PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY AND COMPLIANCE DIVISION
Telecommunications Branch

RESOLUTION NO. T-13068
May 10, 1989

RESOLUTION

REQUEST FOR A GENERAL RATE INCREASE BY STOCKTON CELLULAR TELEPHONE COMPANY (U-3012-C) AND SACRAMENTO CELLULAR TELEPHONE COMPANY (U-3013-C).

SUMMARY

On March 15, 1989, Sacramento Cellular Telephone Company (Sacto), (U-3013) filed Advice Letter No. 12 and Stockton Cellular Telephone Company (SCTC) (U-3012) filed Advice Letter No. 12 (hereinafter referred to collectively as the "Advice Letters"). Sacto and SCTC are affiliates of McCaw Cellular Communications, Inc. (MCCI). By the Advice Letters, Sacto and SCTC seek an overall increase in their 1989 revenues of approximately 11-12 % through: (1) (16-20%) increase on retail and wholesale monthly access and peak usage rates; (2) a $2.00 per day charge and $.05 per minute increase in roaming rates for unaffiliated subscribers; (3) an extension of the peak calling period; and (4) a modification of the manner by which cellular calls are timed. These requested increases would generate on an annual basis $13.3 million for Sacto and $6.0 million for SCTC.

All interested parties and customers were notified of these changes by letter mailed on March 21, 1989. Protests were received from the Commission's Division of Ratepayer Advocates (DRA) and from ten customers. Complaints and comments were received by telephone, telegram, and letters from approximately thirty more subscribers.

We find that the showing made by Sacto and SCTC is adequate and find that the terms, rates, and conditions proposed in their Advice Letters are appropriate and reasonable. Therefore, we grant the rate increase and find that the protests filed by DRA and the customers be dismissed.

BACKGROUND

Sacto is one of two facilities-based cellular carriers in the Sacramento market. SCTC is one of two facilities-based cellular carriers in the Stockton market. In both markets, the other carrier is Sacramento Valley Limited Partnership (SVLP). PacTel Cellular is the controlling partner in SVLP.

Sacto filed Application 87-03-022 for its Certificate of Public Convenience and Necessity on March 12, 1987. Decision 87-10-037 issued October 16, 1987 granted Sacto its CPCN, thereby authorizing Sacto to construct and operate a new domestic public cellular radio telecommunication service to the public in the greater Sacramento metropolitan area.

SCTC filed Application 87-06-019 for its CPCN on June 10, 1987. Decision 87-11-061, issued November 25, 1987, granted SCTC its CPCN, thereby authorizing SCTC to construct and operate a new domestic cellular radio telecommunication service to the public in the greater Stockton metropolitan area.

Prior to commencing facilities-based operations, Sacto and SCTC filed resale tariffs in order to begin building respective customer bases by reselling the service of its wireline competitor, SVLP. This is the case for most non-wireline cellular carriers under the Commission's headstart policy, a policy designed to foster competition and allow the facilities-based carrier which has not received its CPCN to construct to resell to the public by buying numbers in bulk from its competitor. The cellular rates adopted by Sacto and SCTC were established by Sacto's and SCTC's wireline competitor some 12 to 14 months before Sacto and SCTC commenced facilities-based service, and are the lowest in California in some cases by more than 50 percent.

From the last quarter of 1987, when Sacto commenced facilities-based operations, through the end of 1989, Sacto projects that it will have spent $18.36 million on its cellular network in an effort to deliver higher quality and more expansive service than is being provided by its wireline competitor. This figure is approximately 70% more than Sacto originally had projected when it filed its CPCN application in March 1987. Similarly, SCTC has spent some 83% more than it had originally projected. The companies state that the need to compete aggressively for customers requires these additional sums in order for them to provide the highest quality and increased value of service for their subscribers.

