we synthesize competition. We think that the facts speak very strongly that the regulated, the deregulated environment is the way to go. We look forward to working with the Commission to achieve what is necessary so that we can operate in an unregulated environment. Thank you.

CHAIRMAN ROSENTHAL: Thank you very much. Let me ask a question because Senator Russell raised a question about investment. Has AT&T indicated that because of the California PUC decision it is no longer interested in purchasing an interest in McCaw?

MR. PERRY: No, it has not, but it does not believe that the existing order would be implemented. If they did, they would have a different opinion.

CHAIRMAN ROSENTHAL: Okay. Would a major investment help McCaw Cellular continue to expand and modernize?

MR. PERRY: I think if you can see the amount of money that's evidenced by the investment we make, we make a lot more money than, we invest a lot more than our net income and will continue to do so for the foreseeable future and the investment from AT&T will allow us to continue to not only make the investments that we have of the same type, but actually increase the types of investment to give the California subscriber mobile data capability, advanced intelligent network features, new features that our industry hopes to bring forth in the proper regulatory climate.

CHAIRMAN ROSENTHAL: Then finally, we heard where the PUC indicated that they thought that before legislation ought to be introduced we ought to give them an opportunity to work out the program, the plans. Do you have any problem with that?

MR. PERRY: I think we can work with the PUC. The only problem I would have is can the PUC deregulate us, even on a sunset basis or a test basis, without legislation. If that legislation is necessary, we would encourage you to work with the PUC to achieve that.

CHAIRMAN ROSENTHAL: Okay. Thank you very much.

MR. PERRY: Thank you.

CHAIRMAN ROSENTHAL: Now, Brian Kidney, the Executive Director of External Affairs for PacTel Corporation. And, since we have spent quite a bit of time, I would hope that you would not duplicate, but just say, "Me too", if it's me too or tell us what the differences are.

MR. BRIAN KIDNEY: I will do my best, Mr. Chairman. Mr. Chairman, I am Brian Kidney, as you said, Executive Director of External Affairs, PacTel Corporation. PacTel Corporation is the parent of PacTel Cellular which provides service in Los Angeles, Sacramento, San Francisco and San Diego as a general partner. We cover an area with a potential population of over 20 million in California and elsewhere in the United States, including those, about 30 million.

Cellular is a service that I think this state, the Public Utilities Commission and the Federal Communications Commission ought to be proud of. In 1984 PacTel's Los Angeles market provided service with 23 cell sites with one rate plan and ended the year with 8,000 customers having made about a $20 million investment. In 1992 PacTel's operations covered 600,000 customers. Six hundred and fifty million dollars have been invested in California. We provide service, including 30 rate plans, and we have built over 500 cell sites. This is a matter of significant growth and expansion, unparalleled, to my knowledge, in any other industry.

Cellular has been, is today, and probably will be for the very near future, anyway, a discretionary service. It is primarily a business, productivity oriented service. Our customer profile today is about 85 percent business and sales and professionals. Another ten, and really the consumer segment is only about five percent.

CHAIRMAN ROSENTHAL: That may be because of the cost.

MR. KIDNEY: I think that's probably true. I think, as others have suggested, the move from analog to digital technology will permit great expansion in the capability of cellular providers to extend service to customer segments that haven't signed up yet.

I think the cellular industry has been a significant assistance, particularly in emergencies and in providing service that people take for granted these days. The telephones that you see along the roadsides to call in for emergency assistance, by and large, are cellular. Without them there would be a significant land line investment.

Just to take a minute to look at the history of regulation in California, not trying to be duplicative, in 1984 PacTel filed for the first certificate of public convenience and necessity with the Public Utilities Commission and rates were established according to market principles. We have operated by increasing the number and type of rates to provide service to different customer segments over the years. In 1988 the Public Utilities Commission began an investigation of which this latest decision in October is a continuing part, now four years later, and they ask the question, "Is cellular competitive?" In 1990 it ordered a phase two order which found that cellular was a discretionary service, found that rate of return regulation was not suitable for cellular. It authorized rates to be reduced by ten percent on notice to the Commission. It instituted a 30 day advice letter process and reserved five issues for phase three. What we have in phase three, the order that was adopted and then stayed in October, is a complete reversal of those policies whereby a rate of return kind of structure is imposed for reseller access to cellular facilities, a retail price ceiling is established and that PacTel's reseller entity in San Francisco - PacTel Mobile Services - is required to be divested.

The topic of the discussion for the hearing today is why cellular rates in California are so high, and I would like to take issue for a minute with the premise. First of all, you wouldn't expect today to pay a lower price for a car that you buy than you did in 1984, I expect. So, the question is, why would you expect to pay less for cellular? Cellular is not like a local exchange telephone company. It does not have scale economies. It does not have declining marginal costs and it does not have long life infrastructure. It is a system which requires significant and growing investment. The investment fairly tracks subscriber growth and it is a system that is now in transition or at a crossroads, moving, again, from an analog system to digital. But, along the way, we have had significant technological advancements that I don't want to have ignored. The introduction of sectorized cells, tilted antennas and micro-cells has made it possible for carriers to expand service in particularly congested areas like the area you serve in Los Angeles.

Competition and customer choice is not necessarily only accomplished by a focus on the basic rate, which has been a focus of most of the attention of both this Committee and the Public Utilities Commission. There have been new rate plans introduced that provide discounts to a significant number of customers. Promotions have been offered to provide discounts to new customers that sign on and that is the form of competition that has been expressed, at least in California. Now, one of the problems about that is that despite the phase two order, the way in which some of the policies have been implemented restricted the ability of carriers to offer these kind of inducements for customers to sign on to the service. One of the elements that was raised was that, if you have a rate that is in place today and you lower it, it is impossible if that rate does not return an adequate amount to the carrier, to raise it back up again under today's circumstances. In addition, if you have a rate plan that the carrier wants to introduce that changes a number of rates, even if the totality of rates causes a revenue reduction, to the extent that there are any rates that go up, the process of getting such a plan through is a process taking sometimes between eight and ten months, if it's approved at all. In addition, in California there is no capability for carriers to package the sale of equipment with the sale of service which is prevalent across the nation and provides significant discounts for our customers coming on to the service.

One issue that was brought up earlier is that the change in rates or reduction in rates needs to be looked at in the context of returns. To the extent returns are an issue, I just want to offer that PacTel's return overall in California is about 22 percent, which we regard as fairly reasonable for a very risky industry and considerably less than venture capitalists would demand of their kind of investments.

The second part of the Committee's inquiry is how should the state regulate the cellular industry? Our view is one eye should be on the past, recognizing that there has been unequaled customer growth in the area of about 30 percent per year, over a billion dollars of investment in California, over 10,000 jobs have been created and new technology continues to be introduced at a rapid pace. The other eye, we suggest, ought to be put on the future, that there is intense competition that should be recognized, existing today. All you have to do is open a newspaper and see the plethora of ads for cellular service and equipment. The recognition ought to be given that Fleet Call, who will be testifying later, is coming. It has said publicly that it intends to compete directly with cellular carriers and it is also recognized as not being regulated by the state Public Utilities Commission. Further, the Federal Communications Commission has adopted proceedings and is involved in trying to license personal communications networks and their tentative conclusion is to license three in each market, each of which will have 30 megahertz of spectrum, each of which is larger than each cellular provider has today. And, it is not clear whether they will be common carriers regulated by the state or private carriers which are exempt from state regulations.

Finally, in light of these activities which will be happening in the future, the question I raise is, why should the state of California spend resources regulating an industry trying to simulate competition, when competition is today and will certainly be expanded to be abounding? The suggestion that we have is that the Commission revisit one of the elements of its phase two order which suggested a monitoring program be put in place. That was discarded in the latest order. The proposal was to look at how carriers are expanding their systems and evaluate whether they are expanding them rapidly and then look at whether they are pricing their service to fill up that expansion. And, to the extent that both of those things are occurring, there shouldn't be any problem that would warrant an investigation or concern. Thank you.

CHAIRMAN ROSENTHAL: Let me ask a question. The FCC will, at some point, be issuing PCN licenses. Will PacTel Cellular apply for one of those which is in competition with PacBell?

MR. KIDNEY: I need to answer that in two different ways. One is, we need to evaluate whether the opportunity is one that is viable from our perspective, whether it is a good business decision. If it is, we will follow whatever rules and guidelines the FCC issues. They have indicated a preference for awarding those license to operators other than the incumbent cellular operator in a given area. The other issue is whether those will compete with Pacific Bell. That very much depends on what kind of a business we are and whether we continue to be affiliated with Pacific Bell at that time.

CHAIRMAN ROSENTHAL: Finally, is Pacific Telesis opposing the PUC decision to apply affiliate reporting requirements to cellular telephone utilities?

MR. KIDNEY: We filed comments in that proceeding describing that Pacific Bell already is covered by extensive affiliate transaction rules and that the new rules that are proposed offer a layer of burden that is completely unnecessary, not merely duplicative, but quite burdensome.

CHAIRMAN ROSENTHAL: Are you in favor of the monitoring of that, or not? See, one of the things I'm concerned about is cross-subsidation. I'm concerned about the kinds of things which some of the utilities have already been fined for doing when they said they weren't doing. I'm concerned about that type of thing.

MR. KIDNEY: We have no objection to the Public Utilities Commission investigating any allegations of cross-subsidy and we are not aware, as was discussed earlier, of any problems in providing the PUC with information.

CHAIRMAN ROSENTHAL: Okay. Thank you very much.

SENATOR GREENE: Mr. Chairman.

CHAIRMAN ROSENTHAL: Yes.

SENATOR GREENE: I noticed that one of your illustrations was that you would expect to pay more for a car this year than you did last year and so on. Do you want to tell me about a computer?

MR. KIDNEY: A computer is a piece of electronic equipment, also a cellular telephone, where the growth in the sales has produced economies of scale in the manufacturing that permit the manufacturer to reduce the price over time.

SENATOR GREENE: Yes. Which you indicate.

MR. KIDNEY: ...on the scale are not present in the cellular service.

SENATOR GREENE: Well, one wonders. There's an awful lot of different computers being offered at this time. I can't imagine that they are all selling the same number of units. I don't know that IBM and Tandy and Apple and so on and so forth are selling the same number of units. So, apparently this scale is different among them yet the price seems to be drifting southward rather than northward.

MR. KIDNEY: Well, I believe there is economy of scale, at least in some segments of that business and, to the extent it exists, that what forces the price in the marketplace to be what it is. It is not a regulated market and so those with scale will force the price to its market level.

SENATOR GREENE: In other words, I can't draw any conclusion from what you said either about computers or what you said about the product you sell.

MR. KIDNEY: Well, I don't know what conclusions you're...

SENATOR GREENE: Well, you indicated that you would expect to pay more for an automobile next year than you paid this year, and so on, and so you're suggesting out of that that perhaps this is a reason why the price of your commodity can't come down, that it's going to cost more rather than less. And, the more high-tech you go, it makes no difference. It's going to cost more rather than less. On the other hand, no matter how high-tech computers go, and they are increasing in capacity all the time, and in speed and all the rest of it, there seems to be some tendency for their prices to go down rather than up.

MR. KIDNEY: I think the comparison I was trying to draw was between those businesses that tend to have economies of scale and have declining marginal costs, which is...

SENATOR GREENE: Well, and I find it difficult to not include you in that category.

MR. KIDNEY: I don't know what the economies of scale or declining marginal cost capabilities are in the auto industry, but I do know I paid more for a car this year than I did in 1984.

SENATOR GREENE: So did I but I also noted that here was an awful long list of markets that were shown here, you know, with a great disparity of costs. Thank you, Mr. Chairman.

CHAIRMAN ROSENTHAL: Okay. Thank you very much. Peter Casciato. Oh, I'm sorry. Michael Heil, President of L.A. Cellular. I was trying to eliminate you. I'm sorry. Right. And, if I eliminate you, do the costs go down?

MR. PETER A. CASCIATO: Yes. Absolutely.

MR. MICHAEL HEIL: I am Michael Heil. I am the President of the Los Angeles Cellular Telephone Company.

CHAIRMAN ROSENTHAL: Let me, I glanced through this and a lot is duplication of what we have already heard. If you will try and eliminate the duplication, we can get to the gist of the matter.

MR. HEIL: I will, Senator.

CHAIRMAN ROSENTHAL: Thank you.

MR. HEIL: I will try to shed some light on some of the discussions that have occurred. I would like to address three major issues. The first is that the perception that cellular rates are too high. I would like to address that briefly. What can the PUC do to encourage lower rates and expanded service and what could be done by the Legislature to encourage these same goals. Clearly, there is a perception that rates are too high and, admittedly, the standard rate in Los Angeles has remained static at $45 a month and 27 cents a minute.

CHAIRMAN ROSENTHAL: Forty-five cents.

MR. HEIL: Forty-five cents for peak and twenty-seven cents for off-peak.

CHAIRMAN ROSENTHAL: Yeah, but most people use it peak.

MR. HEIL: Correct. In Sacramento, however, the standard monthly rate, I believe, is $24 and the usage is 29 cents for peak and 15 cents for off-peak. Perhaps it is this circumstance that has caused the PUC to propose that California become the first and the only state to impose rate of return regulation on our industry. However, what is not generally recognized is that today nearly half of our customers are on alternative discounted rate plans. And, I'll share some numbers with you. Forty-seven percent of L.A. Cellular's customers now pay less than the standard rate. Just three or four years ago only fifteen percent of those customers paid less than the standard rate. Additionally, there are numerous promotions which the other speakers have enunciated that are underway which give cellular customers free air time credits and other benefits. So, although the standard rates have remained unchanged, cellular has become more affordable to a larger part of the population. And, our average monthly revenues per subscriber have fallen in Los Angeles from 1989 at approximately $150 to about $100 today.

But, for today's purposes, let me assume that today's cellular rates in the large cities, specifically, are still higher than we would like. What prevents them from dropping more quickly? And, I think there are two key answers to the question. The first is supply and demand. Cellular rates all over the country tend to be higher in congested areas where there is great demand and lower in rural and suburban areas where the cellular systems have idle capacity. In Los Angeles, for example, demand is very high and we are incented to expand capacity as quickly as possible and, in fact, we are. In this regard, you should know that we will be one of the first carriers in the country to introduce digital services on a commercial basis and that we have planned to invest hundreds of millions of dollars to expand our system capacity over the next few years. With that additional capacity will come the opportunity for price reductions and, Senator Greene, I want to refer to your comment earlier - and you are correct - there are cost benefits associated with advancing technology. Having personally come from the TV business and having worked for Sony for many years, in a mature product category, once you have wrung all of the costs out of a particular product, there is less opportunity to make technological advances and reduce cost. What you are seeing in PCs is what you will also see in cellular, which is that as we bring new technologies to market there will be an opportunity for decreased costs and, therefore, decreased retail pricing.

The other key to lower rates, in my opinion, lies with the Public Utilities Commission. Once again, it is the conventional wisdom that rate regulation will keep prices down and this, as we have discussed today, may not necessarily be true and, in fact, I do not believe that it is true.

CHAIRMAN ROSENTHAL: Well, let me just break in here. You said a little earlier that because of congestion the prices are high.

MR. HEIL: That's one of the factors, yes.

CHAIRMAN ROSENTHAL: Well, that reminds me of the reason we pay more for gasoline in Los Angeles than we pay for gasoline in Sacramento. Because there are more drivers in Los Angeles. That doesn't make sense from that point of view. Can you comment on that? See, it's not regulation, per se, although regulation may have something to do with it. But, it's because that's where the market is and that's the reason it's higher because that's where you can get the money to make up for the areas perhaps where you can't get the money. See what I'm saying?

MR. HEIL: Yes. I think that part of the reason that rates are high in Los Angeles is because of the supply/demand equation. But, I believe that another reason - and, again, to make the point - there is promise and there is the opportunity for further price reductions after a digital transition which will give us capacity for at least three times our current capacity, but that will take several years to roll out.

The other key to lower rates today, even given the supply/demand equation, lies with a more flexible Public Utilities Commission and, let me give you some specific examples. There seemed to be some confusion earlier as to how that actually occurs. Two years ago L.A. Cellular attempted to institute a gift certificate program which would have allowed $100 reductions to end users. The proposal was protested by our competitor. More than two years ago...

CHAIRMAN ROSENTHAL: Wait, wait, you wanted to reduce, you wanted to give a gift of $100 to every purchaser and your competitor opposed it?

MR. HEIL: That's correct and the PUC upheld the protest. Let me give you another example. More than two years ago...

CHAIRMAN ROSENTHAL: What was the reason? What was the reason they gave? What did the PUC give as a reason?

MR. HEIL: In that particular case I believe that it had to do with the fact that not all of our subscribers on our system would receive that particular gift because it was a promotional offering, if I recall correctly.

CHAIRMAN ROSENTHAL: Discrimination, was that the...?

MR. HEIL: Yes, and the, obviously, in a competitive market any commodity that we've discussed today, there is always the opportunity to buy on a sale weekend at a reduced price and no one anticipates that everyone from here to eternity will receive that same price.

CHAIRMAN ROSENTHAL: Has anybody raised the question that to one reseller you give $300 for selling that service, and another one gets $500? Is that not discrimination?

MR. HEIL: No, this did not have anything to do with resellers, per se.

CHAIRMAN ROSENTHAL: Okay. Would that be a concern of the PUC?

MR. HEIL: Any kind of promotion generally requires a reseller clone, as Wayne Perry mentioned earlier, and there are certain rules that protect their margins.

CHAIRMAN ROSENTHAL: I see.

MR. HEIL: An additional example was more than two years ago we tried to introduce rate discounts of up to 22 percent for small companies and affinity groups, which President Fessler referred to earlier. For the program to be effective, we had to perform individualized billing services for our master customers and this is what the customer needed in order to do business with us. Our offers to do this were protested by the competition again and it took about a year and a half and a petition for modification for the PUC to approve of the plan.

In March of last year we informally sought permission to give discounts of up to $300 to customers who would utilize digital services. The PUC required us to file a formal application. It was again protested by our competitor and it was, fortunately, the application was approved last week.

I can go on with the examples but the point is, and you talked earlier about how does this inhibit competition and these examples are examples of how the administrative and regulatory process can inhibit competition and delay price movement on the down side.

CHAIRMAN ROSENTHAL: Let me ask you a question and if you would rather not answer, just tell me you don't want to answer. Have you ever opposed a reduction that your competition wanted to propose? No, he pointed out that when they wanted to do something they had opposition from the competition. I just want to know if it works both ways.

MR. HEIL: That's correct. It does not in our case. We have, I have been with the company four years. We have not protested one of our competitors downward price movements.

CHAIRMAN ROSENTHAL: Thank you.

SENATOR RUSSELL: May I ask a question? Those are the rules of the game. I mean, that's what the PUC is about. You protest something that the other guy gets an advantage over you and you try to make that up. I mean, I don't think that's a good system but that's the system. Why would you not protest some advantage they get over you if that's...

MR. HEIL: The spirit of the OII was that the PUC wanted us to lower rates. We felt that we could be aggressive, be cooperative and still attract more customers and not protest downward price movements. We would rather compete in the marketplace than compete in the administrative arena. Therefore, that's just a company philosophy.

SENATOR RUSSELL: Do you have any figures as to what it costs to go through one of these protest things that you have to do?

MR. HEIL: I do but they are proprietary in terms of my - they are considerable. The cost of regulation for a company such as ours is quite high when you consider all the fees we will incur as a result of it.

SENATOR ROSENTHAL: Okay. Continue.

MR. HEIL: Exhibit E, to my prepared testimony, lists eight general grounds which have been used to delay or block decreases by cellular carriers. One of the most surprising of these rules is that - and these astound me, actually, - is that no carrier can give a customer more than $25 in cash refunds or $100 in air time credits. So, for whatever reason, there is a distinction drawn between cash and credit and if you are a user of our system I'm sure you wouldn't care if you got a check or a credit and why the limit is $100 and the distinction is $25 and $100, I have not a clue, but...

CHAIRMAN ROSENTHAL: Have you raised that question at the PUC?

MR. HEIL: Yes, we have, and this rule alone has gone far to prevent competition in our industry because when we talk about promoting to the market we have to take into account these rules and it has become very stifling in that regard. I want to emphasize, however, that the present situation is not necessarily the Commission's fault. Whenever a government agency tries to administer prices in a competitive industry, some will use the regulatory system as a device to keep prices high. It has been years since we protested and we discussed that and, unfortunately, the PUC has now suggested a rate of return regulation for cellular carriers and I would like to be very direct and say that putting this suggestion into effect would be disastrous to the industry for the following reasons: First, it would result in inefficiency. From my perspective, rate regulation is basically a cost-plus contract with the public. It encourages waste by the utility and discourages efficiency. I do have filings of my financials as well as my competitors' and I don't know who was remiss in their filings but clearly my competitor and myself have filed in 1991. I'll share with you some numbers. We have $38 million more in revenues during 1991 than our competitor and $21 million less in expenses. Under the PUC's current proposal there would be absolutely no reward for this efficiency and, as far as I know, no attempt has ever been made to impose cost based regulation on a market where two competing carriers have two different rate bases. By definition, the result would be two different price caps. So, either the carrier with the higher price cap would be forced to price predatorily or the low priced carrier would be overwhelmed by the new demand because he would obviously have a cheaper retail price.

Secondly, the proposal would obviously harm the service quality and I think that's the most important point. Because it is the lower cost carrier - in our case it would be us in the LA market - would reduce its price across the board to a level lower than the competition, would result in demand and congestion on the system. Exhibit D to my prepared testimony shows that nearly 170 of our current cell site sectors now experience blocking approaching five percent during the busiest hours.

CHAIRMAN ROSENTHAL: You mean blocking (INAUDIBLE)?

MR. HEIL: You can't get through, you can't get a line, that sort of thing. And, this is mainly in West LA, the most, what we call the core, West LA, Beverly Hills, all the way to Santa Monica, that whole area.

CHAIRMAN ROSENTHAL: Will digital take care of that problem?

MR. HEIL: Over time digital will take care of the problem but it will take a lot of time to deploy digital. It is not something we, it is not like a land line telephone where you just lay the line. We, and these are rough figures but, for every 25 to 30 subscribers we need to order a new voice channel. The number of subscribers in Los Angeles, if they were to all punch the send button at once, and there are over 700,000 of them on both our systems combined - I'm assuming PacTel has kept up with me - there could only be completed about 35,000 calls. So, when you take the voice - less than that, actually, probably 20 or 25,000 calls - so, unlike land line telephone when you lay a line there are a number of circuits, etcetera, we have to have a voice channel for every conversation that's occurring. Now, digital would help but, if you look at the chart, what you will see there is that if demand were suddenly increased, and I'm trying to project what would happen in the current PUC proposal. If demand were increased by as little as 20 percent on these sectors, blocking could increase by as much as 400 percent, so what would happen is that very few people would get a line, to bottom line it.

