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Testimony of

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On behalf of

**Consumers Union, Consumer Federation of America,
Free Press and Public Knowledge**

Regarding

“Competition in the Wireless Industry”

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on Energy and Commerce

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Chairman Boucher, Ranking Member Stearns and members of the Committee, thank you for the opportunity to testify again before you on behalf of Consumers Union¹ (non-profit publisher of Consumer Reports), the Consumer Federation of America,² Free Press,³ and Public Knowledge.⁴

The wireless industry has grown to a point where nearly every man, woman and child in the United States has a mobile phone, with more than 270 million cell phones in use in the U.S. While we are beginning to see some improvement in the public's perception of the wireless industry, we have some significant concerns. *Consumer Reports'* reader satisfaction survey this year indicates that the industry's customer service has inched closer to average. This is a material improvement from where it was a year ago, near the bottom of the barrel (18th out of 20 services rated, according to our *Consumer Reports* survey)⁵. Fewer consumers this year were likely to cite automatic contract extension as their top concern, and most carriers have begun to pro-rate the early termination penalties that lock consumers into lengthy contracts—although we agree with courts that are finding these fees may be illegal considering the unjustifiably high levels they start from, and they are most certainly a detriment to competition.

Our reader survey this year found a **new top consumer concern: the high price of cell phone service**⁶—and this was even before the most recent chapter of our economic crisis unfolded.

¹ **Consumers Union** is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* (with approximately 8 million print and online subscribers) regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

² The **Consumer Federation of America** is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

³ **Free Press** is a national, nonpartisan organization working to reform the media. Through education, organizing and advocacy, we promote diverse and independent media ownership, strong public media, and universal access to communications.

⁴ **Public Knowledge** is a Washington DC based public interest group working at the intersection of communications policy and intellectual property law. Public Knowledge seeks to ensure that all layers of our communications system are open and accessible.

⁵ *Consumer Reports*, "Upfront: News, Trends, Advice," p. 8 (October 2007).

⁶ *Consumer Reports* (January 2009).

As the industry continues to consolidate, as most investment analysts seem to agree it will—policymakers should expect this problem to get worse, not better.

Unfortunately, analysts now suggest that the **U.S. wireless market is headed towards a quasi-duopoly**, with the top two companies controlling the vast share of revenues, and profit margins increasing for those carriers, even including the upcoming cost of \$80 billion in network upgrades for next-generation wireless technology.⁷ And even more unfortunately for those of us who pay the bills, these profits come straight out of consumers' pocketbooks.

The last time consumer groups testified before this committee, we noted that **U.S. consumers pay more for wireless service than consumers in just about any other country in the world**. The largest providers want to obscure this fact with notions of per minute pricing.⁸ But it is the cost to the consumer that matters, and **U.S. consumers pay more for wireless service than other developed nations—an average of \$506 each year**, higher than the OECD⁹ average of \$439, and way above countries such as Sweden (\$246), Spain (\$293), and Germany (\$371).

The way carriers continue to raise prices on text messaging services is a clear example of the negative ramifications of market power in this industry. According to industry analysis, **average revenue per texting subscriber has risen 150% in the last four years**. Why are the dominant wireless carriers all raising prices on a service that according to experts¹⁰ costs them almost nothing to run? Because doing so is profitable, and because they can. A number of public interest groups and wireless competitors have also raised related competition and speech issues with regard to text

⁷ See e.g. McKinsey & Company, "Perspectives on the Evolution of the U.S. Wireless Industry." (April 3, 2009).

⁸ U.S. consumers talk more than consumers in other countries, so our average of 800 minutes of use each month indeed means lower per minute prices. But we see all the carriers rolling out unlimited plans at present, and virtually no one offering plans without flat fees and low per minute pricing. It seems clear that that this is a high fixed-cost industry, and per-minute pricing does not mean much for consumers. It is what consumers pay in the end that hits them in the pocketbook. If the wireless carriers wanted to offer consumers rate plans with no flat fees and per minute billing at that "average" per minute rate of 7 or 8 cents, we would have a different outlook.

⁹ Organization for Economic Co-operation and Development, "OECD Communications Outlook 2007."

¹⁰ Randall Stross, "What Carriers Aren't Eager to Tell You About Texting." *New York Times* (Dec. 26, 2008). Available at: www.nytimes.com/2008/12/28/business/28digi.html.

messages in a petition for declaratory ruling that has been pending before the FCC for the past 18 months.¹¹

When there is a highly concentrated industry—as the wireless industry is according to Department of Justice merger guidelines—that raises prices on consumers for services that have declining costs, reporting revenues that are way up in the midst of an economic recession, this should raise more than a few policymaker eyebrows.