In July 1988, each filed for a general rate increase that proposed 50% increases in retail access charges, from $20.00 to $30.00 per month, and 40% increases in retail usage charges, from $.25 to $.35 per minute during peak periods. Those increases were sought by Advice Letter, pursuant to revisions to General Order No. 96-A adopted by this Commission on May 25, 1988. By those revisions, this Commission extended to cellular service providers the authority to seek a general rate increase on 30-day notice, and to do so by Advice Letter, as an alternative to the formal application procedure that previously had governed such increases.

In response to those Advice Letters, only seven Sacramento customers filed formal protests, although CACD did receive over 300 letters and calls by customers who wished to informally complain and object to the magnitude of the proposed increase. In addition, the Cellular Resellers Association (CRA), which represents a number of resellers of cellular service within the State, protested on the basis that the rate levels and spread between wholesale and retail rates had not been adequately justified. The CRA protest sought an evidentiary hearing.

In response to customer concerns and the CRA protest, the Commission on August 10, 1988, required Sacto and SCTC to refile their requests as applications and assigned to an Administrative Law Judge for hearing. Among the reasons advanced by the Commission for denying the increases on the basis of the Advice Letter filings were: (1) the magnitude of the increases; (2) the fact that standards for the establishment of cellular rates had not been re-examined since the initial decision approving cellular operations in California; and (3) the imminency of an order by the Commission commencing an investigation of the cellular industry which was likely to include a review of ratemaking principles and standards.

In early September 1988, Sacto and SCTC withdrew their applications in order to reconsider the magnitude of the proposed increases, to determine whether a service offering could be developed on a basis that could prove acceptable to cellular resellers and to determine whether Sacto and SCTC could await relief pending the issuance and outcome of the contemplated Cellular OII.

Since the withdrawal of the earlier applications, representatives of Sacto and SCTC and their parent organization, McCaw Cellular Communications Inc., have consulted with representatives of the cellular resellers in an effort to obtain the resellers' views concerning an acceptable spread between wholesale and retail rates; have discussed with Commission staff and others the nature of the supporting material that should be provided in connection with any further requests for rate relief; and have attempted to determine what minimum level of rate relief would be warranted at this time, while awaiting the Commission's review of cellular rate-making principles in the Cellular OII.

Sacto and SCTC argue that they are sustaining continuing losses because of large investments necessary to maintain and enhance the value of their service to subscribers. These investments, if foreseen at the time original rates were set, would in Sacto and

SCTC's views have justified rates at least as high as those now proposed. Sacto and SCTC argue that the Commission need not wait for the completion of its formal review of cellular ratemaking in

the OII in order to approve increases clearly justified by the same principles that have so far been applied to other cellular markets in the state.

By their Advice Letter filings, Sacto and SCTC seek to alter their rate structure in the following manner:

Retail

Category	Current Rates	Proposed Rates	% Difference
Monthly Access Charge	$20.00	$24.00	20%
Peak Usage/Minute	$.25	$.29	20%
Off-Peak Usage/Minute	$.15	$.15	None

Wholesale

Category	Current Rates	Proposed Rates	% Difference
Monthly Access (Per Number)			
up to 100 numbers	$15.30	$18.37	20.10%
Over 100 numbers	$14.30	$17.15	19.93%
Peak Usage (Per Minute)			
0-20,000 minutes/month	$.206	$.239	16.02%

Roaming rates would be changed from the current $.45/minute during peak periods and $.15/minute during off-peak periods, to $2.00 daily access plus $.50 per minute.

Sacto and SCTC contend that the proposed changes in retail rates are accompanied by changes in wholesale rates that provide volume discounts to wholesale subscribers and establish an improved spread between wholesale and retail rates. Through discussions with representatives of the major resellers in the state, Sacto and SCTC further argue that this rate structure should prove acceptable to the resale market.

On March 28, 1989, the companies held a public meeting in Sacramento. The meeting was attended by representatives from the companies, CACD, DRA, and three customers. The companies and Commission staff answered questions from the customers regarding the proposed rate increase and the review process planned by the Commission staff. No complaints or protests were made at the meeting.

PROTESTS

Protests were received from the Commission's Division of Ratepayer Advocates (DRA) and from ten customers. Complaints and comments were received by telephone, telegram, and letters from approximately thirty more subscribers.