CHAIRMAN ROSENTHAL: Is the digital that you're investing in - that's a three times process, or...

MR. HEIL: Over time digital, what we will do will be to layer in our digital in the core area first, the most congested area. It will begin to offload the analog subscribers. There will still be analog available. Then we would overlay the digital system throughout Los Angeles over the next year to two years.

CHAIRMAN ROSENTHAL: Let me ask a question. With all of the advances being made in telecommunications, are you saying that that same instrument that somebody now has would not work on the digital?

MR. HEIL: It will work on the analog which we would continue to provide for an indefinite time period. It will not work on the digital radios but it will work on our system perfectly well. So, the phone you have will work even if you choose not to convert but, because of my capacity increase as a result of digital, I will be incenting you to take digital phones and you would receive added voice privacy, added call clarity, as well as...

CHAIRMAN ROSENTHAL: But I wouldn't have to buy another instrument?

MR. HEIL: Yes, you would.

CHAIRMAN ROSENTHAL: I would have to buy another instrument?

MR. HEIL: To take advantage of digital, that's correct. It's called a dual mode phone. It will work either on digital or on...

CHAIRMAN ROSENTHAL: Why would I as a user be concerned about digital? Why would I buy into your new system?

MR. HEIL: Because it will offer you...

CHAIRMAN ROSENTHAL: Less cost? Will it be cheaper for me?

MR. HEIL: That's correct. It would, $300 off the first year. That's the application that I mentioned earlier that was just approved so we will be incenting you to move to digital. You will also receive better call quality, fewer dropped calls, added voice privacy and other benefits.

CHAIRMAN ROSENTHAL: So, everybody who now has a phone, okay, go ahead.

MR. HEIL: Let me continue. The third reason that I feel that the proposal that the PUC has put forward will not work is that it requires micro-management of an infant industry. The point that Senator Russell made earlier, cost based regulation will require the PUC to pass on the wisdom of every significant expenditure reported by the cellular carriers. They don't have the staff or the funds. I don't understand how we could, together, working together, accomplish that.

Fourth, the proposal ignores the existence of unregulated competitors. Fleet Call, which is only one of these, will be in the Los Angeles market this summer and will compete directly with L.A. Cellular and PacTel. Fleet Call and similar companies are exempt from the PUC's jurisdiction and they will be in a position to price as they please. They will also be able to bundle which we are not allowed to do.

So, setting aside for the moment total deregulation as an alternative, which has been discussed, what I would like to do is answer the question, what can be done to ensure that cellular prices come down more quickly? Exhibit F to my testimony is our alternative proposal. It would abolish all of the technical requirements which now prevent cellular rates from dropping. Whether a decrease takes the form of free air time, a cash refund, credits against future usage, it should be allowed to take effect immediately. The only requirement is that rates would not be allowed to rise above current levels and that reseller margins would be protected.

CHAIRMAN ROSENTHAL: Have you made that proposal to the PUC?

MR. HEIL: Yes, we have and we will continue to formalize it. And, I might say that it is rather frustrating on the eve of our digital transition where we are on the brink of beginning to expand capacity at least three times, and only a few months away from a third competitor in the market, we absolutely need less regulation, not more. I therefore urge you to accept this proposal. It is a middle of the road, workable solution to the problem and it will foster even more competition while, at the same time, ensuring high quality service to our subscribers and that's a balance that we need to be cognizant of.

CHAIRMAN ROSENTHAL: Would that, in effect, call for a rate band?

MR. HEIL: You could call it a rate band, yes.

CHAIRMAN ROSENTHAL: In other words, I'm concerned if, in fact, your sales force is the reseller, that you don't force him out of business by your predatory pricing.

MR. HEIL: We would protect the reseller margins along the lines, in our proposal, along the lines that they are currently protected and, if your point is, Senator Rosenthal, that you would like to put a cap to it, we would support that, as well.

CHAIRMAN ROSENTHAL: Thank you very much.

MR. HEIL: Thank you.

CHAIRMAN ROSENTHAL: Now, Peter Casciato, representing the Cellular Resellers Association.

MR. HEIL: I believe we have one other cellular carrier, Sir. Jim Hendricks.

CHAIRMAN ROSENTHAL: Do you just want to add something? Okay. Take a couple of minutes. You weren't on the agenda.

MR. JIM HENDRICKS: I thought arrangements had been made with staff. I'm sorry, Sir. Chairman Rosenthal and members of the Committee, thank you for allowing me to...

CHAIRMAN ROSENTHAL: How many pages do you have there? And, I would like for you not to repeat what we have already heard.

MR. HENDRICKS: I'm not going to. Thank you for allowing me to testify today. My name is Jim Hendricks and I am the General Manager of Cal-One

Cellular a wire line provider of cellular service to the counties of Siskiyou, Humboldt and Del Norte County. Cal-One is a small cellular carrier in a rural part of the state and the message I would like to send at this legislative hearing on cellular rates, is that rate regulation poses more problems than solutions to the cellular providers and customers. Also, I want to emphasize here that all cellular markets are not alike and that any regulations established by the California Public Utilities Commission for cellular carriers should be sensitive to that fact.

It is my belief that the industry as a whole would be better off and the customers better served if they could be left alone with respect to rate making. And, that goes double for carriers serving rural markets. I can understand the role of the PUC when it comes to the need to review grievances on behalf of customers and intervening when cellular carriers price gouge or provide inadequate service but why should I have to respond in my PUC rate making proposals to wholesale rates for resellers when we have no resellers in my service area. This seems like an unnecessary regulatory burden which takes time and money.

Cellular service is not cheap because it takes a lot of investment to provide quality service and that's maybe why issues of high rates have been raised here. But, I would just simply like to say that the less rate regulation that is put on cellular providers, the more opportunity to reinvest in the local system to provide customers with greater capacity, better quality of service and more personnel to help with customer concerns.

If I might, I would like to read two paragraphs from the testimony I gave to this Committee in Los Angeles in 1988 when I had just been awarded the cellular franchise for my service area. "Based on our experience as a small independent telco regulated by the California PUC, we urge the state Legislature and the PUC to resist the urge to over-regulate cellular. Much has been said about what is wrong with the duopoly structure of the cellular industry, but I submit that cellular in the nation as a whole, and California in particular, wouldn't be enjoying the phenomenal growth and customer acceptance that it has achieved if the carriers weren't doing an outstanding job. The main complainers are the resellers. These people are riding the coattails of companies like PacTel, GTE Mobile Net and L.A. Cellular without making the high capital investments these carriers have made to build their systems. If they don't like the margins, why don't they become a McDonalds or a Minute Lube franchisee. Maybe the margins are better there. If it ain't broke, don't fix it is good advice to those that would over-regulate cellular. The trend in most of the states is not to regulate cellular or to regulate it very little. Those that complain about the high rates in California have not adequately compared the size of the expanded calling areas with some of the other major metropolitan areas and it costs a lot of money to build and operate these huge systems.

Private industry is now investing hundreds of millions of dollars in perfecting and expanding their systems and, given the present health of cellular and its fast growth, we would urge against hasty change, absent a very good cause." End of quote.

CHAIRMAN ROSENTHAL: Thank you very much. May I ask, what is your rate?

MR. HENDRICKS: My rate is $9.95 a month and I have a flexible rate plan that starts out at 75 cents a minute peak and it gets down as low as 22 cents off-peak for higher volume. It's a variable rate plan where the more you talk, the less you pay.

CHAIRMAN ROSENTHAL: That makes sense.

MR. HENDRICKS: Well, we think, what we wanted, we wanted to have a rate that was under $10 so someone that wanted a phone for security purposes could have a phone for under $10 and, naturally, the first 37 minutes are at the highest tier, at the 75 cent peak, 40 cent off-peak rate. But, it rapidly drops at the thirty-eighth minute down from 75 to 40 cents and then, at 151 minutes it drops again, you know, and like I say, it conceivably can go as low as 22 cents. Now, we've found great customer acceptance for this rate plan.

CHAIRMAN ROSENTHAL: That kind of indicates that the high cost is on the basis of volume and not regulation.

MR. HENDRICKS: Well, we are very hampered with regulation. For example, I just had someone approach me the other day and they wanted to know if I could provide free air time to someone that pressed 222 on their phone, which is AAA, the triple A tow truck service. And, to do that I would have to have my attorney file a special tariff with the PUC in order to make it a free call to call a tow truck. I would like to just simply do that for my customers and for roamers but it would probably cost me $1,000 in legal fees to get the authority to give away a free call for a tow truck. That's one of the examples. One of the things that regulation causes, real problems for us small rural carriers, things like that.

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR RUSSELL: It sounded like your rates and prices are lower than the densely populated metropolitan areas. Is that because you have, because you are rural you have less invested in infrastructure?

MR. HENDRICKS: We have a lot more invested in infrastructure per customer...

SENATOR RUSSELL: Per customer.

MR. HENDRICKS: ...because we have a small density. One problem we have up on the north coast is that we don't have a lot of industry up there because of the impact of the Spotted Owl on the logging industry and things like that, and we have a lot more customers that are senior citizens, housewives, people that have the phone for security, RVs, people like that. We have a lot of customers that are like that and they are attracted to these flexible rate plans.

SENATOR RUSSELL: How are you able to have a lower rate than apparently the ones in Los Angeles and the metropolitan areas?

MR. HENDRICKS: I should tell you that we are still losing money and we are in a negative cash flow position at this time. What we are trying to do is grow our system to the point...

SENATOR RUSSELL: Oh, that may have something to do with it. Okay.

MR. HENDRICKS: We have tried to adopt a strategy that works in the rural area. So far, we're ahead of projections on customer growth and we're happy with what we're doing up there. I think we're trying to do a good job for the public.

SENATOR ROSENTHAL: So, they're going to make it up on volume. Okay, thank you very much.

MR. HENDRICKS: I just, one final paragraph here, Mr. Chairman and members. I believe the testimony I gave in 1988 is still valid here in 1993 and it is my hope that the Legislature will help guarantee that any rate regulation determined for the cellular industry be fair and not ultimately harm the most important part of the cellular network, the cellular customer. Thank you very much.

CHAIRMAN ROSENTHAL: Thank you, Sir. Okay, now, Mr. Casciato, representing Cellular Resellers Association. The bad guy.

MR. CASCIATO: I have two children and they are safe, as far as I know.

CHAIRMAN ROSENTHAL: I'm sorry.

MR. CASCIATO: I would like to go right back to the subject that Mike Heil was bringing up about digital and about this digital application in Los Angeles. And, when L.A. Cellular filed its digital application in Los Angeles it included a lot of things in it that were against PUC policy, in the view of the resellers. So, we filed a protest and when we filed the protest, the resellers got back a memorandum from L.A. Cellular and the memorandum was from the Vice President of L.A. Cellular. And, it said, "Our plans to make hardware digital and our analog available to the reseller community have been put on hold as a result of the protest." We could not get equipment. Remember those phones, you've got to buy a new phone for digital? We couldn't get it, if these guys wouldn't allow the manufacturers to sell it to us, because they were buying up the equipment in the market. We took this over to the PUC to show this to them and all of a sudden there were settlement negotiations and we settled our protest with L.A. Cellular. We didn't hold them up and this memo went away and the terms and conditions of how we were going to get both equipment and how we were going to sell service went away. But, do you know what did not go away? The protest by PacTel Cellular. And, the reason that Mike Heil's company has been held up in introducing its digital plan is not my client, but it's because of the PacTel protest, and he could have started a lot earlier but for the PacTel protest. So, when we come up here and have carriers give a rendition of history and policy from the PUC, I suspect it would be better if we got specific facts, because, in this particular case there would be digital faster in the Los Angeles market if PacTel hadn't filed a protest, not because of the resellers. Likewise,...

SENATOR RUSSELL: Why did you file a protest at the beginning?

MR. CASCIATO: In the beginning?

SENATOR RUSSELL: Yes.

MR. CASCIATO: Because the original application, among other things, we felt, discriminated under the Public Utilities Code, among retail customers who were going to receive service. It appeared to bundle equipment with service. It was going to maintain margin requirements.

SENATOR RUSSELL: How did that affect you?

MR. CASCIATO: How did it affect us?

SENATOR RUSSELL: Yes.

MR. CASCIATO: I don't quite understand the question.

SENATOR RUSSELL: I mean, did all those things affect you or the ultimate purchaser of the service?

MR. CASCIATO: They affect me and they affect the ultimate purchaser because I'm trying to sell to the ultimate purchaser too. My client is trying to compete equitably in trying to sell to the ultimate purchaser. He's not looking for a hand out. There seems to be some mistake...

CHAIRMAN ROSENTHAL: Why don't you explain the concept of resellers. What is it you do that's different than what the company does and why is it better or why should we eliminate you, or not.

MR. CASCIATO: Please don't. The PUC, in 1984, when it certificated the Los Angeles SMSA limited partnership as the first cellular provider in the state of California, also certificated five resellers. In that decision, in following up on the decision of the Federal Communications Commission, it decided that an independent resale program was good for the state of California because it would incent the wholesale providers of cellular service for wholesale competition. It would also incent retail competition by an independent third force. Resellers have existed in California since that decision at the end of 1984. They continue to exist today. There are over 70 entities holding reseller certificates in California. All but two, to my knowledge, are based in California. They are all small California businesses. They all employ people.

SENATOR RUSSELL: But, that scenario is not the case in other states that are non-regulated? A few of them have resellers but apparently most of them don't, is that correct?

MR. CASCIATO: My understanding is that there are resellers in New York. I believe that that's...

SENATOR RUSSELL: That's regulated.

MR. CASCIATO: That's regulated. I believe there are still some resellers in Chicago.

SENATOR RUSSELL: That's unregulated.

MR. CASCIATO: Right. And, I believe that there are some resellers in Florida, although they may have been made extinct by...

SENATOR RUSSELL: But, is it a fair statement to say that in most cases where there is no regulation, there are not resellers? Whether that's good or bad, that's not the point. Is that a fair statement?

MR. CASCIATO: I don't know if that's a fair statement or not. I know there are also resellers in Detroit and I don't know whether or not there's a cause/effect between regulation and whether resellers exist.

SENATOR RUSSELL: From your perspective, in fact, where there are no resellers, forms show that the rates were lower than in regulated states where there are resellers. Do you have any comment on that?

MR. CASCIATO: I sure do. I am trying to find out where Mr. Perry got his facts, because I'm looking at a publicly filed notice of ex parte communication by the PUC's division of rate payer advocates, which shows that the rates in Los Angeles and San Francisco are comparable to the rates in Seattle, Miami and New York. Seattle is the home of McCaw and U.S. West, the certificated entity in San Diego, and it's an unregulated state. So, I wonder where this study came from from, Mr. Perry, because, according to the PUC staff survey, this is December 22, 1992, rates are high in Seattle.

SENATOR RUSSELL: Rates are high in Seattle, but apparently, if that is the case, and rates in California are comparable to other rates where they are not regulated, does that mean that our rates are too high or does it mean that all the rates are too high?

MR. CASCIATO: It could be that all the rates are too high. I would suggest to you that if we were to investigate the rates in California further which, I guess, might be part of the proposal of the PUC in its upcoming inquiry, maybe we would find them not only too high but maybe that the costs are not as high as have been projected here today.

CHAIRMAN ROSENTHAL: That's interesting. We heard also that the resellers protested the carrier request of the PUC to lower rates. Why was that done?

MR. CASCIATO: The resellers have never protested a lowering of retail rates in California if wholesale rates were lowered at the same time. The purpose of the 1990 decision of the PUC was that they were going to provide competitive equity to resellers so that lower rate reductions in California, both wholesale and retail, would travel in tandem until the outcome of the 1992 decision which came out in October, which was to establish a method of accounting for wholesale and retail revenues and expenses, so that the carrier would properly account for its costs and not cross-subsidize its retail operation with the operation it was making at wholesale. The idea was that the retail division of the carrier would be transparent, just like an independent reseller, in the way it bought under the wholesale tariff of the carrier and, therefore, it would have to be efficient and go out and make money and be profitable just like the reseller who has no wholesale arm cross-subsidizing it.

CHAIRMAN ROSENTHAL: Is that the reason that they have asked for a separation of wholesale and retail?

MR. CASCIATO: That's correct, and that goes all the way back to 1990. That's not some phenomenon of the 1992 decision. Let me also add that Mr. Kidney misreads the 1992 decision. One can search this decision in vain, and

I'll go through it with anybody, and there is no retail ceiling set on any carrier rate. And, in fact, what this decision says, the Finding of Fact 54, "Existing retail and wholesale rates will remain market priced." So, you're a carrier. You don't have to change a thing today, tomorrow, after the next proceeding. You get to keep them. The only thing this decision says is that if a reseller decides to invest money in a switch and goes into a market and wants to buy only those elements that it needs from the carrier on an unbundled basis and, in turn, can go and buy the elements it needs from the local exchange network on an unbundled basis, then you have to sell it to the reseller, the carrier, at cost plus at least 14.75 percent. And, in fact, if the carrier thinks that 14.75 percent is a bad idea, this decision says, "Come to the next proceeding and tell us why." So, this is not a return to rate regulation of existing bundled wholesale and retail rates. We say it only says if a reseller tries to achieve some competitive equity and resell in a specific market, and not necessarily the rural market that we just heard from, that they're entitled to competitive equity and, "Don't worry, carrier, you're going to make at least 14.75 percent, whether you take the entire staff to Hawaii, or not." And, it is not micro-management of costs. It only says, "Come in and show us the costs."

CHAIRMAN ROSENTHAL: Yes, yes, this is kind of interesting. Figures lie and liars figure. Right? Let me ask you another question, there's been the suggestion that if we have technical, if we make these changes, that all we do is transfer the profits from the duopoly to the reseller. Comment on it?

MR. CASCIATO: Yeah. My clients are the only clients on the public record in the state of California committed to lower retail rates. We are in the record in the proceedings saying that.

CHAIRMAN ROSENTHAL: What does that mean?

MR. CASCIATO: What it means is that if you do sell this to us at cost plus 14.75 percent, or some rate of return which the carriers would like to come in and explain to us, that it will be at some cost for which we can buy and then we will, in turn, not only probably be able to make more money, but we also can offer a break to the consumers. And, we can do it with simple tariffs which say, "The price today for the minute is not 45 cents a minute, it's 44 cents a minute." It's not going to be one of these wonderful tariffs we see out of the carriers which is, if you buy it today and you sign up for twelve months, and you stay on forever, and you don't move out of the service area, and you don't wear a hula hoop, you get a lower rate. The hula hoop is the only part that's not in those tariffs.

CHAIRMAN ROSENTHAL: Why shouldn't we worry about the technical feasibility of reseller switches? In other words, the PUC has...

MR. CASCIATO: No one told anyone who wants to use a switch when intraLATA competition opened, you can or cannot use a switch. The only issue with regard to a switch turns out to be the fact that some carriers have different switches, so these switches have to be able to talk to each other. If a reseller were to switch a call from the L.A. Cellular system to the L.A. SMSA system. At the time of the hearing, when we put on testimony before the PUC, they had projected that in mid-1992 IS 41, a software protocol, would be available and it would function to allow the compatibility of those switches to speak to each other. I am here to tell you today, June 1992, industry periodical, IS 41 becomes a reality, ConTel Cellular and PacTel last month became the first carriers in the nation to claim a successful commercial deployment of IS 41, here in California. So, there is no technical impediment. In the same periodical it indicates the following places where IS 41 is in place, all by carriers: Beaumont, Texas; Allentown, Pennsylvania; Austin, Texas; Detroit, Michigan; New Brunswick, New Jersey; Augusta, Georgia; Bridgeport, Connecticut; New Mexico; Fort Lauderdale, Dallas; Sacramento. This is seven months old. I suspect IS 41 is making its way across the country. There is no technical impediment.

CHAIRMAN ROSENTHAL: Do you have any further testimony?

MR. CASCIATO: Yeah. Remember those high commission rates you didn't like? They're back at L.A. Cellular. In response to the PUC decision, which they don't like, in which they say that the rates are not going to go down, what do they do? Do they try to lower rates? Do they file a simple tariff that says, "Okay, we give up. Wholesale goes down a penny. Retail goes down a penny." No, here's what they do. They go out and they jack up the commission rates so that now, if you offer them numbers of 21 plus, it's 500 bucks a number for dealers. Okay? So, we're back to $500 commission rates. Now, where's the money come from? Well, I can tell you where the money comes from. It comes from all the wholesale money they're making off my client. They're taking the money and they're out buying the marketplace again. They're not lowering rates. So, I, personally, I don't see any behavioral change here. I mean, this is 1985, redux. It might be time to resurrect the bill.

CHAIRMAN ROSENTHAL: So, you're suggesting that one of the reasons they can't reduce rates is because they're paying $500 to you to get them a customer? Is that what you're saying?

MR. CASCIATO: That's what I'm telling you. I'm also telling you I'm also tired about hearing about all the money that has to be spent on digital. Clearly, it's going to take some money to go to digital. Okay? We've talked to manufacturers and they estimate it will cost one-third more of the cost to go to digital. If you spent three bucks to build your system, it's going to cost a buck to go to digital, which means you don't go and take the whole cell site out and throw it in the trash and build a new cell site. You go and get a transceiver and you put in some software. Okay? So, how much money is it going to take? How much money is it going to take in L.A.? What do you think? I think in L.A. maybe they spend $50 million to put the system in. Maybe I'm wrong, maybe $100 million. Okay? So, here's the 1988 annual report, L.A. SMSA. They made $75 million on gross, excuse me, on wholesale net operating income. So, they almost got their money back, let's say, if it cost them $100 million to build the system. That's only the wholesale revenue, okay. That's a 60 percent rate of return off of expenses. So, let's say they need some more money, okay. Here's the 1989 report from L.A. SMSA. That year they made $102 million, net operating income wholesale, roughly, the margin went down a little bit because they had $270 million in revenue, a 40 percent return. Now we've got enough money to go to digital. But, let's assume...

SENATOR RUSSELL: Let me ask you this. When you are talking about the gross return, it seems to me that expenses take-off from that and then the bottom line is the profit.

MR. CASCIATO: This is net operating income. Revenue in millions, net operating income $132 million, 60 percent return. Do you want to be in that business? Is there anyone in the state of California who doesn't want to be in this business? And, that's a utility. That's 1990.

SENATOR RUSSELL: But, how does that compare with the rate of return as of 1988 that we heard from the GAO of 25 percent?