The news abounds these days with tales of **gross overcharges for ordinary Internet** activities. It is little wonder that “data” is where the carriers are finding amazing revenue growth in the midst of an economic depression. Consider the story of Wayne Burdick, who watched a Chicago football game over AT&T's wireless network while at a port in Miami before embarking on a Caribbean cruise. He was billed \$27,000 by AT&T for the privilege. He tried to talk to AT&T about it, and they lowered the charge to \$6,000. After his story appeared in the Chicago Sun-Times, AT&T dropped the charges altogether. Or, consider Billie Parks, who purchased a netbook bundled with AT&T mobile broadband service at a Radio Shack. She thought she was getting quite the deal – a \$99 netbook and a \$60/month data plan - but at the end of the month, she faced a \$5000 bill from AT&T for data overages. These numbers are shocking, and have nothing to do with the actual costs of providing service. After crossing a small 5 gigabyte initial limit using mobile broadband service from Verizon, each additional gigabyte of data transfer costs \$250. From AT&T, after the same 5 gigabyte initial limit, each additional gigabyte costs \$480.

The FCC and Congress made a decision that competition, not rate regulation, will be the preferred method to keep telecommunications market power in check, but Congress needs to revisit ways to keep competition vibrant in the wireless industry. Considering that the very same companies who this industry was supposed to compete against, telephone monopolies, have now

¹¹ See Public Knowledge, et al. Petition for Declaratory Ruling, WT Docket No. 08-7, (Dec. 11, 2007). Available at <http://www.publicknowledge.org/pdf/text-message-petition-20071211.pdf>.

purchased and merged their way to be the two dominant wireless companies, some serious oversight is warranted.

We urge policymakers to eliminate anti-competitive practices and foster competition in the industry by helping to: 1) **reduce switching costs for consumers**, 2) **ensure companies can compete**, and 3) **scrutinize the behavior and market power of dominant carriers**.

Reduce switching costs for consumers

If we want robust competition, by definition we have to make it easier for consumers to switch carriers, to vote with their feet and their wallets. Two prominent switching costs that warrant scrutiny are early termination penalties and number portability.

Number portability – Strong competition requires allowing consumers to take their phone numbers with them when they switch wireless carriers without undue cost or inconvenience. Even after Congress passed a law requiring number portability, the dominant carriers successfully blocked our efforts to let consumers take their numbers with them for several years. The industry’s principal arguments were that no one wanted or needed portability, and that it would be hugely expensive to do it. In 2004, the FCC finally took action to require number portability. Were the industry’s tales of runaway costs and lack of consumer interest accurate? Not at all. The real story is **that number portability benefits consumers, people use this flexibility regularly, and it has not cost the industry nearly as much to implement as they said it would**.

Presently, there is a proceeding before the FCC which would reduce the number portability interval from four days to one day.¹² We applaud this potential change—after all, wireless carriers

¹² Local Number Portability Porting Interval and Validation Requirements, FCC WC Docket No. 07-244; CC Docket No. 95-116.

can port between each other in less than 30 minutes at present because they have automated systems in place. Yet again, the dominant carriers are crying wolf, telling tales about runaway costs, and trying to distract from the real issue at hand with ancillary issues. We hope the Congress and the Commission will see the arguments of the dominant carriers for what they are: transparent protectionist nonsense. It is critical that the FCC move to make it more difficult for companies to hold consumers' numbers hostage.

Early Termination Penalties – the biggest switching cost to wireless consumers are the ubiquitous early termination penalties carriers charge for subscribers who want to leave before their (generally two-year) contract is completed. These fees are penalties designed to stop consumers from switching companies for better service and better price. **These early termination penalties do not save consumers money as the carriers claim,¹³ they rob consumers of the benefits that an open and competitive market would otherwise bring.**

The wireless carriers say they want a national framework, but the truth is that they already have one. The Uniform Commercial Code (UCC) provides standards for “liquidated damages clauses” in contracts that are the same in all 50 states. However, what the industry seeks is nothing more than special treatment that would exempt it from the laws that all other businesses have to follow.