The companies responded to the DRA and customer protests noted above on April 12, 1989.

DRA PROTEST

DRA bases its protest on the companies' failure to provide separate past and pro forma financial statements for wholesale and retail operations. DRA states that the companies provided consolidated financial statements and justification for the proposed increases on a consolidated basis. DRA claims that it has no means to determine whether the wholesale or retail rate increases are justified without the appropriate financial breakdown.

DRA requests additional information and hearings to determine whether the proposed increases are justified. Furthermore, DRA cautions the Commission and suggests that any rate increase granted the companies be on an interim basis pending future resolution of rate-making issues presently being heard in our investigation I.88-11-040.

The companies responded to DRA's protest by calling it an "untimely information request". The companies note that DRA submitted its protest on the final day of the protest period authorized under our General Order 96-A; the companies point out, however, that DRA had numerous opportunities to request this information subsequent to the filing of the Advice Letters on March 15, 1989, yet DRA failed to do so , either formally or informally. The companies point out that annual reports submitted to the Commission for the year 1988 do contain separate financial statements, and copies of these reports were delivered to DRA on April 10, 1988. The companies request that this portion of DRA's protest be dismissed as moot.

We agree with the companies. DRA had numerous occasions, both before the filing of the Advice Letters, and during the twenty day protest period subsequent, to request the information it seeks in its protest letter. The companies supplied the separate information sought by DRA after its protest, yet DRA has been has not supplemented or amended its original protest.

As for the cautions of DRA against issuing permanent rate increases during a period when the Commission is reviewing its policies for rate-making in the cellular radiotelephone services, the company claims that the pendency of our investigation does not justify denial of the rate increase. The companies state that deferral of all rate-setting issues until the completion of the Cellular OII would be contrary to Commission practice and detrimental to all cellular carriers. The companies state that all current Commission regulation of the cellular industry potentially deviates from the regulatory framework which could emerge from the proceeding. The companies stress that the Commission has not halted its regulation of the cellular industry during the pendency of the OII, nor should it.

We agree with the companies. The companies have filed for a rate increase under our General Order 96-A, and we will consider their request under that order until such time as we issue any new or different orders resulting from the Cellular OII. In our General Order 96-A, we state that a cellular utility requesting a rate increase must make a showing before the Commission that the rate increase is justified. If we determine that the increase is justified, we will authorize the increase. We will continue to consider all such rate increase requests made under our General Order 96-A on this basis until we change our General Order 96-A.

Customer Protests

The companies have summarized the customer protests in their response. The companies state that the customer protests raise no novel issues; some customers merely state their opposition to the increase without providing financial and service impact grounds on which their protest is based. Some customers call the 16-20 percent increase "extreme". The companies contend the the 16-20 percent increase is justified; they state that the 16-20 percent is actually 10-12 percent when adjusted for inflation relative to the date the rates were originally set. The companies also compare the relative magnitude of the proposed rates with rates for comparable cellular service in other markets in California.

Our CACD staff notes that customer complaints were similar in nature and scope to the formal protests received by staff and the companies. We will ask the Director of the Commission Advisory and Compliance Division to mail a copy of this resolution to all customers who have formally protested or complained by written communication to staff with notice of a return address.

Protests Dismissed.

We agree with the companies and dismiss the protests of DRA and the customers.

DISCUSSION

The principal basis upon which Sacto and SCTC are seeking rate relief at this time, and the major factors justifying that relief, are discussed below.

Since commencing facilities-based operations, Sacto has sustained cumulative losses through December 1988 exceeding $8 million, and SCTC, $4.3 million. Without the requested relief, Sacto and SCTC anticipate further losses accruing to $10.6 million and $6.3 million, respectively, by the end of 1989. If, as requested, the advice letters become effective on June 1, 1989, Sacto will incur a loss of approximately $800,000, and SCTC, a loss of $1.3 million for calendar year 1989. However, Sacto and SCTC project that they will have limited their cumulative losses through 1989 to approximately $9.1 million and $5.7 million, respectively.