MR. CASCIATO: Well, the nifty thing about the GAO, and I believe the 22 percent mentioned by Mr. Kidney is that he takes all of his markets together and loads them up, which means he might take, for example, Imperial County, and add it to L.A. What he doesn't do is he breaks it out by the revenue in the larger systems in the larger cities which is where the problem is and where there is no competitive equity. And, what I'm trying to tell you is that if you look at where the cash cow is, you will see that the money has been made to go to digital already and that any further money that's going to be made is going to be kept, which is fine, because that's the American system.

SENATOR RUSSELL: But, when you have a company you have to take in all the far flung fields that aren't returning or are at a loss together with the, as you say, the cash cow, and you put them all together and that's the profit margin of the company for that piece of business. Isn't that the way you do that?

MR. CASCIATO: Or, you have to take the money to the Pacific Rim when you break up Pacific Telesis and the President of...

SENATOR RUSSELL: No, you're not answering my question.

MR. CASCIATO: No. I'm precisely answering your question. What I'm telling you is that the money is being taken out of California. They're going to break up Pacific Telesis, according to the December 15, 1992 San Francisco Chronicle. And, they say they want to go and they want to build systems in the Pacific Rim and in Europe. They view it as California during the Gold Rush.

SENATOR RUSSELL: You're not answering my question.

MR. CASCIATO: I think I am answering your question.

SENATOR RUSSELL: No. If, you talked about Imperial and that, somehow or other, you shouldn't consider Imperial - which I guess is a loss - along with all the cash cows and come up with the bottom line figure. You're just giving us - it sounds like - the figures that relate to the cash cow. That sounds terrific but you have other areas, I guess, that aren't as profitable and those have to be figured in some way in the net return.

MR. CASCIATO: I can give you the returns in San Diego.

SENATOR RUSSELL: No. I don't want the returns piece by piece. Just answer the question. Don't you take the whole thing together?

MR. CASCIATO: No, I don't think so at all. In fact, I think quite frankly if one looked at what it cost to build Imperial and compared it to Los Angeles, you would not even see a proportional relationship and as a result of not seeing that proportional relationship I have severe doubt about the 22 percent figure provided by Mr....

CHAIRMAN ROSENTHAL: I understand the point that you're making. The question that I would ask you is why is the rate in Los Angeles different than in Imperial? It would be based then upon the Imperial's problem.

SENATOR RUSSELL: I don't know, Mr. Chairman, but I'll tell you. I listened very carefully to all of the testimony and I'm more confused now about where truth lies than I was when I came to this Committee, so I'm leaving.

CHAIRMAN ROSENTHAL: Well then, maybe we'll just leave it up to the PUC to make the determination.

SENATOR RUSSELL: They've got the determinations anyway.

CHAIRMAN ROSENTHAL: Okay, anything further?

MR. CASCIATO: No, I think I'm pretty much finished.

CHAIRMAN ROSENTHAL: Thank you. Thank you very much. Robert Foosaner. You're Vice President of Fleet Call, a name that we've heard several times this afternoon.

MR. CASCIATO: Mr. Foosaner has asked me to say that he hired both myself and Dick Severy at the FCC for our first jobs.

CHAIRMAN ROSENTHAL: I don't know whether he's happy about that or not.

MR. ROBERT S. FOOSANER: Mr. Chairman, thank you for the opportunity to testify.

CHAIRMAN ROSENTHAL: And, let me tell you that the hour is drawing late and, if you can summarize, we would appreciate it.

MR. FOOSANER: I have nothing to repeat from what any of the previous speakers have said.

CHAIRMAN ROSENTHAL: Okay.

MR. FOOSANER: However, each one of them with the exception of Mr. Hendricks had some comments about Fleet Call and what I'd like to do is tell you who Fleet Call is, what we're about, and what we're about to embark on and I will try to do it briefly. First, let me debunk three general statements that were said about Fleet Call. We are not about to enter the California market. We are here. We have been here for an extended period of time. We serve 60,000 mobiles in the state of California today. Secondly, we are much more heavily regulated than our cellular friends and I'll explain that in a little more detail. Third, the one accurate statement about Fleet Call is that we are going to expand our systems, providing additional services to the citizens of California, starting with the greater Los Angeles area, in August of '93 - August of this year.

Briefly, the SMR industry allocations were created in the exact same proceeding that cellular was created in. We function on a spectrum that is adjacent to and intercedes with cellular spectrum, so that our technical operations can be functionally equivalent over the spectrum. When the FCC set up SMR they set it up as a vehicle to expeditiously introduce new, more efficient technologies. That was the reason stated in the proceeding. That was challenged by state PUCs throughout the country through their regulatory association called NARUC. The courts upheld the concept. NARUC, state PUCs, radio common carriers and cellular companies continued to challenge the concept, took it to Congress and there is now legislation upholding the concept. It's been litigated. It's in place. What comes with being a private carrier is preemption of state regulation, but also what comes with it is much greater regulation by the Federal Communications Commission. A cellular carrier is given 25 megahertz of spectrum, the equivalent of four television channels each. Together they have 50 megahertz of spectrum - an astronomical amount of spectrum. The SMR licensees started out with 50 per market, each having approximately one-quarter of one megahertz, one hundredth of one of the two cellular systems, with the ability to combine if they put the spectrum to use, mainly loading standards. And, if they didn't, the spectrum was taken away from them. Not the kind of regulation cellular has. Cellular puts up sites, towers, and informs the Commission they have done so. The SMR must go through pre-operational authority and must protect adjacent channel licensees. All these regulations do not apply to cellular and that's why there is a federal dichotomy of regulation.

What we have heard today is that Fleet Call is going to provide competition. Fleet Call is going to turn on a system in Los Angeles, where we currently serve 25,000 to 30,000 mobile units, putting in at Fleet Call's own cost to the tune of $150 million, fully digital systems which will provide better mobile communications systems than exist anyplace in the country today, we believe. Our advantage is digital, which cellular is going to convert to. But, we're going fully digital from step one. The digital conversion we're making is leapfrogging what cellular is going to. The reason we're able to do it is because of the regulatory structure we were created under, allowing us to take risks without the protection of the state PUC. Fleet Call is going to be spending $300 million in the state of California over the next three to five years, going to be providing full mobile communication services.

We appreciate the opportunity to comment here. I am sorry that all the other Senators have left. We would be glad to answer any questions and I tried to make our statement very brief. We do have one concern since six of the previous eight speakers took shots at the California PUC. I would be remiss if I didn't take a little shot. California PUC seems intent on attacking the federal preemption, to the extent that they filed a proceeding related to a Boston operation - Boston, Massachusetts, where the Massachusetts PUC didn't file. We think that equal regulation is important. Unfortunately, that's not the way it was federally set up. We think more important is the opportunity for the citizens of California to get competitive services and better services, and we're hoping to have a positive relationship with the PUC, because we believe we're going to be providing that. Thank you.

CHAIRMAN ROSENTHAL: The cellular carriers often point out that your entry into the market proves there is competition. They argue that your entry justifies immediate deregulation - not all of them - but, some of the cellular are talking about deregulation. What's your response?

MR. FOOSANER: A year and a half ago our good friends in cellular said we'll never exist. They told the financial markets a year ago that we're not real, but now it's convenient for them for us to be real. What I would suggest to you is that we think they're right, we're betting on they're right, but I think you need to see a couple of years of our operation to prove they're right.

CHAIRMAN ROSENTHAL: How many years will it take before you believe that you have a significant market share?

MR. FOOSANER: Depending on how you describe "significant market share", I would estimate sometime in '96.

CHAIRMAN ROSENTHAL: Ninety-six?

MR. FOOSANER: Yes.

CHAIRMAN ROSENTHAL: Are we talking about five percent, ten percent, fifteen percent, twenty percent - stop me!

MR. FOOSANER: One of the things I feel reluctant to talk about is marketing, our market goals. If you clear the room I'd feel more comfortable in talking about that.

CHAIRMAN ROSENTHAL: Okay. Your prospectus talks of risks, including land use regulatory approvals and construction delays and predatory rate subsidies from cellular competitors. Will you elaborate on that?

MR. FOOSANER: Yes. The Securities and Exchange Commission requires when you go public for you to list every possible risk. That I provided to your staff to be sure you had full information about Fleet Call. It also is dated, I believe, January of '91. We have acquired 95 percent of our site clearances in Los Angeles to date. We are much more fully funded than at that time. We still face potential competition from the people that control the interconnection arrangements. We're concerned about that but it certainly is not at a level that I wish to raise or complain about.

CHAIRMAN ROSENTHAL: Okay. Anything further.

MR. FOOSANER: We appreciate the opportunity and hope to talk with you further in the future.

CHAIRMAN ROSENTHAL: Fine. Thank you very much. Okay. I'm going to take someone out of order who has to catch a plane. Michael Shames, the Executive Director of Utility Consumer's Action Network, UCAN, Shames, and please give us something new and not repetitive. It's getting late. As you notice, we've lost most of our quorum.

MR. MICHAEL SHAMES: Yes. Mr. Chair, thank you so much and thank you for taking me out of order. As is my custom, I have handed out a prepared statement which I will not repeat.

CHAIRMAN ROSENTHAL: Good.

MR. SHAMES: I wish to leave you with three thoughts and then, as I promised, I will leave quite briefly to catch my plane and have you move on. First off, just sitting here I can't help but be reminded of the same arguments that were presented in support or against any kind of cable television regulation arguments presented by the cable operators. And, I should just tell you that the arguments were weak and the arguments that I've heard today in opposition to any PUC action and inquiry into the cellular rates has also been fundamentally flawed.

One key point that I think has been missed here today is that there is a myth out there that consumers, small consumers, meaning residential and small business consumers have little need or little want for cellular service. In fact, there is a great need, a great desire out there, especially among small business, that need to be able to compete, but cannot, because of the high cost of cellular service. Additionally, there is a principle in the state of California, a well-accepted, long-standing principle of ubiquity that suggests that, in the state of California we will not tolerate an information rich/information poor society, where certain segments of the society have access to telecommunications services that others do not. And, the current trend of cellular pricing will lead to the loss of ubiquity or never achieving the ubiquity that, I think, in California is a long-standing principle.

Finally, I wish to suggest to you that from our vantage point, being the vantage point of UCAN as well as TURN, the California Public Utilities

Commission has begun a process that we believe is intellectually honest. We may not feel that the PUC is acting as quickly or as decisively as we might wish, but at least the process that they have begun in the inquiry into cellular services and prices is intellectually honest and we urge this body to allow the CPUC to continue that process and please do not inhibit it. And, those are my comments.

CHAIRMAN ROSENTHAL: To what extent, if any, has the Cellular Utility Association, or any of the utilities, approached UCAN or other utility consumers to collaborate on ways to lower rates? In other words, has anybody talked to you about it?

MR. SHAMES: Never. Never.

CHAIRMAN ROSENTHAL: Any further comments?

MR. SHAMES: That's it. I appreciate it, and please review my prepared testimony as I go into much greater depth.

CHAIRMAN ROSENTHAL: We will do that.

MR. SHAMES: Thank you so much and thank you for taking me out of order.

CHAIRMAN ROSENTHAL: Thank you. Okay. Richard Severy, Director of Regulatory and Government Relations of MCI.

MR. RICHARD SEVERY: Thank you, Mr. Chairman, and I appreciate the opportunity to be here today. I, too, have submitted a prepared statement which I will try not to elaborate upon. As the Committee is aware, MCI supports the steps taken by the Public Utilities Commission to foster competition in the cellular marketplace. Specifically, MCI supports those aspects of the Commission's decision which imposed unbundling requirements on facilities based cellular carriers. President Fessler of the Commission referred to this aspect in his earlier comments but did not elaborate and my comments today are focused solely on that aspect of the Commission's decision.

Simply stated, unbundling separates the functional elements of a telecommunications network. This allows users of the network to purchase only those elements that they need from the facilities based carrier instead of being forced to buy a full bundle of features which would, portions of which they may not need or portions of which may be redundant to facilities featured services they can provide themselves. Unbundling promotes open and equal access to the underlying network. The users or, in this context, cellular resellers, can then add the capabilities, take the capabilities of the facilities based carriers that they are interested in, combine those with any other value added features or, in this case, perhaps switching features, to create their own new or innovative features that may be important to their customers.

MCI supports this decision. We support competition generally in all aspects of telecommunications. Competition in telecommunications has brought and will continue to bring substantial benefits to California consumers, businesses and the California economy in general. I will talk a little bit about some of those benefits in a bit.

Why is MCI interested in this proceeding and in this market? There are several reasons. MCI today provides long distance service to cellular customers. Cellular customers can and do use long distance services. We believe that more open and fair and equal access to cellular systems will create new opportunities for us to provide services to cellular customers and for cellular customers to have greater choices of the kinds of services that they need.

CHAIRMAN ROSENTHAL: Are there some cellular carriers that do not offer open access to long distance?

MR. SEVERY: Under the anti-trust settlement decree that applies to all the Bell Telephone companies the Bell operating companies are required, and cellular systems in which they have a material interest, are required to provide equal access to long distance companies. That requirement does not today apply to cellular systems in which...

CHAIRMAN ROSENTHAL: ...the duopoly?

MR. SEVERY: Well, keep in mind that many of the cellular systems in California, both systems in a market may be owned in part by Bell operating companies, such as in Los Angeles. So, both of the cellular systems in Los Angeles, it is my understanding, have a legal obligation to provide equal access.

CHAIRMAN ROSENTHAL: Right, but that's not the same all over the state?

MR. SEVERY: That's a nationwide requirement that's a product of the anti-trust decree that the Bell companies entered into back in 1982.

CHAIRMAN ROSENTHAL: Are there some cellular carriers that do not offer open access for long distance companies.

MR. SEVERY: Yes. For example, in those markets where McCaw, which is not a Bell company, is the sole owner of the cellular system, they are not required to provide equal access.

CHAIRMAN ROSENTHAL: How does that effect competition and consumers, in your opinion?

MR. SEVERY: Adversely. In fact, we, earlier last year MCI petitioned the

Federal Communications Commission to open up a proceeding to require equal access to all cellular systems. We were supported in that effort by a number of other parties, including AT&T, including some public utility commissions. That matter is still pending before the FCC.

CHAIRMAN ROSENTHAL: Today, if I have McCaw cellular, I can't use MCI?

MR. SEVERY: Today, the way it works is the cellular provider determines which long distance carrier will provide service to its customers. So, in most cases, the end user, the cellular customer, doesn't have the option to get the long distance service that they might desire. In our case, where we do provide long distance service we have a number of specific services that are tariffed and directly targeted to cellular customers. In addition, a cellular customer who has access to our network can use any of our discount programs such Friends and Family where you get a 20 percent discount, calls to certain numbers.

CHAIRMAN ROSENTHAL: What future role does MCI envision for personal communication network services, PCNs?

MR. SEVERY: We have an organization within the company that has been very active looking the field. We are exploring some of the technologies. We have been looking at certain applications in today's environment. We also filed comments with the Federal Communications Commission asking to be one of the providers in a nationwide consortium which would be one of the providers of PCS services in this country. So, we're actually looking at that.

CHAIRMAN ROSENTHAL: Do you have any further comments?

MR. SEVERY: Yes, I wanted to talk, in our experience, competition has had enormous benefits and you raised the question earlier, Mr. Chairman, about the technical objections to resellers owning their own switches. These are not dissimilar from some of the objections that long distance, competitive long distance companies faced early on when we were trying to enter the market. With equal access, which really started being introduced in 1984, we have seen tremendous strides in this country. Long distances, both nationwide and within California, have come down dramatically. You've seen an outpouring of new and innovative types of services and discount plans and programs designed to benefit consumers, both residential and business. You've seen an outpouring, a real growth and spurt in the use and deployment of new technology. I think it's interesting to note that technologies like digital switching and fiber-optics have been introduced first in the more competitive aspects of the industry like long distance and we have invested, and other long distance companies, have invested in those new technologies because we have an incentive to do so and the incentive to provide new and improved features for our customers.

With respect to the Commission's decision to require unbundling, we think that is going to welcome new providers to look at the cellular market, to create new and value added features for cellular customers. The Commission's decision in the recent cellular proceeding to require unbundling is consistent with earlier Commission decisions where, back in 1989, where the California Commission ordered or required unbundling of local exchange networks, which we need to go through, we're dependent upon to reach our customers and for our customers to get to the local exchange, to reach our network and international network. So, the Commission has sort of a long standing policy about requiring unbundling, inter-connection, fair and equal access, and we think the latest decision is consistent with those earlier initiatives. It is also consistent with recent initiatives by the Federal Communications Commission to open up access within the local exchange and we think that that is a policy that should be fostered by policy makers within California.

That summarizes my testimony and if you have any further questions, I'd be happy to answer them.

CHAIRMAN ROSENTHAL: Thank you very much. And, finally, Jeffrey O'Donnell, Assistant Director, Division of Ratepayer Advocates for the PUC.

MR. JEFFREY O'DONNELL: Thank you, Mr. Chairman, members. I've been sitting here listening to all everybody has said and I am well aware of the admonition not to repeat that. We have covered most, actually, of what I wanted to say but there are a couple of things I would like to add. First of all, Division of Ratepayer Advocates is a separate arm of the Commission. What I am going to say today will represent the Division of Ratepayer Advocates but not necessarily the Commission.

CHAIRMAN ROSENTHAL: I hope so.

MR. O'DONNELL: Very well. As to competition, we believe there is no where close to enough. And, we are looking to competition to bring rates down. Why do we think rates are too high or there is not enough competition? First of all, incredibly high returns earned by the cellular utilities and those are reported returns, not ones we've audited to find out if they are understated or not.

CHAIRMAN ROSENTHAL: Wait, wait. Those are the statements they've given you?

MR. O'DONNELL: That's correct.

CHAIRMAN ROSENTHAL: But those are not the statements that are for public distribution?

MR. O'DONNELL: No. I didn't say that. My point is, these are their claims. We haven't checked to see if they're understated or not and their claims are very high returns.

CHAIRMAN ROSENTHAL: Are they presenting to you what is now required to be presented?

MR. O'DONNELL: Yes. Generally.

CHAIRMAN ROSENTHAL: Okay. So, it isn't that they're not giving you some information that you've asked for?

MR. O'DONNELL: Right. I'm not claiming that. All I'm saying is...

CHAIRMAN ROSENTHAL: Okay. I just wanted to, just...I understand.

MR. O'DONNELL: Their report says they're high. That's one point. Another thing that comes out, why would, if there aren't high returns, if there aren't, because of high returns, some opportunity for rate reduction, why would AT&T be interested in buying McCaw? Why would Fleet Call be willing to put in, as he said, $300 million in digital equipment to serve L.A. and, in essence, compete with the L.A. cellular utilities? Why wouldn't PCN devices be just over the horizon? We believe that these are indicators, along with the duopoly structure and all of these things, that clearly there is an opportunity to bring rates down and we prefer that competition provides that opportunity as opposed to regulation. But, we don't have that competition and, therefore, we are still for regulation. It's not a perfect world, but it does work.

CHAIRMAN ROSENTHAL: Would you comment on the fact that the PUC regulations stand in the way of them reducing rates without waiting 30 days or going through a process?

MR. O'DONNELL: I'll offer some comment. One is that if they want to reduce rates by up to ten percent, they can do it effective immediately. No 30 days.

CHAIRMAN ROSENTHAL: What, they can reduce the basic rate up to ten percent...

MR. O'DONNELL: That's correct.

CHAIRMAN ROSENTHAL: ...without going to the PUC?

MR. O'DONNELL: No. They have to go to the PUC but the day they file the rates can come down.

CHAIRMAN ROSENTHAL: They don't have to wait 30 days?

MR. O'DONNELL: That's correct. If it is a larger decrease they do.

CHAIRMAN ROSENTHAL: But, up to ten percent they could reduce it?

MR. O'DONNELL: That's correct.

CHAIRMAN ROSENTHAL: They could go from 45 to 41?

MR. O'DONNELL: That's correct. So, again, I'm not saying regulation is a perfect way to go and, in some cases for larger reductions, yes, there is a 40 day, 30 day process. But, it is a process that applies to both carriers and to resellers. So, it may cause rates to come down slower but it's not going to stop them from going down.

Now, earlier there were some comparisons given with L.A. and other parts of the country purporting to show that regulation causes rates to be high. Now, I don't pretend that those comparisons necessarily prove that because there are plenty of other factors. But, if you will look at that you will find, this is based on the study my folks did, if we compare with L.A. and we look at, for example, Miami, this is based on 120 minutes of monthly usage on the basic rate...

CHAIRMAN ROSENTHAL: A hundred and twenty minutes?

MR. O'DONNELL: A hundred and twenty minutes. If L.A. is charging $99 a month total price for that usage, Miami is charging $93.

CHAIRMAN ROSENTHAL: Ninety-three?

MR. O'DONNELL: Ninety-three. If I look at New York...

CHAIRMAN ROSENTHAL: Wait, wait, you know, that's interesting. I'm looking at McCaw. They have different figures.

MR. O'DONNELL: I can't talk about...

CHAIRMAN ROSENTHAL: Can we ask the PUC to comment on McCaw's Rate Chart E?

MR. O'DONNELL: I don't have it, so I can't very well comment.

CHAIRMAN ROSENTHAL: No, I mean in writing for the record?

MR. O'DONNELL: We'd be happy to.

CHAIRMAN ROSENTHAL: Okay?

MR. O'DONNELL: Yes.

CHAIRMAN ROSENTHAL: Thank you.

MR. O'DONNELL: Another example would be, and that's Miami where it's not really regulated to any degree. Chicago has been claimed to be unregulated. Now, down there, compared to L.A. at $99, the figures I have show Chicago at $59. Does that mean that regulation is causing that? No. Let's look at

Sacramento. On the same basis I have, depending on which carrier, $60 and $52. So, California's rates, or actually these are monthly charges, span the range. They are at both extremes of these other cities where it's either regulated or unregulated. So, my claim is, at least as far as these figures are concerned, it does not prove that regulation is causing these to go up - state regulation, not federal.

CHAIRMAN ROSENTHAL: No, I understand. Do you think, do you think it's caused by the demand for the service?

MR. O'DONNELL: I would think the demand for the service should cause it to go down, not up, so I don't see increased demand causing more. If demand for the service was a problem, I'm not too sure why Fleet Call would be interested in serving in L.A..

CHAIRMAN ROSENTHAL: I think some carriers argue that the high rates are needed to prevent capacity overload and service degradation.