The Uniform Commercial Code provides an important distinction, which is the law in 50 states: it says that **liquidated damages clauses can be used to recover actual damages, but they cannot be used as arbitrary penalties designed to prevent consumers from switching**

¹³ Evidence was presented at trial in California (*Ayyad v. Sprint*, CA Superior Court, Alameda County) that one carrier's early termination fee program actually cost them more money to implement than they recovered from it. In other words, this program does not save consumers money—it costs them extra. Further, according to internal memos, the company performed one calculation and one calculation only in determining the ETF: the effect on subscriber churn.¹³ That is, they did not examine whether they fully recovered “subsidies” they offered consumers, they simply said this will make it harder for consumers to switch. Clearly, this is about penalizing consumers for voting with their feet and pocketbooks, not about saving them money.

companies.¹⁴ Where the carrier can prove that they have suffered actual economic harm because of subsidies they have given to the consumer, ETFs are reasonable. But the early termination penalties the wireless industry is charging consumers are so far and above the value¹⁵ of subsidies provided that something else is clearly going on.

The wireless industry is quick to note that they have other costs they recoup through the ETF, namely marketing and customer acquisition costs. But should consumers really have to pay for wireless companies' advertisements? Should consumers have to bear the costs of multi-million dollar Super Bowl commercials? Do we really believe it is fair or legal to force a customer who is going to another carrier to pay for the cost of finding another subscriber for her old carrier?

The answer is clearly no. If all businesses with customer acquisition costs were to be exempted from the law of liquidated damages, there would be no law at all. Furthermore, indicators like customer acquisition costs (CAC) are simply a measure of the efficiency of a carrier's marketing operation, and are NOT a measure of any value being given to the consumer. If a wireless carrier is doing a good job of advertising one quarter, they have lower CAC; if they do a bad job the next quarter, CAC goes up. But consumers should not have to pay a penalty fee related to whether the company is running effective ads or not. **If Congress is to take any action to constrain or condition ETFs, it must absolutely exclude advertising and marketing expenditures from the definition of a "reasonable" fee.**

¹⁴ Cal. Civ. Code, Sections 1671(d) and 1670.5.

¹⁵ \$14.33 is the average phone subsidy provided to the consumer according to the best data we have seen so far on carrier subsidies. In data submitted by the wireless carriers to the International Trade Commission, the average value of wireless handsets in 2006 was \$115.¹⁵ The wireless industry's trade association (CTIA) says that the average price paid for phones in 2006 was \$65.67, and the carriers also charge a \$35 activation fee that they treated as handset revenues on their books—for a total of \$100.67 paid by the average consumer for their handset. That leaves us \$14.33 in average upfront savings. Do consumers pay that off in their first month of service? Their second? Surely it does not take two full years. If the carriers were to reduce their ETFs to \$14.33—or even triple that amount—no one would be here today asking questions. But considering these penalties (at a minimum of \$175 from the two largest carriers) are more than 12 times the benefit consumers are receiving, something else is going on.

Ensure companies can compete by fixing roaming and special access

If policymakers value competition from non-dominant wireless carriers, urgent attention is needed to fix roaming and special access.

Roaming - Automatic roaming agreements have been a standard industry practice for decades in the wireless industry. These agreements assist all carriers in filling inevitable gaps in network coverage, and in a real sense, comprise a “safety net” that permits all consumers to obtain comprehensive wireless service when they travel throughout the United States. Two years ago, the FCC appeared to recognize the importance of automatic roaming, but at the urging of the nation's largest carriers, also created an “in-market” exception that allows a carrier to refuse roaming service in any area where the requesting carrier merely has spectrum usage rights.¹⁶ Predictably, the nation's largest carriers continue to defend this gaping policy loophole in various proceedings now pending at the FCC, and exploit it to the detriment of smaller, rural and regional carriers and their subscribers. The continued consolidation in the wireless industry in our view has led to increased market power by certain carriers and led correspondingly to a spike in anticompetitive roaming practices.

Congress should ensure that automatic voice and data roaming is available to all consumers on reasonable terms and conditions, at reasonable prices, and with no geographic carveouts.

Special Access – competitive wireless carriers, Internet providers, and vital institutions like hospitals, universities and banks all need “special access” lines which are like on-ramps to the “backbone” of our telecommunications systems. AT&T and Verizon collectively control more than 90% of special access lines, and by some estimates, this market power is being used to generate profits of more than 125% in special access revenues.

¹⁶ Reexamination of Roaming Obligations of Commercial Mobile Radio Service Providers, WT Docket No. 05-265, Report and Order and Further Notice of Proposed Rulemaking, FCC 07-143 (rel. Aug. 16, 2007), summarized at 72 Fed. Reg. 50,064 (Aug. 30, 2007) (“Roaming Order”).