Sacto Net Income (Losses)
(in thousands)

	1987	1988	1989
Per CPCN application			
Annual	($3077)	($303)	$1998
Cumulative	($3077)	($3380)	($1382)
Without Rate Relief			
Annual	($4742)	($3602)	($2219)
Cumulative	($4742)	($8344)	($10563)
With Rate Relief			
Annual	N/A	N/A	($757)
Cumulative	N/A	N/A	($9091)

SCTC Net Income (Losses)
(in thousands)

	1987	1988	1989
Per CPCN application			
Annual	($695)	($230)	$354
Cumulative	($695)	($925)	($571)
Without Rate Relief			
Annual	($1539)	($2800)	($1995)
Cumulative	($1539)	($4339)	($6334)
With Rate Relief			
Annual	N/A	N/A	($1344)
Cumulative	N/A	N/A	($5683)

Sacto's projected cumulative losses without the requested rate relief are approximately 147% (nearly $6 million), over those projected for its initial two-year operation as reflected in its March 1987 CPCN application. Moreover, without the rate increases, it projects that for calendar 1989 it will lose an additional $2.2 million, as compared to its original estimate that it would generate an operating profit in 1989 of approximately $2 million. Most of the amount by which its actual and currently projected operating losses exceed its 1987 projections is attributable to increased investment in its cellular network. In this regard, Sacto projects that by the end of 1989, it will have spent $18.36 million on its network, or 70% more than originally been projected in March 1987. SCTC's experience and projections are similar: without the requested relief, by the end of 1989 it will incur cumulative losses exceeding its original projections by almost $ 6 million, the majority of which are attributable to investment in service enhancements.

These service enhancements, which will benefit Sacto's and SCTC's subscriber base, include the installation of a fully automatic roaming system, expanded coverage to Yuba City and Modesto, and an increase in available RF channels of about 67%. Sacto is also constructing several new cell sites, which will bring the total number of cell sites serving the market to twelve by year end. In addition, it is significantly expanding its switch capacity to handle projected growth in cellular traffic.

Because Sacto and SCTC entered their respective markets so long after their competitor had established market share, each company had to closely conform its rates to its competitor's rates so as to be capable of attracting customers until service quality differentials could justify seeking an increase in rates.

The low rates established by Sacto's and SCTC's competitor, combined with the increased investment that was necessitated, in part, by Sacto's and SCTC's need and desire to distinguish its service from that provided by its competitor, have led to significant losses, far in excess of those originally projected in Sacto's and SCTC's initial CPCN applications.

CACD staff performed a financial analysis of the projected operations for Sacto. The analysis included a reasonable debt/equity ratio as well as a 13% return on equity (the figure the Commission has recently found reasonable for major local telephone utilities, which may be less risky than cellular utilities). The analysis then compared the resulting revenue requirement with the actual revenues that were generated (or forcasted) for 1987, 1988, and 1989. The results show a substanatial shortfall compared to what a traditional rate-of-return revenue requirement would call for:

Traditional Revenue Requirement (Sacto)

Year	Revenue Requirement	Actual Revenue	% Difference
1987	$5,534,814.00	$2,677,000.00	52%
1988	9,655,469.00	7,596,000.00	21%
1989	20,316,827.00	12,173,000.00	41%

Thus, in 1987, 1988, and 1989, a rate base-cost of service revenue requirement for Sacto was respectively 52%, 21%, and 41% higher than the revenue that was actually generated. For this three year period, the cumulative difference between the revenue requirement Sacto would have been allowed and the revenue actually received was $13.171 million. The rate of return, that is, the net income divided by rate base, was -28.41%, -8.33%, and -16.24% for 1987, 1988, and 1989 respectively.

The proposed rate changes, in combination with a modification to the method by which completed calls are timed, are anticipated to yield a total increase in the cost of service to Sacto's and SCTC's retail customers of 20%. This increase is offset somewhat when adjusted for the effects of inflation since rates were initially established in the market. The consumer price index, for example, has increased by 8% from early 1987 to February, 1989.