MR. O'DONNELL: Well, I'm sure they feel that. They don't want to compete but in a real market it wouldn't be that way. As soon as you have a lot of sales, what are you going to do? Are you going to say, Well, we don't want to sell it? No. You take a business risk which is what it involved in putting out additional money to go digital, for example. You take a business risk, just like you did when you started up cellular, and you find out what happens. You might lose, but I doubt it. Fleet Call doesn't seem to think so.

So, that's the comparisons to L.A. The other thing I'd like to point out is that we have some very limited and, I believe, inefficient competition at the retail level but, for a dollar's worth of cellular service, only about twenty cents is at the retail level. The rest is at the wholesale level where there is no competition at all. The cellular carriers are telling us, leave us alone, we're good guys, in the future prices are going to come down. That's not a reason to deregulate. I'm not from Missouri but I do feel that, to answer a question like that, I'll say, show me. The prices come down? If we see real competition? Then DRA would certainly be in favor of less regulation and possibly no regulation if that's the right answer. But, we're certainly not convinced yet and I have seen nothing that the cellular carriers have said today that shows that to be the case.

I don't know that I've covered every point but I'm certainly available for questions.

CHAIRMAN ROSENTHAL: Well. I think that's the end of our agenda. Just a closing personal comment. I think the Committee ought to continue its oversight. I'm not yet convinced that deregulation legislation is needed and I intend to continue a dialogue with all parties. But, I have heard conflicting testimony today and I'm not sure that I'm, that the Committee is competent to separate out all we've heard, but that's the role of the PUC. With that I want to thank everyone for participating and the meeting is adjourned. Thank you.

WRITTEN STATEMENT OF

Cheryl A. Tritt

Chief, Common Carrier Bureau
Federal Communications Commission

HEARING

BEFORE THE

Senate Committee on Energy and Public Utilities

California Legislature

January 12, 1993

Chairman Rosenthal and Members of the Senate Energy and Public Utilities Committee:

I appreciate this opportunity to provide testimony regarding the Federal Communications Commission's (FCC) actions to promote competition in the nationwide cellular telephone industry.

The growth of the cellular telephone industry in the United States has been nothing short of phenomenal. The first cellular system was activated in October 1983. At the time of the Bell divestiture in 1984, 32 systems serving approximately 92,000 customers[1] had been licensed by the Commission. At the end of 1991, there were 7.6 million cellular subscribers; and today, that number has climbed to more than 10 million customers. According to an industry trade association, cellular service is available to approximately 85 percent of the population in both metropolitan and rural areas.[2]

The result of this growth is that nearly 100,000 new jobs have been created in the industry with a steady decline in the rates for cellular service. There has been a 19 percent decline in rates since 1983 (adjusted for inflation) and a 44 percent drop in the cost of owning and operating a cellular telephone in that same period.[3]

In its most recent assessment of the cellular marketplace, the FCC stated that "it appears that facilities-based carriers are competing on the basis of market share, technology, service offerings, and service price."[4] In part, this is due to Commission action in 1988 that liberalized regulations governing cellular licenses, affording providers with greater technical flexibility in offering a wider variety of services.[5] Recently, the Commission also reaffirmed its requirement that cellular carriers permit unrestricted resale of their services to all customers.[6] That decision provided a limited resale restriction with respect to a carrier's facilities-based competitor, which is intended to give all carriers the incentive to build out their systems fully and promote the maximum amount of facilities-based competition in each market. In turn, this market-by-market build out should result in the creation of a seamless and integrated nationwide cellular service system.

---

1 *Report of the Bell Companies on Competition in Wireless Telecommunications Services, 1991* (released Oct. 31, 1991) (*Wireless Competition Report*) at 21.

2 Cellular Telecommunications Industry Association (CTIA) Update on Key Wireless Policy Issues, "The Changing Face of Communications: Emerging Wireless Technology and Services", Dec. 17, 1992.

3 CTIA, "Cellular Competition: The Charles River Study," Nov. 1992.

4 Bundling of Cellular Customer Premises Equipment and Cellular Service, CC Docket No. 91-34, Report and Order, 7 FCC Rcd 4028 (1992).

5 Auxiliary Cellular Order, 3 FCC Rcd 7033 (1988), recon., 5 FCC Rcd 1138 (1989).

6 Petitions for Rule Making Concerning Proposed Changes to the Commission's Cellular Resale Policies, 7 FCC Rcd 4006 (1992).

Although the current level of cellular competition may not be optimal,[7] I would like to stress two points in assessing the development of competition and the FCC's expectations for the future of competition in the cellular marketplace. First, when the FCC established the licensing system for accepting cellular applications in 1981 -- under which two carriers would compete in each cellular market -- the Commission noted that competition "will foster important public benefits of diversity of technology, service and price. . . ."[8] With this duopoly market firmly established, the cellular industry has seen strong and steady growth, burgeoning demand, competition based on price and service, and continued improvement in service quality and coverage.

Second, there are new services driven by new technologies that will play a major role in bringing a greater level of competition to cellular markets. Emerging new offerings such as Personal Communications Services (PCS) are expected to facilitate a variety of new and innovative services to meet consumers' demands and needs for mobile and portable communication services.

The FCC anticipates that these services will be priced competitively with existing mobile communications services such as cellular, paging and private radio services that will result in lowering the cost of these existing services. PCS also could augment emergency communications when disasters, such as earthquakes or tornadoes, render the public switched telephone network inoperable. Several consumer studies have projected that there could be over 60 million PCS users in the United States within ten years.[9]

Among the existing mobile communications technologies that may compete with cellular is Specialized Mobile Radio (SMR). SMR currently provides businesses with mobile radio services to meet internal communications needs. Advances in digital technology will allow SMR to develop cost-effective services that are likely to compete directly with cellular.

In 1991, the Commission waived the one-year construction requirement to allow Fleet Call, Inc. to create several wide-area digital SMR networks in six frequency congested markets, including Los Angeles and San Francisco, California.[10] (At the end of last year, Fleet Call purchased Dispatch Communications (DisCom), a SMR provider in the Mid-Atlantic and New England areas.) Recently, Fleet Call announced its plans to offer digital Enhanced SMR service in Los Angeles in August, 1993; expanding to

---

7 Bundling of Cellular Customer Premises Equipment and Cellular Service, *supra*, note 4.

8 An Inquiry into the Use of Bands 825-845 MHz & 870-890 MHz for Cellular Communications Systems, 86 FCC 2d 469, 478 (1981).

9 See, e.g., "Market Researchers See Large Demand for PCS in U.S.," Microcell News, Mar. 25, 1992 cited in Amendment of the Commission's Rules to Establish New Personal Communications Services, (Notice of Proposed Rule Making and Tentative Decision), 7 FCC Rcd 5676 (1992).

10 Fleet Call, Inc., 6 FCC Rcd 1533, recon. dismissed, 6 FCC Rcd 6989 (1991).

San Francisco, Chicago and New York in 1994; and Dallas/Forth Worth and Houston in 1995.[11] With the Fleet Call/DisCom merger and with advances in equipment manufacturing, some expect SMR to offer comparable system cost structures and competitive pricing relative to cellular.[12]

Mobile satellite two-way voice service and mobile data service are additional new technologies that will compete for business and consumer wireless customers in the future. While it is expected that high end international business users will most likely benefit from mobile satellite services, mobile data will compete both in the business and consumer segments, and it may be offered over cellular, SMR, satellite, and other public and private network systems.

I should also point out that the balance between state and federal regulation of the cellular industry has been one of the Commission's primary concerns. For example, at the time the Commission created the regulatory structure for cellular service it preempted state regulation of technical standards. This ensured compatible operation of equipment on both local and national levels. The Commission stated that it is imperative that no additional technical requirements be imposed by the states which could conflict with our standards and frustrate the federal scheme for the provision of nationwide cellular service. This remains one of our primary concerns today. We would closely scrutinize any measures -- such as state-imposed requirements that cellular carriers provide interconnection to reseller switches -- which may interfere with the compatible operation of cellular equipment.[13]

I thank Chairman Rosenthal for this opportunity to submit my written comments regarding competition in the cellular industry. As the FCC embarks on the licensing of unserved areas in the cellular service, we can expect that additional members of the public will receive cellular service. In addition, future competition for cellular is assured by the new technologies I have mentioned, and I expect the competitive alternatives available to consumers will keep prices at market levels. As needed, the Commission remains committed to taking further steps to foster additional competition in the cellular marketplace.

Cheryl A. Tritt
Chief, Common Carrier Bureau
Federal Communications Commission

---

11 "Fleet Call, DisCom Eye $320M Tax-Free Merger," Radio Communications Report, Jan. 4, 1993.

12 See CTIA Paper, "The Changing Role of Cellular in the Wireless Marketplace," Dec. 1992.

13 Cellular Systems, 89 FCC 2d 58, 95 (1982). See Sections 2(b) and 221(b) of the Communications Act. 47 C.F.R. §§2(b) and 221(b).

United States General Accounting Office

GAO

Testimony

Before the Senate Committee on Energy and Public Utilities
Legislature of the State of California

For Release on Delivery
Expected at
1:30 p.m., PST
Tuesday
January 12, 1993

TELECOMMUNICATIONS

Cellular Service Competition

Statement of John H. Anderson, Jr., Associate Director
Transportation and Communications Issues
Resources, Community, and Economic
Development Division

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to discuss the competitiveness of the cellular telephone service industry. Cellular phone service is one of the fastest-growing segments of the telecommunications industry. Since the industry's inception in the early 1980s, annual cellular phone service revenues in the United States have grown to nearly $7 billion and over 10 million subscribers pay over $68 per month for service. Under current Federal Communications Commission (FCC) rules, no more than two cellular carriers may operate in each geographic market area. To address questions about the cellular marketplace, Senator Harry Reid asked us to examine the competitive structure of the industry and to determine whether FCC's policies ensure the availability of cellular services at competitive prices. This testimony is based on our July 1992 report to Senator Reid on these issues.[1]

In summary, we found the following:

-- A market in which only two firms provide a product or service--like the cellular market--is unlikely to have competitive prices because the firms may have incentive to recognize their interdependence and maintain prices above the competitive level. In addition, when market entry is restricted and adequate substitutes for the product or service are not available, the likelihood increases that prices will be above the competitive level.

-- Resellers buy blocks of cellular service at wholesale rates from the two licensed carriers in a market and then repackage and sell the service to consumers. Because the

---

[1]Telecommunications: Concerns About Competition in the Cellular Telephone Service Industry (GAO/RCED-92-220, July 1, 1992).

resellers do not own or operate cellular systems under the current market structure, they do not compete with the carriers at the wholesale level. Consequently, the resellers' presence in a market will not generally lead to lower rates for consumers.

-- FCC has not periodically obtained cost and pricing data to evaluate the profitability of the industry. The available data on costs and prices in the cellular marketplace have been too limited for FCC to determine whether prices for cellular services are competitive. Because of the potential for noncompetitive behavior in this type of market, the industry may need further examination.

-- States have authority to regulate intrastate cellular rates. California, the state with the largest cellular service market, has some regulation of cellular service. The California Public Utilities Commission reported in an August 1989 study that prices of cellular service in the California markets were generally much higher than costs but decided in a June 1990 interim decision not to regulate prices.

-- Emerging technologies that provide service similar to cellular service may improve the competitive structure of the industry if they are furnished by firms other than those already providing cellular service in a given market. However, controversies over the source of the scarce spectrum to support these technologies and the method of licensing the providers of these new communications services may delay their introduction into the marketplace.

In our July 1992 report we made recommendations to FCC that are designed to (1) enhance competition in the cellular service industry and (2) facilitate an evaluation of the industry's competitiveness if increased competition is not forthcoming.

BACKGROUND

FCC administers the allocation and use of the electromagnetic spectrum (radio waves) for all nonfederal users--including the radio spectrum used by cellular telephones--and it licenses cellular carriers to use specific spectrum frequencies.[2] In 1981, FCC authorized the licensing of two carriers in each market to build facilities and offer cellular telephone service. Typically, one license went to the existing local telephone company and one to an applicant not affiliated with the local telephone company. FCC allocated the use of the radio spectrum to the two licensed carriers, which in turn invested the capital to build, operate, and maintain cellular systems. In late 1983, the first cellular telephone systems began operating commercially in the Washington, D.C./Baltimore, Maryland, area and in Chicago, Illinois. Currently, licensed carriers operate in all 734 urban and rural geographic market areas designated by FCC.

Licensed carriers sell cellular services directly to consumers, or they hire independent agents to obtain subscribers on a commission basis. Also, FCC allows an unlimited number of firms, called resellers, to buy blocks of cellular phone numbers from carriers at wholesale prices to sell to consumers at retail prices. In effect, resellers become their customers' cellular phone company, handling billing and services, while the licensed carrier operates and maintains the system.

---

[2]The National Telecommunications and Information Administration, in the Department of Commerce, allocates the radio spectrum assigned to federal users.

CURRENT MARKET STRUCTURE MAY PROVIDE ONLY LIMITED COMPETITION

The two-carrier (duopoly) market system that FCC created may not provide significant competition in cellular markets. In any duopoly market, adequate competition is a concern because producers are likely to recognize their interdependence and may be able to maintain prices above the competitive level. In general, the fewer the number of producers, the less likely that pricing will be competitive.

In addition, the following characteristics of the cellular marketplace may reduce competition:

-- Although one carrier may have a somewhat larger service area or offer somewhat better service, few significant differences in quality exist among cellular carriers. Economic theory indicates that similarity in product quality may facilitate noncompetitive behavior.

-- The cellular industry is a duopoly not because of market forces but because FCC established this market structure and continues to restrict market entry. The more freely new firms can enter a market, the more difficult it becomes to maintain noncompetitive pricing practices. Noncompetitive behavior is more likely to occur in a restricted-entry industry than in an open-entry industry.

-- Because licenses for cellular service may be sold by the original licensee--and many have been--a carrier may find that its competitor in one market is also its competitor in several other markets. Moreover, where licenses have been sold to carriers in partnership, competitors in one market may be partners in another market. This pattern of ownership may facilitate the type of interdependence among competitors that is conducive to noncompetitive behavior.

-- Currently, many analysts believe that no adequate substitutes exist for cellular service. Lack of adequate substitutes for a given product or service makes it easier for firms to maintain prices above the competitive level because consumers have no alternatives. If the consumer wants the particular product or service and there are few adequate substitutes, price becomes less important in the buying decision.

When it set up cellular markets in the early 1980s, FCC required cellular carriers to sell to resellers on a nondiscriminatory basis. Although FCC recognized the resellers' potential to enhance competition at the retail level, it was uncertain whether the inclusion of resellers in the market would either diversify service or lower prices.

The resellers' costs are, for the most part, controlled by the carriers from which the service is purchased. The resellers do not compete directly with carriers at the wholesale level and their presence does not alter the industry's duopoly market structure. Hence, their presence in a market cannot deter licensed carriers from exercising market power, and it generally does not lead to lower prices for consumers.

THE COMPETITIVENESS AND PROFITABILITY OF THE CELLULAR INDUSTRY ARE NOT BEING EVALUATED

Profitability is a critical criterion for evaluating whether an industry's prices are set at or near competitive levels. However, a firm's profits in the cellular phone service industry stem from both access to the radio spectrum and market power. The radio spectrum that FCC allocated to cellular carriers is a scarce and valuable resource, and a portion of carriers' profits are probably attributable to control of this resource. Some analysts contend that, from a public policy perspective, it might have been preferable for taxpayers rather than private firms to reap the return from this scarce public resource. However, FCC currently licenses, and hence allocates, spectrum generally through either comparative hearings or lotteries--neither of which provide the government, and thus taxpayers, with a financial return for the allocated spectrum.

The source of the profits notwithstanding, determining profitability may be an appropriate first step in assessing the reasonableness of prices for cellular service. However, neither FCC nor the states currently have any system in place to regularly obtain sufficient evidence to determine the profitability of cellular carriers. States have the authority to regulate intrastate cellular service rates, but during our review we found no evidence that any states required carriers periodically to submit financial data for the purpose of determining whether cost-based pricing regulation should be imposed. At the time of our study, according to public utility officials from the six most populous states, cellular was not an essential service, and the industry was sufficiently competitive, so traditional public utility regulation was not necessary.[3] However, in October 1992 California's Public Utilities Commission ordered that cellular carriers semiannually submit financial data for review. The order was stayed pending rehearing.

According to agency officials, FCC has the authority to regulate interstate but not intrastate cellular rates. However, FCC does not collect revenue, cost, and other data from cellular carriers. As part of ongoing industry monitoring, FCC, among other

---

[3]We consulted with officials from California, Florida, Illinois, New York, Pennsylvania, and Texas.

things, reviews complaints filed against carriers, responds to petitions for rulemaking, and adopts or modifies rules as needed. In addition, FCC says that it reviews all applications for and transfers of licenses to ensure that the public interest, convenience, and necessity are served. FCC acknowledged that, in the absence of evidence such as price and cost data, it is difficult to conclude that the cellular service industry is fully competitive. FCC believes that concerns about the lack of sufficient competition in the cellular service industry should be resolved through the introduction of new personal communication services in the near future.

During our review, we examined data on retail prices that licensed carriers charged for cellular service in the 30 largest cellular phone markets between 1985 and 1991. We obtained the unverified data from a consulting firm, which was the only source we were able to identify that had compiled industry data of this type. According to these data, average prices were fairly constant over the period. However, when inflation was taken into account, there were real price decreases of about 27 percent on average across the 30 largest markets. In about two-thirds of the markets, the best available prices between the two carriers were very close and often nearly identical for a given package of cellular services. In about one-third of the markets, prices differed by more than 10 percent--with an average difference of 22.4 percent. However, even in markets where prices were nearly identical, additional information would be needed to conclude that noncompetitive pricing practices had occurred.

Our review included the four largest markets in California. We found that, on average, California prices were about 31 percent above those of other markets. Our data also showed that the average price difference, if any, varied no more than about 3 percent between the two carriers in these markets.

Although cash flows have been negative for many cellular carriers because of large initial capital outlays, FCC and others contend that the industry will be very profitable in the future. For example,

-- According to a 1989 report by the California Public Utilities Commission, which analyzed 1988 data for 14 of its licensed cellular carriers, the average return on sales for wholesale operations was 31 percent and the average return on sales for all operations was 15 percent. The average return on equity reported by these carriers was a very healthy 24.5 percent.

-- The California-based Cellular Resellers' Association's analysis of the financial performance of the cellular carriers in Los Angeles, San Diego, and San Francisco/San Jose showed wholesale investment returns of between 25.3 percent and 123.1 percent in 1988.

-- Stock analysts, optimistic about the future of the industry, report that growth of cellular cash flow and earnings should be robust over the next decade and that stock values should appreciate substantially in the long run.

Finally, the value of cellular licenses as represented by sales transactions indicates the high expected value of these firms. Several analysts have noted that the prices of licenses sold divided by the total population of the market area have increased considerably since cellular systems first went on line. For example, some systems recently sold for over $200 per person in the market area. More importantly, analysts believe that these prices are considerably greater than the actual replacement cost of the firms' assets. Analysts attribute these high prices to, among other things, the expectation of future earnings.

EMERGING SERVICES HAVE POTENTIAL TO ENHANCE COMPETITION

Today's personal communications services--paging devices and cellular phones--will soon be joined by new services that share certain characteristics with cellular service and use both existing and new telecommunications technologies. For example, digital cordless telephone radio networks are essentially self-contained services that will use inexpensive, pocket-sized terminals, intelligent networks, and smart cards, and they will be capable of voice, data, and image transmission. As technologies advance and this and other new services that provide a function similar to cellular service are brought to the marketplace, competitiveness in the cellular industry may improve.

FCC is currently developing regulatory policies for implementing the new services. As part of this process, FCC invited comments on a wide range of issues, including whether restrictions on license eligibility are needed. FCC has acknowledged that potential problems and benefits may result if it licenses carriers for new services in a market where they are licensed cellular carriers. However, FCC officials told us that if any restrictions are placed on granting additional licenses to existing carriers, the existing carriers would be able to use their current spectrum allocation for other mobile services, including some personal communications services. We continue to support giving first preference to firms that are not current cellular providers in a given market area in order to increase the number of sources available to consumers and thereby encourage carriers to lower their prices. FCC is currently analyzing comments received on its proposals to provide additional spectrum for personal communications services. It is not clear when FCC will make a final decision on these proposals.

FCC has also begun what it calls a "pioneer preference" program to ensure that innovators have an opportunity to participate either in new services that they develop or in existing services that incorporate new technologies. This program should foster the formation of new services, but it could guarantee licenses to existing cellular carriers if they develop the new services. FCC has made 3 tentative selections under this program and one of the firms tentatively selected proposes to operate in the San Diego area. In addition, FCC approved a proposal by Fleet Call to develop specialized mobile radio systems in the congested cellular markets of Chicago, Dallas, Houston, Los Angeles, New York, and San Francisco. The new service, which may be available in Los Angeles as early as this August, will be similar to cellular service within the immediate market. Fleet Call and Dispatch Communications, Inc., the nation's second and third largest specialized mobile radio system operators, respectively, have recently announced a merger of their firms. Such a merger would result in coverage of about 70 metropolitan service areas. Fleet Call sees this as an opportunity to be the third major provider of mobile phone services, in direct competition with the cellular carriers, in these markets. In California, the Los Angeles and San Francisco markets, as defined by Fleet Call, comprise 82 percent of the state's population.

SOURCE OF SPECTRUM MAY PRESENT MAJOR HURDLE FOR NEW TECHNOLOGIES

Besides Fleet Call's initiative, FCC expects other new services with new providers to begin competing in the cellular marketplace in the near future. However, the scarcity of radio spectrum presents major obstacles that may delay introduction of the new services. Virtually all of the spectrum that is suitable for these services has already been allocated. In January 1992, FCC proposed using 220 megahertz of spectrum that had been allocated for other purposes for emerging telecommunications technologies. During June 1992 hearings before the United States Senate Committee on Commerce, Science, and Transportation, incumbent users of the frequencies asked FCC to suspend the proposal. These users--railroads, electric cooperatives, and others--have expressed strong concern about the disruption to safe and reliable rail transportation and electrical power services that could result from reallocating the radio frequencies that they use. FCC released the report and order on the reallocation in October. A notice of proposed rulemaking on how the transition will be accomplished has been released for comments, which are due tomorrow. FCC noted that taking spectrum from other purposes and reserving it for new services will enable FCC to decide upon frequencies for new applications in an orderly manner, without having to go through a difficult and time-consuming spectrum reallocation each time a new service is introduced.