Virtually every wireless competitor, Internet companies, and businesses across America rely on these lines to bring their services to the public. If the dominant carriers can continue to overcharge these innovators, this broken market will ensure a slowed economic recovery for all but one small sector of our economy.

Policymakers must scrutinize application blocking and exclusive handset contracts

Among our greatest concerns are the stark signals the dominant carriers are sending that they intend to continue to move towards closed networks, away from the open Internet model. For years we have been warning that this would happen, and in response we were told “watch and wait, and let us see if the industry will work this out.” We are here today to tell you they have not worked it out and worse, there are clear examples of where they are breaking the Internet. We urge Congress to hold further oversight hearings immediately on these important issues.

Application blocking - we see continued evidence that network providers are acting as gatekeepers, disabling or restricting applications created by Internet innovators. This behavior should not be countenanced by Congress or the FCC.

Many thousands of AT&T subscribers have downloaded the **iPhone Skype application, and these users are barred from using the application over the mobile broadband service they pay for. In response, AT&T’s top public policy executive said “we absolutely expect our vendors not to facilitate the services of our competitors.”**¹⁷ Based on the number of restrictions in their terms of service, the company apparently envisions a lot of competitors – including unlikely companies such as Sling Media. AT&T has a disappearing, reappearing prohibition on the use of video redirecting over its network. After beginning with a broad general prohibition, they changed the terms of service to make clear that the use of Sling Media's technology to redirect video was impermissible over AT&T's network. Following massive consumer complaints, AT&T backed

¹⁷ Leslie Cauley, “*Skype’s iPhone limits irk some.*” USA Today (Apr. 2, 2009).

down and removed the prohibition entirely - only to reintroduce the original, broad prohibition after a few days.

Furthermore, as a Wall Street Journal article¹⁸ noted, handset manufacturers have been trying to offer consumers services for free on new handsets, but network operators have said “no” to those free services because they compete with services that the wireless carriers want to charge for.

According to the article, RIM (manufacturer of the Blackberry) wanted to offer a free mapping service to customers who buy the Blackberry, but again AT&T refused, because they had a service that they wanted to charge users \$10 a month for.

Handset exclusives - Handset exclusivity arrangements worsen the divide between major carriers and competitors, and further concentrate the market. Because of handset exclusivity arrangements, 8 of the 10 most popular smartphones are available to only one carrier. Popular phones, particularly innovative smartphones, drive growth in the market for wireless services, and offer the best chance for wireless carriers to survive and grow. Small carriers lack the market power and the promise of nationwide advertising needed to get the best deals. This is a downward spiral: small carriers cannot get innovative devices, and thus cannot grow, while large carriers get exclusive deals and grow larger.

Without the ability to offer affordable and functional PDAs, rural wireless carriers can not attract enough customers to justify investment to build out their 3G networks. Without the threat of competition in the network marketplace, the big four national providers have no incentive to expand and increase the capacity of their own 3G data networks.

In Europe and Asia, wireless consumers have better choices. They can buy cell phones in London, and simply swap out a small card (called a SIM card) in the back of the phone and it works across any other European network. **This decoupling of networks and handsets has created a**

¹⁸ Jessica Vascellaro, “*Air War: A Fight Over What You Can Do on a Cell Phone – Handset Makers Push Free Features for Which the Carriers Want to Charge.*” Wall Street Journal (June 14, 2007).

vibrant European handset market, where manufacturers innovate relentlessly to keep customers loyal. In stark contrast, the U.S. handset market lags European and Asian markets, precisely because wireless operators have the power to dictate which phones will interoperate with their networks, keeping out the competition.

Conclusion

Wireless Internet services will increasingly become the way that consumers connect to the Internet. **If we allow anti-consumer, anti-innovation practices to continue—such as unjustified early termination penalties, application blocking and handset exclusives—we should expect our international broadband rankings to continue to slide, innovation to be less robust, and our mobile phone markets to continue to lag behind Europe and Asia.**

Free markets and competition can help solve many of the problems noted above, but only when consumers are armed with reliable information about the services they buy and when they do not encounter undue obstacles to voting with their feet and pocketbooks. Right now, this market is not free, and it is not fair. **We ask policymakers to reject the anti-competitive behavior of companies who control consumers' on-ramps to the Internet, to take real action and engage in earnest oversight so that innovation can blossom and our Internet economy can help boost our economic recovery.**

Mr. Chairman, we are grateful for the opportunity to testify before your Subcommittee today. Thank you.