The effects of the proposed rate increases on individual subscribers depend on their unique usage patterns. However, a "typical" retail subscriber, assuming usage of 175 minutes of peak usage per month and 45 minutes off-peak minutes per month, and with the appropriate access charges, would pay the following amount, depending on what market he/she subscribes:

Current

Market	Monthly Access	Peak Period Usage Rate	Off-Peak Usage Rate	Including Access Monthly Bill Assuming 175 minutes peak 20 minutes off-peak
Los Angeles	$45.00	$.45	$.27	$129.15
San Francisco	45.00	.45	.20	127.75
Santa Barbara	45.00	.45	.20	127.75
Napa	45.00	.45	.20	127.75
Santa Cruz	45.00	.45	.20	127.75
Salinas	45.00	.45	.20	127.75
San Diego	35.00	.40	.20	109.00
Redding	30.00	.35	.25	96.25
Fresno	31.00	.35	.20	96.25
Sacramento	20.00	.25	.15	66.75
Stockton	20.00	.25	.15	66.75

With the Rate Increase:

Sacramento	$77.75
Stockton	77.75

At the current rates, Sacramento and Stockton customers utilizing cellular service at the basic plan, using 175 minutes peak and 20 minutes off-peak, pay about one half of what those customers pay in L.A., S.F., Santa Barbara, Napa, Santa Cruz, and Salinas. Similarly, Sacramento and Stockton customers pay about 40% less than those customers in San Diego, Redding, and Fresno.

The differences in what Sacto and SCTC subscribers pay for cellular service compared to what other subscribers in other parts of the state will be addressed in our review of the cellular industry in I.88-11-040.

Approval of this increase for Sacto and SCTC will result in a pricing disparity in those markets between the two wholesale carriers. This is the first instance in California where such a notable pricing difference will have occurred. We will be interested to observe the resulting effects upon competition in these markets. We have already noted how network investments related to service quality are the main financial justification for this increase. We expect to learn more about how pricing and qualify considerations relate in the competitive dynamics of these and other cellular markets.

In any case, we should expect to analyze and review very carefully any attempted rate increase by Sacto's and SCTC's competitors. In the critical review by the Commission Advisory and Compliance Division, it was found that the primary reason why this rate increase should be approved is that Sacto and SCTC are losing money; the reasons for these losses were examined and were found to be justified. Similar scrutiny will be given to any other requested increases tendered before the conclusion of our OII.

It is worth reiterating that our entire approach to regulatory oversight of cellular pricing may change as a result of the OII. For example, both Sacto and SCTC have experienced marketing expenses that have exceeded original forecasts. These expenses have in part been related to industry marketing practices that are under discussion and review in the OII. This resolution is not intended to prejudge issues regarding marketing practices that have been or may be raised in the OII or in any other proceeding. Similarly, we have used a rate-of-return baseline as one of several approaches for evaluating the reasonableness of this proposed increase; it is our judgment that the requested increase easily passes this baseline in this case. However, our OII may produce a revised method of overseeing rates that does not depend upon a rate-of-return approach.

Based upon our review of the above, we will allow the utilities in question to raise their rates by the amount aforementioned.

FINDINGS

The Commission finds that the rates, terms, and conditions proposed in Sacto's and SCTC's Advice Letters No. 12 are appropriate and reasonable, and therefore good cause appearing dismisses the protests of its customers and DRA.

It is ordered that:

1. Authority is granted to made Sacto's and SCTC's Advice Letter No. 12 effective on June 1, 1989.

2. The protests of Sacto's and SCTC's customers and DRA be dismissed. The Director of CACD will mail a copy of this resolution to all customers who have formally protested or complained by written communication to staff.

The effective date of this resolution is today.

I certify that this resolution was adopted by the PUC at its regular meeting on May 10, 1989. The following Commissioners approved it.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

Victor Weisser

VICTOR WEISSER
Executive Director