During the last Congress, several bills were introduced but not passed to auction spectrum for the new services to the highest bidder rather than to allocate it without charge. Some of these bills would have amended the Communications Act by adding a provision authorizing the use of competitive bidding (auction) for awarding all licenses. Controversies over the source of the spectrum and whether to charge for the spectrum allocation could delay the introduction of new services, thereby delaying the introduction of new competition to cellular service. Consequently, we believed that FCC needed to consider interim steps for monitoring competitive conditions in the industry to protect consumers' interests.

CONCLUSIONS

In summary, Mr. Chairman, our work has shown that the existing two-carrier cellular telephone service market structure may produce only limited competition. Because of this structure and entry restrictions, resellers cannot be expected to compete with carriers at the wholesale level. In the past, neither FCC nor states gathered the data needed to determine whether cellular service prices are competitive. However, California proposes to collect such data. Emerging developments in cellular and similar technologies may solve some of the concerns with the existing cellular market structure. Indeed, FCC is relying on new services from new sources to increase competitiveness in the cellular marketplace. We hope that this will occur. However, FCC must first overcome obstacles, including the equitable and safe reallocation of radio spectrum, which could significantly delay the introduction of the new services. If such delays occur, other actions may be needed to protect consumers' interests. Therefore, our July 1992 report recommended that if the new services are not available within the time frames that FCC currently envisions, FCC should begin evaluating the status and development of competition in the cellular service industry. As a first step, FCC could obtain data necessary to begin assessing the profitability of carriers operating in the 30 largest markets.

FCC's approval of Fleet Call in six frequency-congested markets should guarantee a new competitor in these markets. FCC's new service-licensing rules and pioneer preference program offer further potential for competition. However, it is not yet known whether additional carriers or the existing cellular carriers will provide new services in most of the markets across the country. Our report recommends that, in granting licenses and allocating spectrum for the new communication services, FCC consider establishing a policy that gives first preference to firms that are not current cellular providers in a given market, particularly if only one new license is granted in the market. However, when FCC may determine that a current cellular carrier is the most appropriate provider of the new service, FCC should ensure that the benefits of licensing that carrier outweigh the benefits of enhancing competition. FCC's December 24, 1992, response to our report is silent on this recommendation. The Chairman did say that it is difficult to conclude that the cellular market is fully competitive. He added that, at a later time, depending on the outcome of FCC's personal communication services rulemaking--and the emergence of other competitive services and their effect on the cellular marketplace--obtaining revenue, cost, and other data on the 30 largest cellular markets, as we had recommended, could be beneficial in evaluating the competitiveness of the cellular service industry.

- - - - -

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions.

348006

TESTIMONY OF WAYNE M. PERRY,

Vice Chairman of McCaw Cellular Communications, Inc.,

Before the

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

January 12, 1993

Thank you very much for this opportunity to testify. My name is Wayne Perry, and I am the Vice Chairman of McCaw Cellular Communications, Inc., the nation's largest cellular service provider. McCaw has made a substantial investment in California: we operate the Cellular One systems in Sacramento, Stockton, Fresno, Redding, Yuba City, Modesto, and Visalia, as well as the systems serving the North Bay Counties, Monterey, Salinas, Santa Barbara and Ventura. We also hold significant partnership interests in Los Angeles Cellular Telephone Company and Bay Area Cellular Telephone Company.

Our only business is wireless communications, so it is essential to us that we make cellular attractive to everyone in this state, which means that we must offer a high-quality product at very affordable prices. We have made an excellent start toward that goal. Our customers tell us that cellular is a good value today, and our growth rate exceeds 35% a year. Still, we have much to improve if we are to penetrate the broad consumer market that we want to serve.

Fortunately, the cellular industry has developed new technologies that will enable it to accommodate more subscribers than it can today, to provide them with more services that it can today—and to do it all at lower prices. We can deliver these benefits to California if—but only if—industry and government create a constructive regulatory framework, one that both promotes network investment and encourages pricing innovation.

We are thus at a crossroads in cellular's development, and I hope this hearing will help us choose the right path to the future. I respect the concerns that you have about cellular rates; they are concerns that we share. But it is important to understand what forces have shaped current prices and what opportunities there are to lower them, before we can craft a coherent regulatory policy for cellular in California.

CELLULAR RATES TODAY

I would like to make three fundamental points about current cellular service rates:

1. The Demand for Quality Service.

First, cellular rates are a function of customer demand for quality. In survey after survey, cellular subscribers say they want one thing above all else, and that is high-quality service.

Quality means clear reception and broad service areas, which require substantial network investment. As we show on the maps that accompany my testimony (Attachment A), McCaw has more than trebled the size of its coverage areas in California since it began operations here just five and a half years ago. What the maps cannot show is the investment we have also made to improve the reliability of service within these coverage areas, so that you can make calls consistently with a lightweight portable as well as with a higher-powered car phone.

Since 1987, McCaw has spent nearly $200 million in California on cellular network equipment, not counting the capital invested by the Bay Area and Los Angeles systems in which McCaw subsidiaries are partners. Our competitors have made similar investments, in an effort to attract customers to their service rather than ours. So far, this contest for quality seems to have served the public well, since our industry has maintained dramatic growth even through the current recession in California.

But it is crucial to note that, given today's analog radio technology, quality cannot survive growth without continued, aggressive investment. There are no significant economies of scale in our business at present; on average, we spend an additional $1200 on plant for each new subscriber. As a result, McCaw has yet to recover its investment in network infrastructure in California, even after including its share of income from Bay Area and Los Angeles operations. (See Attachment B.)

2. Alternative Rate Plans

My second point is that, despite these high costs, cellular carriers are introducing discounted rate plans, not only to attract new subscribers but also to ensure that existing customers do not switch to a competing carrier. It is true that basic rate plans have not changed significantly in California. However, the development of optional plans has given customers an opportunity to realize savings at a variety of usage levels. For example, package plans enable subscribers to secure discounts off of basic rates by purchasing minimum quantities of airtime in advance each month. For a typical subscriber in McCaw's California systems, savings can range up to 7% over basic service charges. (See Attachment C.)

The reduction of service prices results from intensifying competition between cellular carriers, competition that began in the realm of service quality and that extends to the domain of rates. We welcome this competition: it enables us to differentiate ourselves from our competitors, to learn more about what our customers really value, and to constantly improve ourselves.

3. Regulatory Constraints

The third factor affecting cellular rates in California is regulation. The cellular market is regulated far more extensively in this state than elsewhere. In fact, most states do not regulate cellular rates, and we believe that rates would be lower here if they were not regulated. The PUC has itself noted that traditional tariffing rules discourage price competition. It is not hard to deduce why. Competitive forces are undermined when rate strategies must be announced to one's rivals in advance, or when each new retail plan must be offered to resellers—who are supposed to be competitors—with their own special discounts. Two years ago, the PUC tried to streamline the tariffing process, but even the "simplified" arrangement has proven to be confusing and prone to delay. The situation has been a source of frustration for both cellular carriers and the PUC itself. (See Attachment D.)

More importantly, regulatory constraints have probably cost the cellular customer as well. Our review of cellular prices in major markets across the United States shows that in areas that are not subject to rate regulation, cellular bills are 10% to 50% lower than those paid by subscribers in Los Angeles and the Bay Area. (See Attachment E.)

REGULATORY POLICY

What these statistics tell me is that we do not need more price regulation in this state but more appropriate regulation. The need for a new regulatory policy will become even stronger over the course of this year, in which we will see two new developments that will directly affect cellular rates.

1. The Challenge of New Competitors

The first development is the entry of new competitors. As you will hear later this afternoon, Fleet Call, a specialized mobile radio operator, is building a digital, national wireless network that has more potential subscribers (over 90 million) than any cellular carrier, including McCaw. Fleet Call plans to launch service in Los Angeles this summer; by mid-1994, the company expects to serve most of California's population, with subscriber capacities comparable to those of cellular systems. Furthermore, because the FCC has classified Fleet Call as a private carrier, it does not need to file any tariffs in this state. It is completely free to price its services—and tailor its offerings—in the manner most responsive to a particular customer's needs.

Other private carriers and cellular providers are beginning to compete in the burgeoning mobile data market. And, in the next year or two, the FCC is expected to issue several licenses for new personal communications services, which will target the consumer market that cellular also wants to serve. These new competitors will expand the communications revolution that cellular has begun, and we look forward to the challenge of pioneering new products and features to meet increased demand for wireless services. However, we also need a regulatory environment that permits us to act quickly and imaginatively in a marketplace that will be even more demanding than the one we face today.

2. The Digital Opportunity

The other important trend that we will see in 1993 is cellular's transition from analog to digital technology. Digital equipment enables cellular carriers to expand the capacity of their systems, to improve existing services and to introduce new, intelligent network features at significant capital savings. Consequently, the implementation of digital can provide the industry with the economies of scale that have generally eluded us so far. Those economies will allow us to price our service more inexpensively. For example, when we began to sell digital service in our Florida systems earlier this month, we introduced digital airtime discounts of 15% to 20%. We did this not because of regulatory requirements—Florida does not regulate cellular—but because it makes good business sense.

Los Angeles Cellular Telephone Company intends to launch digital service in the first half of 1993, and McCaw's California systems hope to follow suit soon thereafter. However, the extent to which the digital conversion actually progresses here will depend largely on California's regulatory policies. The transition to digital technology is not without risk: it will be expensive and, in an environment marked by rapid technological change, what is state-of-the-art today may become passe tomorrow, necessitating a new round of upgrades. Thus carriers will refrain from making digital investments if they feel that they cannot compete freely against unregulated service providers, or if their ability to recoup past losses is jeopardized by caps on annual returns, or if they cannot reconfigure their networks to improve service or lower costs.

CELLULAR AT THE CROSSROADS

Our concern is that California may adopt a regulatory scheme which frustrates true competition between those who want to expand service offerings and enhance the state's infrastructure, all for the sake of resellers, who cannot expand cellular capacity or reduce the capital investments required for network development. We are by no means opposed to cellular resale, but we question regulatory priorities that promote concern over reseller margins over both immediate and long-term savings for the public-at-large.

Thus, the cellular industry in California stands at a crossroads. One direction leads to a wide variety of competitive, low-cost wireless services that will be available for both businesses and consumers, and that will enhance both the productivity and lifestyle of California's citizens. The other direction leads to a dead-end: a stagnation of investment, a slow deterioration in service quality, and, ironically, an absence of real price competition.

We know that the PUC is the focal point for establishing cellular regulatory policy in California. And we want to reaffirm today, with the Commission and with the Committee Members, that we are eager to work with the PUC as it reviews the it reviews the changes that face the wireless communications industry in the immediate future. We are aware, as well, that we have not always seen eye-to-eye on regulatory issues. But I do not believe that such differences should—or will—prevent us from developing a constructive dialogue in the months to come.

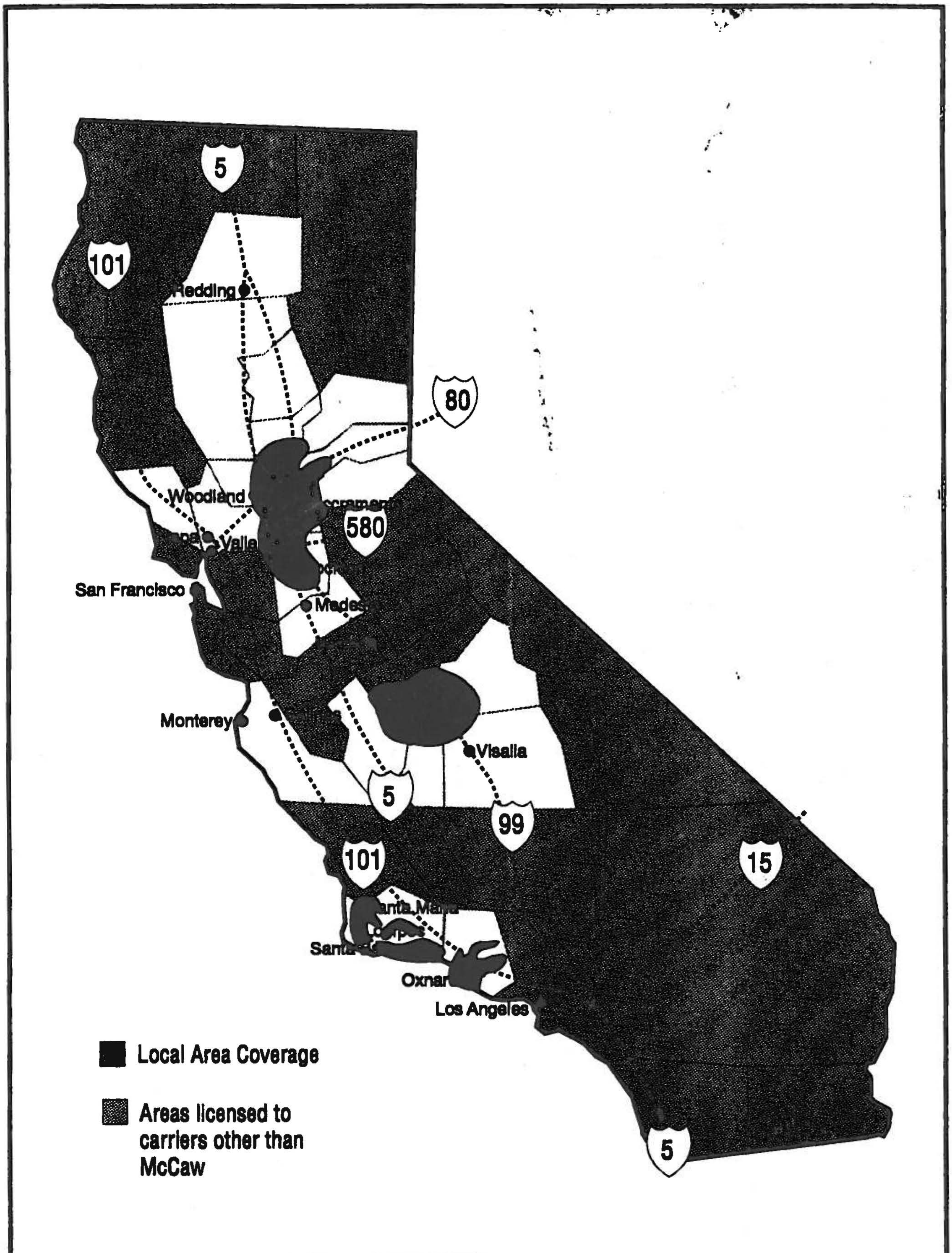
In order to allow a thoughtful discussion on all possible impacts of wireless competition, we hope that, should the Commission embark on a major investigative endeavor, recent decisions involving wholesale rates and switching will also be included for review. We also hope that the present vacancies on the Commission will soon be filled so that we can pursue this task in earnest. As I mentioned earlier, 1993 will be a pivotal year for the development of cellular in this state, and we can ill-afford to let precious months slip by before basic regulatory policies are resolved.

In closing, I reiterate McCaw's pledge to do all it can to promote high-quality cellular service at increasingly affordable rates. With your cooperation and the cooperation of the PUC, I am confident that we can fulfill that pledge.

Thank you very much.

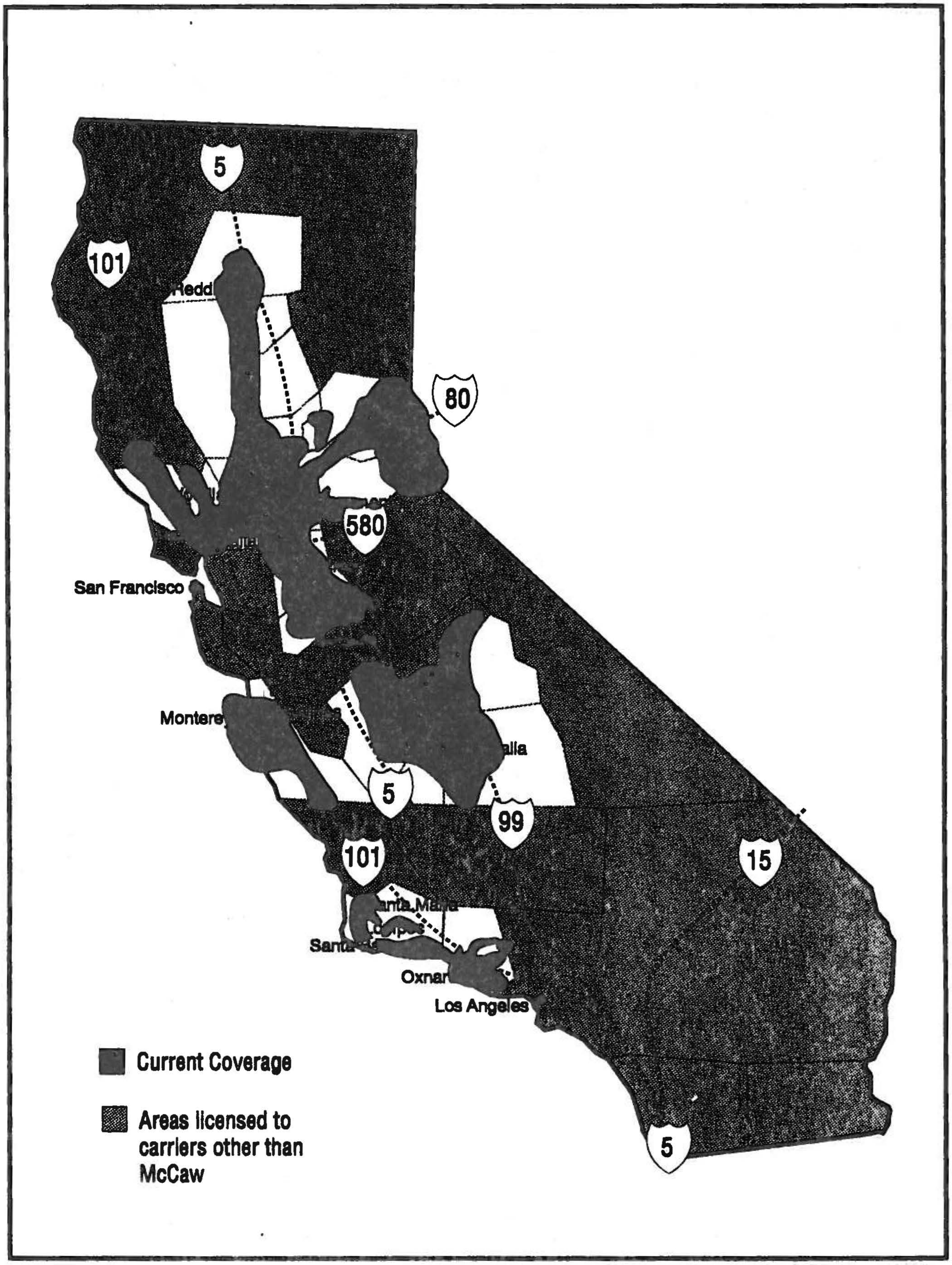
CALIFORNIA

McCaw Cellular Markets: 1987



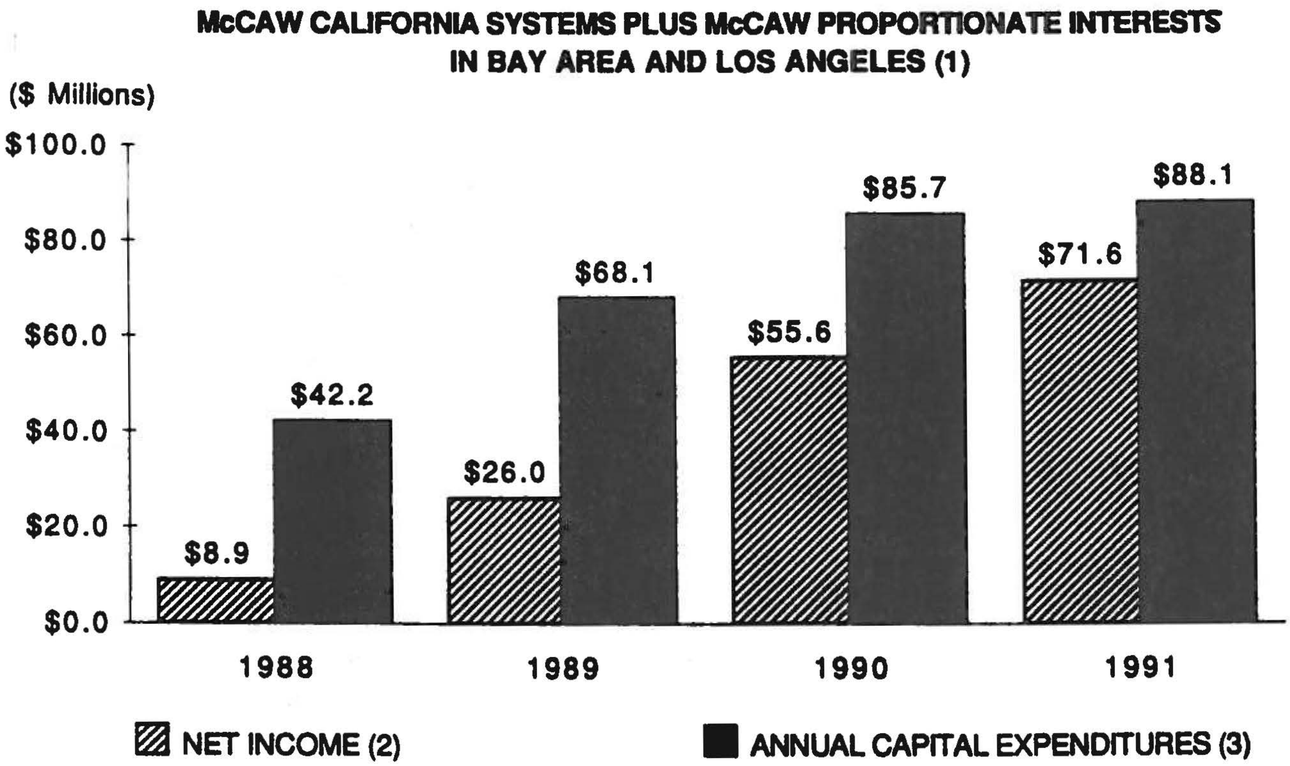
CALIFORNIA

McCaw Cellular Markets: 1992



ATTACHMENT B.

ANNUAL CAPITAL EXPENDITURES HAVE EXCEEDED ANNUAL NET INCOME EVERY YEAR SINCE McCAW COMMENCED OPERATIONS IN CALIFORNIA



(1) Sacramento - Yuba City; Stockton - Modesto; Fresno - Visalia; Redding - Tehama; Santa Rosa - Napa; Monterey - Salinas; Santa Barbara; and Ventura; plus 33% interest in Bay Area and 40% interest in Los Angeles.

(2) Net income after imputed taxes. Does not include McCaw corporate interest expense.

(3) Capital expenditures include purchases of fixed assets and do not include acquisition costs.

ATTACHMENT C.

THE INTRODUCTION OF OPTIONAL RATE PLANS SINCE 1990 ENABLES McCAW'S CALIFORNIA CUSTOMERS TO ACHIEVE AIRTIME SAVINGS

	60 Minutes	120 Minutes	180 Minutes	360 Minutes
Sacramento 1990	$39.72	$55.44	$71.16	$118.32
Sacramento 1992	$39.72	$53.57	$70.74	$116.14
Difference	---	3.19%	0.59%	1.84%
North Bay	$69.00	$93.00	$117.00	$189.00
North Bay	$69.00	$90.50	$114.50	$172.75
Difference	---	2.69%	2.14%	8.60%
Santa Barbara 1990	$69.00	$93.00	$117.00	$189.00
Santa Barbara 1992	$69.00	$88.85	$111.95	$172.75
Difference	---	4.46%	4.32%	8.60%
Ventura	$69.84	$94.68	$119.52	$194.04
Ventura	$69.99	$90.11	$111.43	$172.71
Difference	-0.21%	4.83%	6.77%	10.99%

ATTACHMENT D.

ILLUSTRATIVE RATE REDUCTIONS OF McCAW'S SACRAMENTO SYSTEM 1991-1992

1991 Holiday Promotional Offer: Provided a waiver of up to $100.00 of local usage airtime charges incurred during two weeks following activation by a new subscriber. (December, 1991)

Protested by Resellers; Effective after settlement negotiations.

Roaming Rate Reduction: Reduces roaming rates for the average subscriber and provides a high-usage roaming discount. (February, 1992)

Suspended by staff; Temporarily approved after eight-month review; Requires renewal of authority by formal application.

Freedom Package Plans: Plans for small- and large-volume users which include monthly access, a package of cellular minutes and a package of long-distance minutes at a discounted rate. (October, 1992)

Protested by Resellers; Rejected by Resolution issued six months after tariff filed.

100 Phone Promotional Offer: Provides customers who activate 100 access numbers during a specific time period a credit for the amount of service establishment for such numbers. (November, 1992)

Effective

Right Fit Package Plans (Occasional, Standard, Frequent, Premier, Premier 36): Packages include access, varying amounts of airtime usage in an expanded calling area, and custom calling features for a discounted monthly rate (discounts range up to 17%). Additional minutes of usage in excess of the allotment are available at further discounted rates. (October, 1992)

Effective

Multi Line Discount: Provides discounts to subscribers who activate multiple access numbers on the Company's Optional Package Plans. (October, 1992)

Effective

ATTACHMENT E.

REGULATED RATES REMAIN HIGHER THAN THOSE IN UNREGULATED MARKETS

	60 Minutes	Diff	120 Minutes	Diff	180 Minutes	Diff	360 Minutes	Diff
REGULATED MARKETS								
Los Angeles	$69.84	- -	$94.68	- -	$119.52	- -	$194.04	- -
New York	$59.99	14%	$89.99	5%	$113.39	5%	$179.79	7%
San Francisco/ San Jose	$69.00	1%	$90.50	4%	$114.50	4%	$172.75	11%
UNREGULATED MARKETS								
Chicago	$31.90	54%	$48.60	49%	$64.68	85%	$108.00	44%
Detroit	$44.15	37%	$53.20	44%	$70.28	70%	$111.92	42%
Washington D.C.	$44.95	36%	$60.14	36%	$83.66	43%	$149.95	23%
Dallas	$55.93	20%	$71.77	24%	$79.99	49%	$122.77	37%
Miami	$60.00	14%	$80.64	15%	$95.00	26%	$136.37	30%
Pittsburgh	$49.99	28%	$69.99	26%	$90.39	32%	$139.59	28%
Minneapolis	$48.00	31%	$70.08	26%	$72.00	66%	$117.36	40%
Denver	$50.72	27%	$69.99	26%	$77.49	54%	$117.49	39%
Seattle	$49.99	28%	$74.71	21%	$86.99	37%	$139.99	28%
Tampa	$49.95	28%	$70.83	25%	$93.87	27%	$152.49	21%

The percent difference is relative to Los Angeles rates.

Assumptions:
- Best price plan for the number of minutes.
- 80% peak/20% off peak.
- Free minutes in package plans are attributed to peak usage first.

ATTACHMENT E.

REGULATED RATES REMAIN HIGHER THAN THOSE IN UNREGULATED MARKETS

	60 Minutes	Diff	120 Minutes	Diff	180 Minutes	Diff	360 Minutes	Diff
REGULATED MARKETS								
Los Angeles	$69.84	- -	$94.68	- -	$119.52	- -	$194.04	- -
New York	$59.99	14%	$89.99	5%	$113.39	5%	$179.79	7%
San Francisco/ San Jose	$69.00	1%	$90.50	4%	$114.50	4%	$172.75	11%
UNREGULATED MARKETS								
Chicago	$31.90	54%	$48.60	49%	$64.68	85%	$108.00	44%
Detroit	$44.15	37%	$53.20	44%	$70.28	70%	$111.92	42%
Washington D.C.	$44.95	36%	$60.14	36%	$83.66	43%	$149.95	23%
Dallas	$55.93	20%	$71.77	24%	$79.99	49%	$122.77	37%
Miami	$60.00	14%	$80.64	15%	$95.00	26%	$136.37	30%
Pittsburgh	$49.99	28%	$69.99	26%	$90.39	32%	$139.59	28%
Minneapolis	$48.00	31%	$70.08	26%	$72.00	66%	$117.36	40%
Denver	$50.72	27%	$69.99	26%	$77.49	54%	$117.49	39%
Seattle	$49.99	28%	$74.71	21%	$86.99	37%	$139.99	28%
Tampa	$49.95	28%	$70.83	25%	$93.87	27%	$152.49	21%

The percent difference is relative to Los Angeles rates.

Assumptions:

Best price plan for the number of minutes.
80% peak/20% off peak.
Free minutes in package plans are attributed to peak usage first.

McCaw® Cellular Communications, Inc.

January 18, 1993

Wayne M. Perry
Vice Chairman

The Honorable Herschel Rosenthal
Chairman
Senate Committee on Energy and Public Utilities
State Capitol, Room 4070
Sacramento, California 95814

SUPPLEMENTAL TESTIMONY

Re: Committee Hearing on Cellular Rates

Dear Chairman Rosenthal:

Enclosed is a revised copy of Attachment E to my January 12 testimony before the Committee concerning cellular telephone rates. The enclosure corrects typographical errors in the original Attachment E that was submitted with my testimony. The errors, which stem from a computer program "glitch", affect the percentage column next to the cost figures for 180 minutes of service.

I apologize if the errors have caused any confusion. Please note, however, that the actual cost figures shown on Attachment E remain unchanged, as does the conclusion supported by Attachment E, namely: tariffing rules in regulated markets tend to impede price competition, and thus tend to maintain higher prices than are found in unregulated markets.

Another issue related to Attachment E is worth mentioning. We understand that Committee members question why our data differ from the results of the market comparisons performed by the CPUC Division of Ratepayer Advocates. Ours are based on lowest rate available to an individual in each market; the lowest rate for a given level of usage is not necessarily the "basic" rate which the Division used. (I have enclosed Seattle rate plans to illustrate this point; the Occasional and Premier plans are cheaper for lower and higher-end customers, respectively, than the Standard -- or "basic" -- plan.) We will work with the Division of Ratepayer Advocates in an effort to produce a market-by-market pricing comparison that all of us can endorse as a fair analysis of cellular rates.

Once again, thank you for the opportunity to testify. If you have any further questions, by all means feel free to call me.

Sincerely,

McCAW CELLULAR COMMUNICATIONS, INC.

Wayne M. Perry

Wayne M. Perry
Vice Chairman of the Board

Enclosures

letk.004

P.O. Box 97060 • Kirkland, WA 98083-9760 • (206) 827-4500
5400 Carillon Point • Kirkland, WA 98033-7397

PREPARED TESTIMONY OF MICHAEL HEIL BEFORE
SENATE ENERGY AND PUBLIC UTILITIES COMMITTEE

January 12, 1993

My name is Michael Heil. I am President of the Los Angeles Cellular Telephone Company. L.A. Cellular is one of the two regulated facilities-based carriers providing cellular service in Los Angeles, Orange, Riverside, and San Bernardino Counties. It is generally recognized that this market is one of the largest, if not the largest, in the country in terms of the number of people served and geographical area.

My presentation will cover three general issues, i.e.:

1. Are cellular rates too high?

2. What could be done by the PUC to encourage lower rates and expanded service?

3. What could be done by the Legislature to encourage the same goals?

1. Are cellular rates excessively high?

Many argue that cellular rates are too high. They say that the so-called "standard" plans offered by the facilities-based competitors are generally the same, and that these standard rates have not been reduced since competition began in various markets.

This argument has become a sort of conventional wisdom among those who would increase the already high level of cellular regulation in California. Indeed, the idea that cellular rates are too high recently led the PUC to propose (in its Decision 92-10-026) that California become the first state to impose cost-based, rate of return regulation on this new industry.

In fact, cellular pricing is not much different from what one should expect for a new technology which must satisfy a high level of pent-up demand, and which is subject to an unprecedented degree of regulation. Indeed, by many measures, prices have been substantially reduced. I also believe that rates would fall further _if_ the industry were allowed to expand its capacity more rapidly, and _if_ it were given substantially greater freedom to reduce current prices.

A major flaw in arguments that prices are too high is that they consider only the "standard" month-to-month plans offered by the carriers. Because of almost insuperable regulatory obstacles to rate increases, few carriers have considered permanent reductions in their "standard" tariffed packages. Instead, they compete by means of alternative, lower cost plans. These include lower rates for multiple-line users (such as large and medium sized companies, and affinity groups), for high-volume users, for "off-peak" users, and for long-term customers. Exhibit "A" hereto shows that since 1989, nearly half of our customer base has enrolled on these alternative plans. One of the most important of these plans is the one for multi-line master customers like corporations, bar associations, medical groups, automobile clubs and so on. While the PUC delayed these plans for many months they are now in place, and over time will provide rate reductions of up to 17% for a large part of our customer base.

There are also numerous promotional campaigns which involve fee waivers, air time credits, or outright cash payments to customers who sign up for service during the period of the promotion. In the case of L.A. Cellular, the combination of lower rate plans and short-term promotions has resulted in a substantial de facto rate decrease. For this and other reasons, L.A. Cellular's monthly revenues per customer, which approached $150 in 1989, are now less than $98.

All of this is in the face of a 23% cost of living increase over the past four years. There is also the fact that system coverage and service quality have increased enormously at the same time that rates, expressed in real dollars, have dropped. L.A. Cellular began operations in March, 1987, with some 30 cell sites, which covered little more than the highly populated areas of Los Angeles and Orange Counties. Today, the company has constructed nearly 350 cell sites, which cover more than 75% of the total area of Los Angeles, Orange, Riverside, and San Bernardino Counties. See Exhibit "C".

Whether prices are still too "high" is of course a subjective question. However, there are some standards of judgment available to us. One is the number of people who have signed up for service. With only 17,000 units in service as of March, 1987, L.A. Cellular today services nearly 360,000 units. New activations for December, 1992 were at a record high -- despite the recession. Our customers have obviously concluded that they are receiving fair value -- and they are. One interesting and little noted fact is that cellular per-minute rates absorb all toll and long distance charges for calls within a service area which is more than 220 miles across. Thus, L.A. Cellular's retail per-minute charges compare very favorably with coin telephone charges for calls of comparable distance, even though cellular, as a mobile service, is far more useful and valuable to its users.

2. <u>What could the PUC do to encourage lower rates and expanded service</u>?

At the outset, it should be realized that cellular service has already expanded throughout California without excessive regulation by the PUC. California was divided by the FCC into more than twenty-five markets, with licenses being awarded to two facilities-based competitors in each market. Because of various FCC decisions, one competitor in each market tended to enjoy a "headstart" over the other. Despite the obstacles, there are now two wholesale competitors (and many more retailers) in every California market, including the most remote. Unlike other utility systems, cellular operations have not been built with rate-payer dollars. Instead they have built with hundreds of millions of dollars in risk capital. All of this has happened in the brief period since late 1986 and early 1987 when facilities-based competition began in the San Francisco Bay Area and the Los Angeles Basin.

Cellular rates tend to be higher in the densely packed urban areas, and lower in medium sized cities and rural areas. This is not because of illicit collusion among competitors. On the contrary, it is the natural result of supply and demand factors that are easily understood. In Los Angeles, despite allegedly "high" rates, our system is approaching capacity even as we race to expand that capacity. Despite a very aggressive build-out policy, service quality is already threatened by excessive demand in the congested parts of our service area. If L.A. Cellular were forced to reduce its rates across-the-board, it is doubtful whether the company could accommodate the increased demand pressures without serious degradation of service quality. For example, Exhibit "D" shows that in today's 60 most congested sites, a 20% increase in demand would result in 200% greater congestion. The PUC's rate regulation fails to deal with this fact, and for this reason alone is doomed to fail.

Customer demand, then, is one reason why cellular rates have not fallen more rapidly in Los Angeles. A more troubling explanation lies in the nature of the regulatory process.

It is often forgotten that rate regulation for public utilities can lead to artificially high prices. California is easily the most highly regulated cellular market in the country. Yet rates in California seem to be "stuck" at higher levels than in other states. Another phenomenon noted by many is the prevalence in California and other regulated markets of identical or near-identical standard rates.

There are several reasons for the apparent sluggishness of cellular prices in California. Three of these are to be found in the nature of our present regulatory process itself.

First, no rate can be changed under present law without prior announcement to the world at large. This gives the competition time to adjust its own rates to meet the challenge, and takes away much of the incentive for the first carrier to even begin the process.

Second, the system allows competitors, PUC staff, and others to protest even downward rate changes, and to delay or block them.

Third is the fact that existing PUC rules assume a single monopoly provider of an essential utility service. The result is a strong bias against short-term promotions, volume discounts, and individualized pricing. Instead, the rules favor long-term, uniform prices, stated in tariffs, without the day-to-day, pro-consumer price changes that characterize an unregulated, competitive market.

L.A. Cellular has recently performed an in-depth study of nearly 40 recent instances where proposals to reduce cellular rates have been delayed or permanently rejected by the PUC. A summary of the study is attached as Exhibit "E", and the whole document has been made available to your staff. Among the most troubling examples described by the study are the following:

- The PUC was for a long time reluctant to authorize lower prices for corporate users and non-profit affinity groups like automobile clubs, bar associations, and the like. L.A. Cellular's attempts to provide reductions of up to 22% in service rates for these groups was effectively delayed by nearly two years as a result of competitor protests at the PUC.
- The PUC has established a uniform rule that any credit of more than $100, or cash rebate of $25.00, to an individual customer, constitutes an illegal "gift", even if properly tariffed.

- The PUC has been very reluctant to authorize uniform roaming rates for customers who travel among different cellular systems -- even though the overall impact of such uniformity would be lower bills to the customers.

These and other instances are more than annoying. They have led to the notion at the PUC itself that cellular carriers do not want to compete, and that they alone are responsible for rates being "stuck" at an allegedly high level. This notion has in turn led to the PUC's recent Decision 92-10-026, which would impose even stricter regulation of cellular rates. As noted above, the Decision could lead to increased numbers of blocked and dropped calls, and even to forms of rationed service. It would also be unworkable from an economic standpoint. Since each carrier has a different cost structure, there would be two permanently different price caps in each market, with the more efficient carrier being penalized with a lower price cap. Great numbers of customers would migrate to the lower priced carrier, thereby increasing costs per customer for the remaining carrier. The ultimate result would be to encourage inefficiency, and perhaps even to put a permanent end to competition in the market.

I want to emphasize that the fault is not alone that of the PUC. Whenever a competitive industry is subject to a complex set of regulations, some players learn how to compete through the regulatory process rather than in the marketplace. When an innovative tariff change is suggested, the competitor protests it, and urges the regulators to extend their old, monopoly-driven rules into new territory. The result is not competitive pricing, but rather administered prices which change slowly, if at all.

The present system, which is frustrating enough, will become unworkable with the arrival this Summer of new, unregulated competitors. The FCC has already granted substantial amounts of radio spectrum to so-called "private" companies which are immune from state regulation even though their service will in most ways be indistinguishable from cellular. One of these is nearing completion of its construction phase in Los Angeles and the Bay Area, and promises to begin competing with cellular in the middle of this year. Because they are immune from the PUC's tariff rules, these companies will be able to bid privately for the business of larger accounts, with there being no way for cellular companies to respond. This is true both under the status quo and under the rigid wholesale rate caps and retail pricing floors recently ordered by the PUC for facilities-based cellular carriers.

L.A. Cellular has informally suggested an alternative plan. This is summarized on Exhibit "F". This plan would allow cellular carriers freely to compete whenever the result would be lower rates for an identified group of customers. The idea is that any rate change within a generously defined range below current rates (say, 25%) would become effective immediately. It would not matter whether these reductions took the form of affinity group discounts, fee waivers, air time credits, or back end refunds. So long as the result is lower rates for a reasonably defined group of customers, there should be no ground for protest or delay.

3. <u>What could be done by the Legislature to encourage lower rates and expanded service</u>?

L.A. Cellular believes that the PUC could go a long way even under present law to allow cellular utilities to compete with each other and with their unregulated rivals. However, some PUC staff members have questioned this, and have based their positions on existing statutes. These statutes were designed for other times, when there was only one, monopoly source for essential transportation, communications, and energy services. L.A. Cellular would support legislation designed to cover the new situations where there are multiple sources of service, both regulated and unregulated. If mobile communication services are to be competitive, providers must be allowed to bid freely for customer accounts, and to react quickly to market changes. The present system -- where significant price changes must be across-the-board, and announced in advance -- has not worked as well as it might.

There are two ways by which the Legislature could open up the mobile communications market to competition. One would be to deregulate cellular services entirely, thereby putting cellular on an equal footing with the new competitors licensed by the FCC. The other would be to enact a statute which would preserve the public utility status of some mobile service providers, but which would make it clear that downward price movements in response to competitive forces will <u>not</u> be regarded as discriminatory or otherwise improper. Such price movements would be allowed to take effect immediately, and could take any of the forms (credits, fee waivers, refunds, etc.) described above. In this way, efficient providers would be encouraged to be leaders in reducing prices, while less efficient ones would be prodded to improve themselves.

ATTACHMENTS

(1) Exhibit "A": Customer Migration to Lower Cost Plans (1989-92)

(2) Exhibit "B": Monthly Revenues per Customer (1989-92)

(3) Exhibit "C": Cell Site Build-Out

(4) Exhibit "D": Congestion Analysis

(5) Exhibit "E": Regulatory Barriers to Rate Reductions

(6) Exhibit "F": Alternative Proposal.

5818\8806\PRES1.DMW

% of Retail Subs on Standard Rate Plan

1990–1992

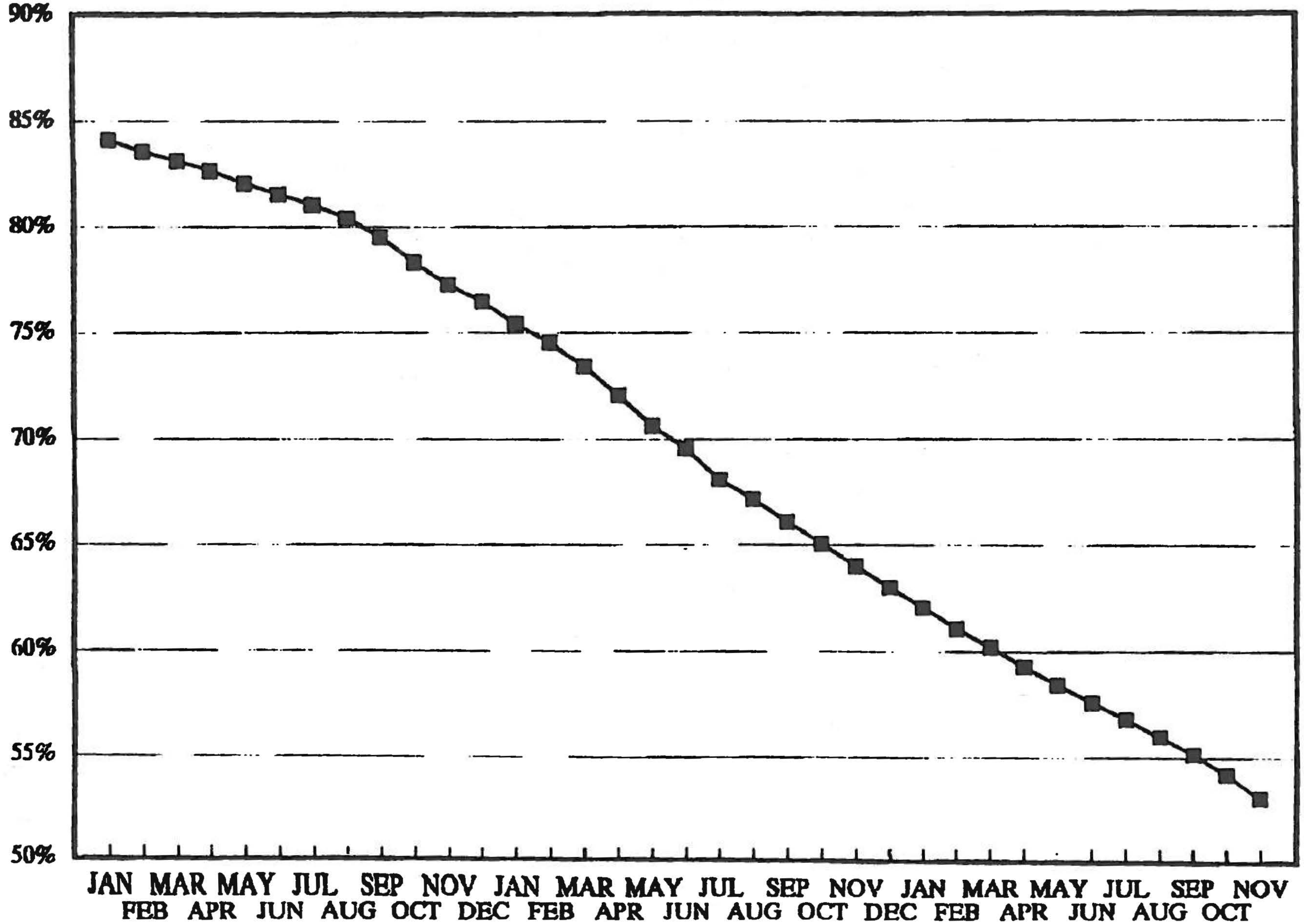
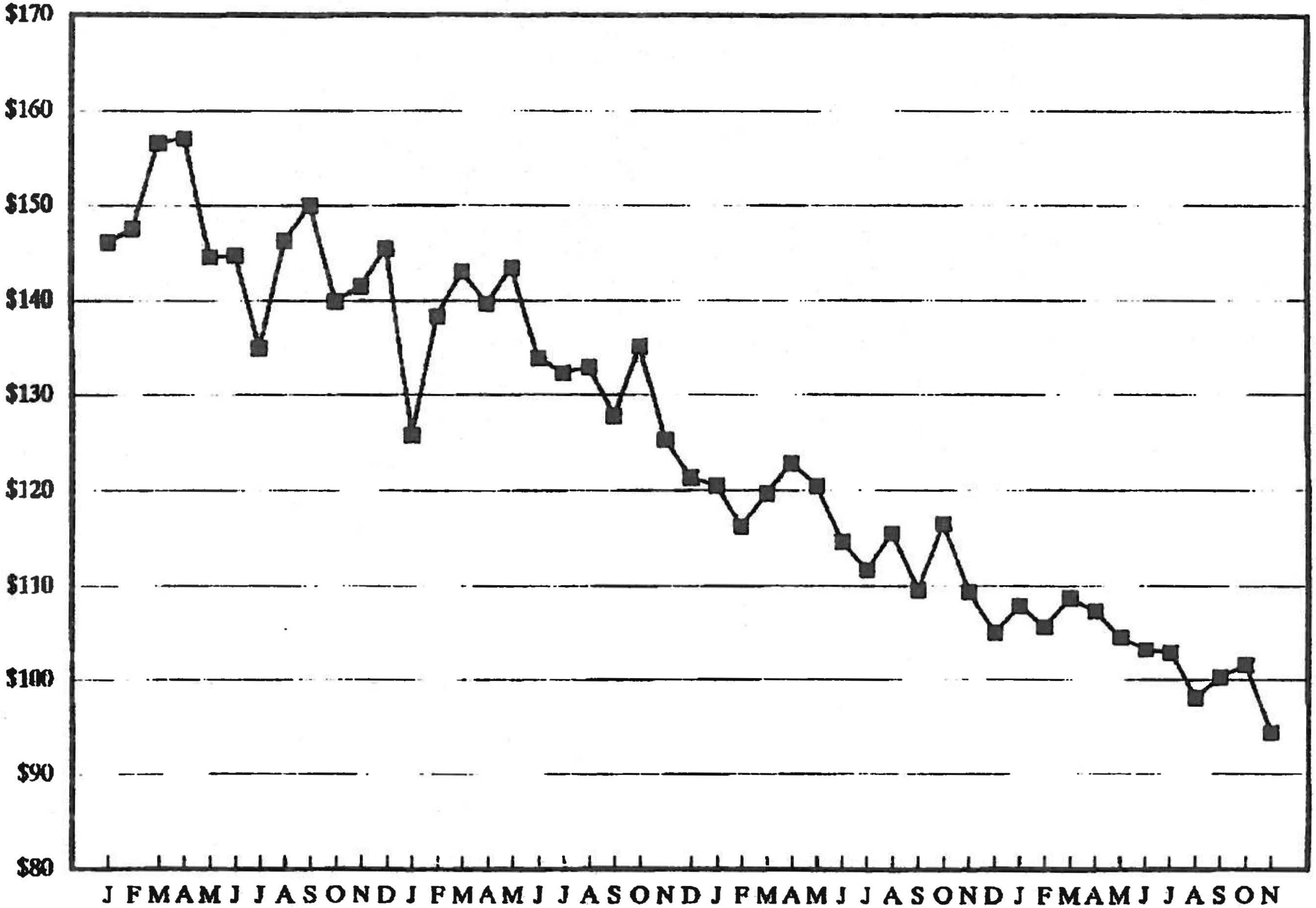


EXHIBIT A

EXHIBIT B

Retail Revenue per Sub per Month

1989–1992



Airtime & Access Revenue

L. A. CELLULAR SYSTEM GROWTH

Total Cell Sites: JAN 90 - DEC 92

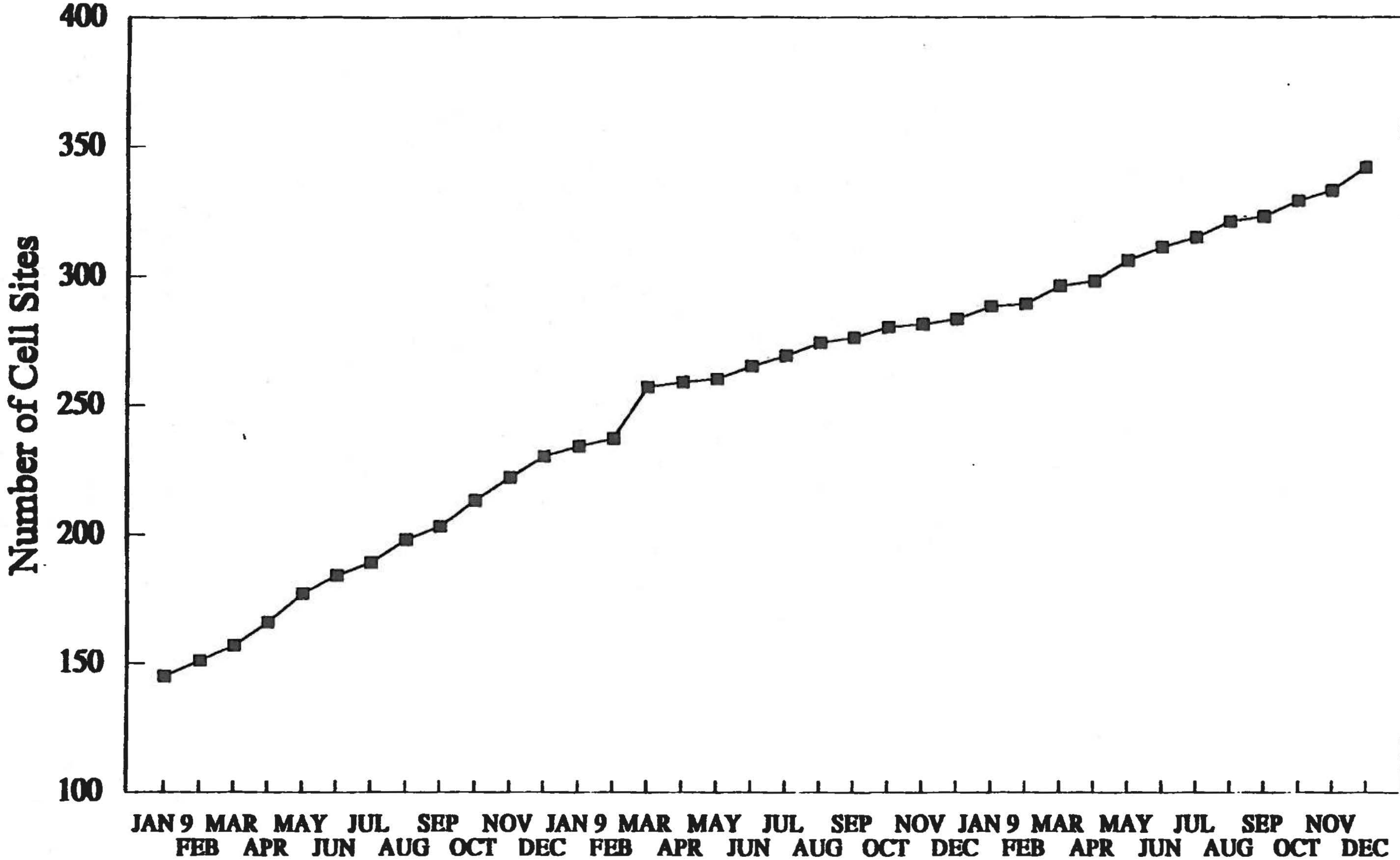
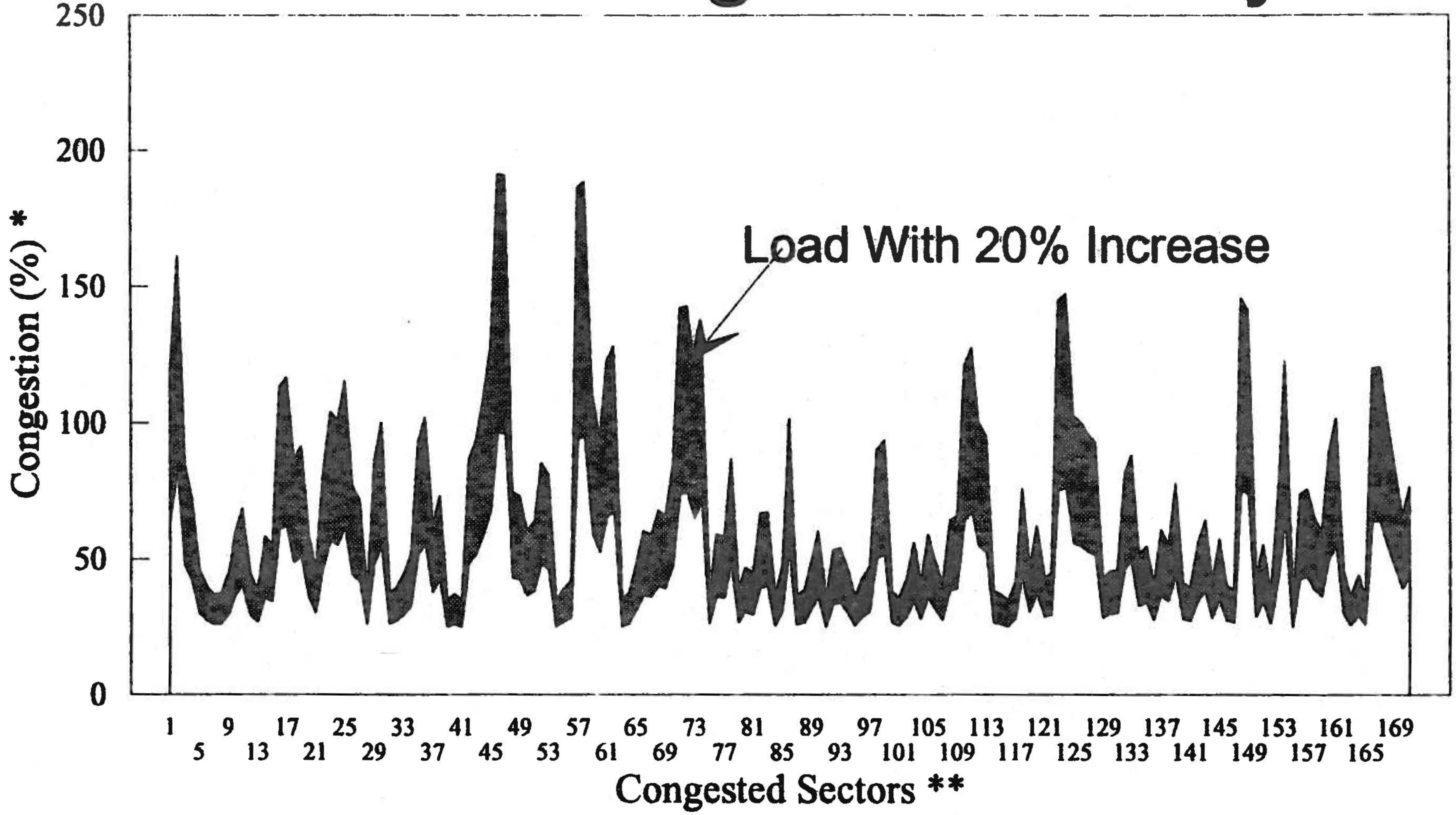


EXHIBIT C

Cellular Congestion Analysis



* "Congestion" levels may exceed 100% due to multiple access attempts and directed retry at a single sector.

** "Congested Sectors" are those where five percent or more of calls are blocked, notwithstanding directed retry attempts.

EXHIBIT D

Cellular Rate Reductions

Present Rule and Practice:

A proposed rate decrease will be delayed or barred entirely if:

- it results in a cash refund of more than $25.00; or
- it gives a billing credit of more than $100.00; or
- it exceeds more than 10 percent of the average customer's monthly bill; or
- it increases some rate elements, but decreases others, even where net impact is to reduce the customer's final bill; or
- it changes the spread between individual wholesale and retail rate elements, even where the overall margin is unaltered; or
- it is "provisional"; or
- it reduces charges for roaming in other markets; or
- it is part of a market trial.

EXHIBIT E

5818\8806\PRESREDS.JNS

Cellular Rate Reductions

Proposed Rule:

Any decrease in cellular rates will be effective on filing, so long as:

- the net impact of the filing is not to reduce average billings over the life of the affected customer accounts by more than XX percent, and
- there is no decrease in the "spread" between the wholesale and retail rates charged for service to the affected customer category.

A decrease may take the form of:

- activation fee waivers,
- usage credits,
- access charge discounts,
- cash refunds,
- reductions in roamer charge pass-throughs, or
- any other reasonable mechanism.

Reduced rate programs:

- may be provisional or permanent,
- may contain increases for some rate elements so long as total charges to the affected customer are reduced, and
- may be a part of a market trial aimed at an identifiable customer subgroup.

EXHIBIT F

MCI Telecommunications Corporation
Pacific Division
201 Spear Street
Sixth Floor
P O. Box 7167
San Francisco. California 94120
415 978 1100

MCI

Hearing of the Senate Committee on Energy and Public Utilities

January 12, 1993

'High Cellular Telephone Rates in California How Should the State Regulate the Cellular Industry"

Comments of Richard B. Severy
Director, Regulatory and Government Affairs
Western Region
MCI Telecommunications Corporation

As this committee is aware, MCI supports the steps taken by the California Public Utilities Commission (PUC) in its recent "Phase III" decision regarding the California cellular market. Specifically, MCI supports the unbundling requirements set forth in that decision. My comments today address the benefits of unbundling for consumers and competitors.

COMPETITION

MCI fully supports competition in all aspects of telecommunications. Competition in telecommunications has brought and will continue to bring substantial benefits to California consumers, businesses and the California economy in general. As you know, MCI championed competition in the long distance industry which brought the benefits of reduced prices and increased innovation in the development of advanced technologies. Competition makes available to consumers a wide variety of new, innovative service offerings, and increases the efficiency of all service providers.

UNBUNDLING AND THE IMPORTANCE OF OPEN ACCESS POLICIES

MCI agrees with the regulatory principle of "unbundling" which is embraced by the PUC's recent cellular decision. Simply stated, "unbundling" separates the functional elements of a telecommunications network. This allows users of the network to purchase only those elements needed, instead of a full "bundle" of features which may be redundant of the users' own capabilities. Unbundling encourages open and equal access to the network.

Successful long distance telecommunications competition is vitally dependent upon regulatory and legislative policies which encourage open and equal access for competitors to those essential network facilities which are necessary to link the end user to the networks that comprise the national and international telecommunications infrastructure. For MCI and other long distance competitors, the battle has been to gain access to the essential facilities of monopoly local exchange companies.

As newcomers in the telecommunications business, we had to overcome claims that open interconnection threatened the integrity of the nation's telecommunications system. From very modest beginnings, long distance competition has come a long way in the last two decades. It could not have come so far so fast without the support of regulators and lawmakers for equal access policies. In that time, the cost of long distance service has fallen dramatically, a host of new technologies and products have become available, and whole new businesses have developed to serve the ever increasing demand for specialized and innovative telecommunications services. Contrary to the early warnings, the nation's telecommunications system is of higher quality and more reliable than it was before competition.

MCI believes that an analogy can be drawn between our experience expanding competition in the long distance industry and the PUC's recent decision to allow nondiscriminatory access to cellular radio networks. This is a modest and extremely enlightened first step toward increasing competition in the cellular industry, to the benefit of the people of California.

THE CELLULAR INDUSTRY AND ITS IMPORTANCE TO MCI

MCI regards the cellular industry as a complement to, not a replacement of, wireline telecommunications services. MCI is excited about the prospects for growth and the development of new applications in the cellular industry. The more "open" the networks, the more possibilities for development of new ideas to meet unique consumer needs. For this reason, MCI has advocated the adoption of equal access policies for cellular service in regulatory and legal forums and in the technical standards-setting process.

MCI provides basic long distance service to cellular customers. An MCI cellular customer has access to all MCI discount programs for residential customers, such as our "Friends and Family" program which provides a twenty percent (20%) discount on long distance calling to as many as twenty frequently-called numbers.

We are also developing new technologies which build from the innovations of cellular technology. MCI was one of the first to petition the Federal Communications Commission (FCC) for permission to provide personalized communications services (PCS), which will rely on advanced micro-technology to bring the power of telecommunications, both voice and data, into the pocket of your overcoat.

THE COMMISSION'S DECISION

The PUC's recent cellular decision is a good example of the vital role state commissions can play in advancing the publicly beneficial forces of increased competition. The requirement in the decision for unbundling essential elements of the cellular network is a welcoming invitation to new telecommunications providers, encouraging innovation to serve the specialized needs of consumers. Specifically, in its decision the Commission has articulated interconnection, unbundling and resale policies that are procompetitive in nature and clearly designed to enhance economic efficiency and consumer welfare.

After lengthy proceedings which resulted in a careful review of both the legal standards and policy goals in this area, the Commission has:

> Promoted resale competition by requiring facilities-based carriers to unbundle and tariff their wholesale rates into specific subcomponents; and
>
> Authorized cellular resellers to install their own switches to enable them to perform key switching functions.

This decision is consistent with another PUC decision of direct importance to MCI. In October of 1989, the PUC adopted the principle of unbundling, advocated by MCI, for the essential elements of the local exchange network. As you know, this is the network MCI is dependent upon to provide access to our long distance customers. The PUC, in the decision of October 1989, as well as in the recent cellular decision, appropriately recognized that unbundling of access to the essential facilities of the incumbent carriers is essential to ensure open and nondiscriminatory access for competitors.

The unbundling requirement will allow resellers to acquire access on a cost-supported basis to only those facilities of the underlying carriers that they must have to provide their services, while leaving the resellers free to be innovative and cost efficient in the provision of the competitive portions of the service, such as marketing, billing, collection and, in the foreseeable future, switching features. This enhanced flexibility should result in new, more innovative and improved services for the benefit of cellular customers.

Unbundling and cost-based access rates are also powerful tools that can be used effectively to detect and prevent anticompetitive discriminatory access pricing on the part of facilities-based carriers. Efficient competition for the provision of the competitive components of cellular service could be thwarted or eliminated by the discriminatory pricing of essential access -- just as happened in the case of long distance service.

In adopting the principle of unbundling for the access services provided by local exchange carriers, the Commission recognized that unbundling was necessary to prevent anticompetitive price squeezes and inappropriate bundling strategies. The Commission also recognized that unbundling was essential to promote a vibrant and diverse competitive telecommunications market by allowing competitors, such as interexchange carriers or information service providers, to interconnect with and utilize only those elements of the local exchange network which were necessary to the provision of competitive services, while providing their own innovative and diverse competitive elements of a service. The Commission's recent order extends those same principles to the cellular marketplace. These are important principles which deserve the support of California's policymakers.

Testimony of Jeffrey P. O'Donnell, Deputy Director

Division of Ratepayer Advocates
California Public Utilities Commission

HIGH CELLULAR TELEPHONE RATES IN CALIFORNIA

HOW SHOULD THE STATE REGULATE THE CELLULAR INDUSTRY?

Senate Committee on Energy and Public Utilities

January 12, 1993

Good Afternoon. I am appearing here today on behalf of the Public Utilities Commission's (Commission) Division of Ratepayer Advocates (DRA). DRA is an independent division of the Commission that represents ratepayers in proceedings before the Commission. I am DRA's Deputy Director responsible for telecommunications issues that affect California ratepayers. DRA is concerned about the high cellular rates that California subscribers pay and appreciates this opportunity to comment on how the cellular industry should be regulated.

Let me begin by explaining why DRA believes regulation of the cellular industry is the appropriate response to high cellular rates at this time. The cellular carriers provide a service that relies on a public resource, namely the airwaves over which cellular communications are sent. Because the airwaves are a national resource, it is incumbent upon the carriers to provide their services at just and reasonable rates. Where the free market and competition cannot induce the carriers to provide cellular services at reasonable rates, then regulation must act as competition's proxy.

DRA does not believe that the cellular carriers function in a competitive market. The Federal Communication Commission (FCC) decided that only <u>two</u> wholesale carriers could operate in each market and issued the licenses accordingly. The FCC believed that the duopoly market structure was appropriate for the cellular industry. However, economic literature tells us that if there are only two firms in a market, each firm has a greater incentive to cooperate with each other than to compete against each other.

The duopoly structure is further exacerbated by the fact that there is extensive cross ownership in the major markets. For example, McCaw Cellular and PacTel are partners in the Bay Area while they are competitors in the Los Angeles market. We do not need economic theory to tell us that McCaw will not compete vigorously against PacTel in the Los Angeles market if they work together in the Bay Area.

If the cellular market were competitive, then we would expect to see cellular rates vary over time. For example, rates would likely decrease as a company experienced economies of scale. However, cellular basic rates have not changed since they were introduced in 1984, despite the fact that the number of California cellular users has grown from 15,000 to over 1 million today. Furthermore, the rates <u>within</u> each market are very similar, and quite often identical. In fact, when one of my staff called the two carriers in Los Angeles to find out what their basic rates were, she was told by each carrier that their rates were identical to the other carrier and, in fact, they are identical.

The cellular carriers will attempt to tell you that regulation is the cause of high cellular rates in California. They will tell you that the Commission makes it extraordinarily difficult for them to lower their rates. What they will not tell you is that they are able to lower their prices up to 10% and have it effective <u>the day they ask for the rate decrease</u>. The 30-day notification period is for price decreases greater than 10%. Furthermore, if the Commission so effectively stifles their ability to offer lower prices to their customers, then the carriers need to explain how they are able to offer any promotional plans that result in lower prices for certain classes of customers. When and where the carriers genuinely want to offer lower prices, they have generally managed to get those plans approved.

Although many different factors could be the cause of high cellular rates and DRA believes that a lack of competition is the main reason, my staff analyzed cellular basic rates in 12 major metropolitan areas to determine if there was a relationship between high rates and cellular regulation, as the cellular companies allege. DRA staff analyzed the basic rates in the 4 largest California markets - Los Angeles, Sacramento, San Diego and the Bay Area - and in 8 other major cellular markets in the country. The results of that survey are attached to my testimony. While it is true that San Francisco and Los Angeles have the highest rates in the country (along with New York), Sacramento has the lowest rates of all the cities surveyed. San

Diego's rates are lower than rates in Seattle and Miami, which are unregulated markets. Clearly, there is no definitive relationship between cellular rates and regulation. California has some of the highest and lowest cellular rates. California's rates are both higher and lower than rates in states where the cellular industry is unregulated.

The cellular carriers further argue that competition from other wireless communications, such as Enhanced Specialized Mobile Radio (ESMR) and Personal Communication Services (PCS), is imminent. DRA believes that the threat of competition from ESMR and PCS is still a way off. ESMR will begin implementation of its digital service in Los Angeles this year and in San Francisco in 1994. The PCS spectrum has not even been allocated yet, so its emergence as a competitive alternative is much further off.

Although the wholesale cellular market is not competitive, the reseller's market is very competitive. However, the resellers are dependent upon the wholesale carriers to provide them with access to the cellular network. So, no matter how competitive the reseller market may be, they are always confronted with the necessity of buying air time from one of two wholesale carriers. Currently in California, out of every dollar a subscriber pays for cellular services only 20 cents goes to the reseller while the other 80 cents is paid to the wholesale carrier. Clearly, the wholesale carriers have the most control over the rates.

DRA analyzed the cellular carriers' rates of return in 1989 and found them to be excessive. Recent reports by both the U.S. General Accounting Office (GAO) [1] and Commission staff [2] indicate similar findings. The continuous high profits and lack of incentive to compete indicate that regulation is needed. The Commission's recent Phase III decision takes an important step toward gathering the information necessary to determine, in a uniform manner, the rates of return that all California cellular carriers earn.

Present legislation has empowered the Commission to set just and reasonable utility rates. DRA does not believe that any additional legislation is needed to encourage or guide the Commission in fulfilling its responsibility. Clearly, the current cellular market structure does not support deregulation of the industry. Instead, DRA recommends that the Commission open a new investigation into the cause of continued high cellular rates in California. Since 1988, the CPUC has regulated the industry based on a regulatory framework that assumed the duopoly market structure was competitive and would eventually result in lower rates. DRA believes that the market is not adequately competitive and that it is time to reexamine the

---

1 U.S. General Accounting Office, "Concerns About Competition in the Cellular Telephone Service Industry," July 1992.
2 Commission Advisory and Compliance Division, Finance Branch, "1992 Cellular Financial Status Report," October 26, 1992.

method of regulating the industry. While new competition may appear in the future, DRA believes that regulation is needed today and until a truly competitive wireless market becomes a reality.

Table 1

CELLULAR BASIC SERVICE RATE COMPARISON – December 1992

City/Carrier		Activation Fee	Monthly Rate	Peak Rate	Off-Peak Rate	Peak Hours	Monthly Charge **	Charge Compar. with LA
Los Angeles	A	$50.00	$45.00	$0.45	$0.27	7-7	$99.00	100.00%
	B	$50.00	$45.00	$0.45	$0.27	7-7		
SF	A	$25.00	$45.00	$0.45	$0.20	7-7	$95.00	95.96%
	B	$25.00	$45.00	$0.45	$0.20	7-7		
Sacramento	A	$50.00	$24.00	$0.29	$0.15	7-8	$60.00	60.61%
	B	$50.00	$20.00	$0.25	$0.15	7-7	$52.00	52.53%
Seattle	A	$40.00	$29.99	$0.56	$0.25	7-7	$93.00	93.94%
	B	$40.00	$29.95	$0.58	$0.25	7-7	$95.00	95.96%
Chicago	A	$35.00	$19.95	$0.32	$0.20		$59.00	59.60%
	B	$35.00	$19.95	$0.34	$0.20	6-10	$62.00	62.63%
Houston	A	$50.00	* $31.99	$0.45	$0.45	7-7	$77.00	77.78%
	B	$45.00	* $19.95	$0.75	$0.75	7-7	$92.00	92.93%
Boston	A	$40.00	$21.00	$0.44	$0.29	7-7	$74.00	74.75%
	B	$40.00	$19.00	$0.50	$0.33	7-7	$78.00	78.79%
New York	A	$55.00	* $39.99	$0.65	$0.40	7-9	$99.00	100.00%
	B	$50.00	$33.00	$0.56	$0.36		$101.00	102.02%
Philadephia	A	$75.00	$14.95	$0.74	$0.35	7-9	$104.00	105.05%
	B	$50.00	$24.95	$0.50	$0.30	7-9	$86.00	86.87%
D.C.	A	$60.00	$24.00	$0.39	$0.19	7-9	$72.00	72.73%
	B	$60.00	$24.95	$0.39	$0.19	7-9	$73.00	73.74%
Miami	A	$45.00	$42.00	$0.39	$0.29	7-7	$93.00	93.94%
	B	$45.00	$39.00	WDs $0.45 WEs $0.20	$0.10	7-10	$92.00	92.93%

* Rates include 30 free minutes a month.

** Monthly Charge includes:

1. 120 minutes a month based on California's average cellular system utiliztion distribution (see DRA's Phase II Comments), and
2. activation fee amortized over a 12-month period.

WDs/WEs: Weekdays/Weekends

Table 2

CELLULAR SUBSCRIBERS STATISTICS IN CALIFORNIA (MSAs-1991)

	Subscribers Penetration (Subsribers/ /Population)	Subscribers Distribution (Subsribers/ Total Subs)	Frequencies Efficiency* (Subsribers/ Frequencies)
Chico/Redding	0.50%	0.20%	
Sacramento/Stockton	5.50%	13.40%	
San Francisco Bay Areas	2.60%	18.00%	
Fresno/Bakersfield	3.20%	5.10%	
Santa Barbara	1.20%	0.50%	
Los Angeles	3.60%	54.2%	
San Diego	3.30%	8.60%	
MSAs	3.39%	100.00%	

Total Population in MSAs:	28,700,000
Total Cellular Subscribers in MSAs:	**
Number Pairs of Frequencies per MSA:	832

* This is a rough assessment of the efficient use of the radio frequencies.
The efficiency is highly affected by the size and terrain of the areas.

** Information was received by CACD under G.O. 66 C.

This chart is not for public distribution.

DRA

Phone (415) 703-2061
FAX (415) 703-1981

California Public Utilities Commission
DIVISION OF RATEPAYER ADVOCATES
505 Van Ness Avenue
San Francisco, CA 94102-3298

EDMUND J. TEXEIRA
Director

SUPPLEMENTAL TESTIMONY

February 17, 1993

The Honorable Herschel Rosenthal
Senate Committee on Energy and Public Utilities
State Capitol, Room 2035
Sacramento, CA 95814

Dear Senator Rosenthal:

Enclosed is the Division of Ratepayer Advocates' (DRA's) analysis of the differences between McCaw Cellular's Exhibit E to Wayne Perry's testimony before the Senate Committee on Energy and Public Utilities, January 12, 1993, and DRA's Table 1 to my testimony on the same date. I apologize for the delay in providing DRA's analysis, but as you know, McCaw Cellular did not provide the information necessary for DRA to complete its analysis until February 5, 1993.

In response to your request that DRA explain the differences between the cellular service rates calculated by DRA and those calculated by McCaw, I have enclosed a table comparing McCaw's and DRA's calculated cellular rates. DRA and McCaw used similar but not identical assumptions in deriving their cellular rate tables. The differences in assumptions are discussed below.

1. **Choice of Carriers**

DRA's original analysis included cellular rates for both the wireline and the non-wireline carrier in each city surveyed. McCaw looked solely at the non-wireline carriers' rates. In many cases, the wireline carriers' rates were higher.

2. **Choice of Markets**

While DRA and McCaw surveyed some of the same markets, there are notable absences from McCaw's list of markets. McCaw did not include Sacramento, California nor Boston, Massachusetts in their list of regulated markets. DRA included these two markets and found their rates to be significantly less than rates in many regulated and <u>unregulated</u> markets.

3. **Choice of Rate Plan**

McCaw's table presented cellular rates calculated from "the most economical rate plan currently available in each market to an individual end user." The plans McCaw presented assume that the customer knows his or her monthly calling pattern. In fact, when a DRA analyst contacted one cellular service provider, she was told that plans which included free airtime were primarily for existing users who had developed a measurable usage pattern. Many of the plans that McCaw presented included 30 to 150 minutes of free airtime. These plans also often require a minimum one year contract period with substantial penalties, some as high as $250, for early termination. DRA has indicated which rate plans require such a commitment in the attached tables. DRA's cellular rates table presented rates that were from a carrier's basic or standard rate plan in each market. Typically the basic plans are available on a regular basis, do not include any free minutes of airtime and do not require a one-year commitment. The basic plans are more appropriate for new customers who have not established a predictable usage pattern.

4. Amortization of Activation Fee

In most cases, beginning cellular service requires payment of an activation fee. DRA's analysis revealed that these fees ranged from $25.00 to $75.00, but were generally identical within a given market. DRA included the activation fee in its analysis by amortizing the fee over 12 months. DRA believes that the activation fee is not insignificant and should be included in the analysis. The activation fee is significant in the short run and can influence whether a customer decides to continue service with his current carrier or switch to the other carrier in the market. McCaw's analysis fails to account for the one-time activation fee.

5. Distribution of Peak/Off-Peak Minutes

McCaw and DRA assumed that 80% of the 120 minutes of airtime would occur during peak hours and the remaining 20% during off-peak hours. The 80% peak and 20% off-peak allocation is considered the typical usage pattern. However, McCaw first allocated the free minutes in any plan to peak usage and the remaining free minutes to off-peak usage, rather than on the 80/20 calling pattern. This allocation methodology understated the rates calculated by McCaw.

6. Airtime

DRA and McCaw both presented rates that were based on using 120 minutes of airtime. In addition, McCaw presented 3 other scenarios with 60, 180 and 360 minutes of airtime used. For DRA's comparison of McCaw's and DRA's rates table, DRA compared rates at 120 minutes of usage.

Given the different assumptions McCaw and DRA used to derive their tables, it was necessary to develop a common set of assumptions in order to make a valid comparison. The following changes were made to McCaw's original rates table:

1. Corrected rates for New York and Minneapolis (per letter of February 5, 1993 and FAX on February 11, 1993 from Scott Morris, McCaw to Linda Woods, DRA) were inserted.

2. Recalculated McCaw's rates to include amortization of the activation fee over 12 months and to reallocate any free minutes of use based on the 80/20 peak/off-peak calling pattern.

Table 1 (attached) shows McCaw's original cellular rate figures and those same rates after making the above-mentioned adjustments. Including the activation fee and reallocating the free minutes increases the rates that McCaw presented in their original table.

Table 2 (attached) compares the cellular rates tables presented by DRA and by McCaw under a common set of assumptions, as explained previously. Although DRA's rates are still higher than McCaw's, some of the discrepancy has been explained by the use of different assumptions. The remaining difference is due to the choice of plan. DRA's figures show the rates for <u>basic</u> cellular plans in each market, whereas, McCaw's figures show rates for various plans that differ by market. For instance, McCaw used plans in some markets that included 30 minutes of free airtime while in other markets, customers were offered 120 minutes of free airtime. DRA believes it is more valid to review plans that are as similar as possible across all markets and, for that reason, reviewed the rates of basic plans in each market.

Table 2 supports DRA's assertion that no clear link is apparent between a state's rates and its level of regulation. For instance, California regulates the cellular market throughout the state and yet has markets with both high and low rates. Sacramento's cellular rates were among the lowest of all the markets that DRA surveyed. Using McCaw's methodology of selecting the most economical plan for the number of minutes used, DRA contacted Sacramento again and calculated the monthly rate. Even using McCaw's methodology, Sacramento's rates are still among the lowest. DRA remains convinced that regulation is not the cause of high cellular service rates in California. DRA believes that a myriad of factors are at work in California which result in high rates. Those factors include, but are not limited to, the lack of competition in the industry stemming from the duopoly market structure, greater demand for cellular services, higher disposable income in the areas with the highest rates, greater population density and a highly mobile population.

McCaw's assertion that regulation in California and New York is the cause of high cellular service rates in San Francisco, Los Angeles and New York City has not been proven. McCaw has not explained why California has some of the lowest cellular service rates (e.g., Sacramento) or why markets in other regulated states (e.g., Boston) have relatively low rates.

Furthermore, DRA strongly disagrees with McCaw's assertion that "while Sacramento's rates are among the lowest in the country, that fact is irrelevant to whether California's tariffing rates help maintain cellular rates that were originally set at higher levels. . ." (January 11, 1993 letter from James L. Barksdale, McCaw Cellular Communications, Inc. to President

Fessler) As I stated in my testimony before the Senate Energy and Public Utilities Committee on January 12, 1993, California cellular carriers may reduce their cellular rates by up to 10% and have the rate reduction take effect immediately. I would also like to mention that although Sacramento does have relatively low cellular rates, McCaw raised those rates by 20% in 1989.

I sincerely hope that the enclosed analysis satisfactorily explains the differences between DRA's and McCaw's cellular service rate calculations. Additionally, I believe that it's apparent that one cannot conclude from either McCaw's or DRA's cellular rate surveys the cause of high cellular rates in California. If DRA can be of any further assistance, don't hesitate to contact me at (415) 703-3084.

Sincerely,

Jeffrey P. O'Donnell
Deputy Director, Division of Ratepayer Advocates

TABLE 1

McCAW'S RATES ADJUSTED FOR DRA ASSUMPTIONS

(REGULATED MARKETS ARE IN BOLD ITALICS.)

CITY	MCCAW		MCCAW(1)		
LOS ANGELES	***$94.68***	***100.00%***	***$98.84***		***100.00%***
SAN FRANCISCO	***$90.50***	***95.59%***	***$92.58***		***93.67%***
NEW YORK	***$89.99***	***95.05%***	***$100.81***	*	***101.99%***
MIAMI	$80.64	85.17%	$86.07	*	87.08%
SEATTLE	$74.71	78.91%	$81.28		82.23%
DALLAS	$71.77	75.80%	$74.69		75.57%
TAMPA	$70.83	74.81%	$75.91	*	76.80%
DENVER	$69.99	73.92%	$73.32	*	74.18%
PITTSBURGH	$69.99	73.92%	$74.15	*	75.02%
BOSTON	***$68.20***	***72.03%***	***$73.33***		***74.19%***
MINNEAPOLIS	$66.96	70.72%	$73.41		74.27%
HOUSTON	$65.97	69.68%	$72.44	*	73.29%
PHILADELPHIA	$64.95	68.60%	$69.53	*	70.35%
WASHINGTON, D.C.	$60.14	63.52%	$63.06	*	63.80%
SACRAMENTO	***$54.03***	***57.07%***	***$58.20***		***58.88%***
DETROIT	$53.20	56.19%	$55.72	*	56.37%
CHICAGO	$48.60	51.33%	$53.84		54.47%

PERCENTAGES ARE RELATIVE TO LOS ANGELES RATES.

** REQUIRES COMMITMENT TO ONE YEAR CONTRACT*

(1) REVISED TO INCLUDE ACTIVATION FEE & ALLOCATION OF FREE MINUTES

ASSUMPTIONS:

1. ALL RATES ARE BASED ON 120 MINUTES OF USE (80% PEAK/20% OFF PEAK).

2. RATES FOR BOSTON, HOUSTON, PHILADELPHIA, AND SACRAMENTO WERE ADDED BY DRA USING MCCAW ASSUMPTIONS.

TABLE 2

DRA AND McCAW
CELLULAR RATE COMPARISON CHART

(REGULATED MARKETS ARE IN BOLD ITALICS.)

CITY	DRA (A)		DRA (B)		MCCAW(1)		
LOS ANGELES	***$99.00***	***100.00%***	***$99.00***	***98.02%***	***$98.84***		***98.05%***
NEW YORK	***$99.00***	***100.00%***	***$101.00***	***100.00%***	***$100.81***	*	***100.00%***
PHILADELPHIA	$97.24	98.22%	$86.00	85.15%	$69.53	*	68.97%
SAN FRANCISCO	***$95.00***	***95.96%***	***$95.00***	***94.06%***	***$92.58***		***91.84%***
MIAMI	$93.00	93.94%	$92.00	91.09%	$86.07	*	85.38%
SEATTLE	$93.00	93.94%	$95.00	94.06%	$81.28		80.63%
DENVER	$83.00	83.84%	$88.00	87.13%	$73.32	*	72.73%
DALLAS	$80.40	81.21%	$89.35	88.47%	$74.69		74.09%
HOUSTON	$77.00	77.78%	$92.00	91.09%	$72.44	*	71.86%
MINNEAPOLIS	$76.00	76.77%	$76.00	75.25%	$73.41		72.82%
BOSTON	***$74.00***	***74.75%***	***$78.00***	***77.23%***	***$73.33***		***72.74%***
DETROIT	$72.44	73.17%	$70.31	69.61%	$55.72	*	55.27%
WASHINGTON, D.C.	$72.00	72.73%	$73.00	72.28%	$63.06	*	62.55%
SACRAMENTO	***$60.00***	***60.61%***	***$52.00***	***51.49%***	***$58.20***		***57.73%***
CHICAGO	$59.00	59.60%	$62.00	61.39%	$53.84		53.41%
PITTSBURGH	N/A	N/A	N/A	N/A	$74.15	*	73.55%
TAMPA	N/A	N/A	N/A	N/A	$75.91	*	75.30%

PERCENTAGES ARE RELATIVE TO LOS ANGELES RATES.

** REQUIRES COMMITMENT TO ONE YEAR CONTRACT*

(1) REVISED TO INCLUDE ACTIVATION FEE & ALLOCATION OF FREE MINUTES

(A) NON-WIRELINE CARRIER

(B) WIRELINE CARRIER

ASSUMPTIONS:

1. ALL RATES ARE BASED ON 120 MINUTES OF USE (80% PEAK/20% OFF PEAK).

2. RATES FOR BOSTON, HOUSTON, PHILADELPHIA, AND SACRAMENTO WERE ADDED BY DRA USING MCCAW ASSUMPTIONS.

Utility Consumers' Action Network

UCAN
1717 Kettner Blvd., Suite 105
San Diego, CA 92101-2532
619-696-6966

PREPARED STATEMENT OF MICHAEL SHAMES

Oversight Hearing on High Cellular Telephone Rates in California
Senate Committee on Energy and Public Utilities
January 12, 1993

My name is Michael Shames and I am the executive director of Utility Consumers' Action Network (UCAN), a San Diego-based utility consumer watchdog group. We have a membership of 53,000 San Diego residential and small business billpayers and have represented their interests in telephone and power utility issues since 1984. The concerns I express today are shared by Toward Utility Rate Normalization (TURN), a statewide utility consumer advocacy group.

Today, both UCAN and TURN ask this committee to take immediate action to reduce the chronically high cellular telephone rates in California. It is abundantly clear to all consumers that cellular service rates are being kept artificially high by the cellular companies' manipulation of the cellular market, a manipulation is only possible by the duopoly position that they currently enjoy.

We view the abuses of this market as being very analogous to the well-documented pricing and service abuses visited upon consumers by the cable television operators during the 1980s. The federal government finally took action last year to begin rectifying a problem that was evident in California over five years ago. We should not wait that long to address a similarly obvious abuse of the marketplace.

Action must be taken immediately. On behalf of residential and small business consumers throughout the state of California, we offer the following major points for this Committee to consider.

Ubiquity is Undermined by Artificially High Cellular Rates.

At present, the high cellular phone rates have limited the customer base to the business community. Small business and residential customers who need the accessibility offered by cellular are constrained by its formidable price. In the 1980s, consumers reasonably expected that, over time, increased demand and technological advances would drive down cellular rates, as it has done in other high-tech industries. These consumers were only half-correct; prices for cellular phone hardware have dropped by 80% since 1985, yet usage rates remain unchanged. As a result, ubiquity in cellular phone service has not occurred.

The long-standing and very important regulatory principle of fostering ubiquity in telecommunications compels making cellular technology available to as many consumers as economically possible. Permitting cellular rates to be maintained at artificially high levels is contrary to California's well-accepted principle of communications service ubiquity.

For too long, the cellular companies have perpetuated a myth that cellular service is uniquely designed for large businesses, relegating small businesses to paging services and residential customers to pay phones. It is a self-serving myth that has permitted the companies to milk the market with its monopoly rents.

In fact, cellular technologies should be made available to all customer classes to the extent that it economic to do so. UCAN believes that cellular service could be an important tool for families with children, for senior citizens, for small businesses that want to improve customer service, for use by individuals in case of emergency (such as earthquakes and fires) as well as government employees who should be trying to improve their responsiveness to their respective constituencies.

UCAN and TURN are also concerned about the way in which cellular pricing structures work to discourage residential and small business consumers. There is no affordable rate structure available for infrequent users. And cellular pricing includes anomalies such as charging both calling and called parties for one transaction.

In short, the myth must be busted. But it will not be unless competition is imposed and the true cost of cellular service is established.

Business Efficiencies are Enfeebled

Business efficiencies are frustrated by artificially high cellular rates. As the state enters its third year of recession, California has recognized the role of global competition and the importance of ensuring that California businesses can compete. This state's competitiveness is undermined when communications costs are higher and service is inferior to that offered in other countries. It is UCAN's understanding that California's cellular services are proportionately higher cost and lower quality than comparable services offered in Pacific Rim and European countries. The state simply can not afford to permit its communications infrastructure to be inferior in service and price to its competitors.

CPUC Steps to Increase Competition in the Industry Must be Supported

In October 1992, the CPUC took important steps towards encouraging greater competition in the cellular industry. Its ruling to compel unbuntheir own switching equipment were, if anything, overly conservative but much needed steps to inject competition in this competitively moribund industry.

The industry's duopoly privilege has allowed it to escape the true-cost disciplines that are imposed on all other competitive industries. Even regulated industries such as electric, gas and telephone utilities in California have been systematically subjected to least-cost pricing disciplines in an effort to reduce costs and become competitive. Yet, cellular companies enjoying comparable market leverage fear no such discipline.

This committee, the legislature as a whole, and the California Public Utilities Commission must take the following actions:

1. Encourage the CPUC to take swifter and more decisive action to inject competition in the cellular industry;
2. Compel the cellular companies to demonstrate why its charges for cellular service have not dropped;
3. Compel the cellular companies to create an affordable rate for residential and small business consumers who use cellular service intermittently and during off-peak hours;
4. Investigate Pacific Telesis' recent announcement that it intends to spin-off its cellular division to ensure that it will not lead to further market abuses;
5. Investigate the current barriers-to-entry to the cellular industry and;
6. Investigate the current pricing structures of the industry that may discriminate against residential and small business consumers and that may constitute unfair doublecounting.