Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

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In the Matter of	)	
	)	
CTIA Petition for Expedited Declaratory	)	WT Docket No. 05-194
Ruling on Early Termination Fees	)	
	)	

Declaration of Harold W. Furchtgott-Roth

June 6, 2006

Summary

I have been asked by CTIA to review the economic basis for early termination fees (ETFs) for commercial wireless services and to evaluate the effects of such ETFs on consumers.

I find that ETFs are part of the rate structure of wireless services. Consumers have generally benefited from the absence of price regulation of wireless services. Restrictions on the rate structure of wireless services, including ETFs, have few if any identifiable consumer benefits but would impose substantial costs on consumers. Although there may be compelling legal reasons for the Commission to adopt a specific position in this docket, there are no compelling economic or consumer reasons to reinforce or expand government limitations on the rate structure of wireless services in general and of ETFs in particular. Indeed, the opposite holds: limitations on the rate structure of wireless services, including ETFs, clearly harm consumers. I reach the following eleven conclusions:

1. Multiple wireless carriers vigorously compete for customers;

2. Consumer complaints are not a reflection of limited competition, and the FCC receives a relatively small and declining number of complaints plausibly related to ETFs;

3. Each wireless carrier has multiple offerings, including both prepay and hybrid plans without ETFs, designed to meet the needs of different consumers;

4. American consumers value the wide range of choices of wireless service plans both with and without early termination fees, and the vast majority choose plans with ETFs due to the benefits received;

5. ETFs are a common part of the unregulated rate structure of services in other industries;

6. Consumers pay less for wireless services and handsets with term contracts with ETFs than with plans without ETFs; consumers generally receive more minutes and services with ETF plans;

7. There is no economic reason to expect ETFs to be exactly the same, and the magnitude of ETFs for individual carriers is not unreasonably large relative to revenue or cost structure;

8. Rather than just a “false choice,” American consumers have many attractive choices for wireless services with frequent opportunities to switch, and they frequently choose wireless plans with ETF;

9. Most American consumers never breach wireless contracts, never pay ETFs, and never complain about ETFs;

10. Prorating ETFs would not improve consumer welfare and is not a sensible form of regulatory intervention; and

11. Limiting the range of wireless service ETFs would substantially harm American consumers.

I. Introduction

A. Qualifications

My name is Harold W. Furchtgott-Roth. Since 2003, I have been president of Furchtgott-Roth Economic Enterprises, an economic consulting firm. I have consulted on a variety of topics, including both regulatory and antitrust matters. I am chairman of the board of the Telecommunications Policy Research Conference, one of the primary forums for research on telecommunications issues in the United States. I chair the board of Oneida Partners, a wireless communications company. I am on the board of MRV, a publicly traded telecommunications manufacturing company. I serve on several advisory boards.

From June 2001 through March of 2003, I was a visiting fellow at the American Enterprise Institute for Public Policy Research (AEI) in Washington, DC. At AEI, I completed the manuscript for a book, *A Tough Act to Follow: The Telecommunications Act of 1996 and the Separation of Powers*, AEI Press (2006).

I was a commissioner of the Federal Communications Commission (FCC) from November 1997 through the end of May 2001. My statements as a commissioner at the FCC have been cited by federal courts.

I have worked for many years as an economist. From 1995 to 1997, I was chief economist of the House Committee on Commerce where I served as one of the principal staff members helping to draft the Telecommunications Act of 1996.

My academic research concerns economics and regulation. In addition to *A Tough Act to Follow*, I am the coauthor of three books: *Cable TV: Regulation or Competition*, with R.W. Crandall, (Washington, DC: The Brookings Institution), 1996;

Economics of A Disaster: The Exxon Valdez Oil Spill, with B.M. Owen, D.A. Argue, G.J. Hurdle, and G.R. Mosteller, (Westport, Connecticut: Quorum books), 1995; and *International Trade in Computer Software*, with S.E. Siwek, (Westport, Connecticut: Quorum Books), 1993. I am a frequent commenter on matters before the Federal Communications Commission, and daily newspapers, including the *Wall Street Journal*, have published my opinion pieces. I have a weekly column in the business section of the *New York Sun*. I have testified on many occasions before committees of the U.S. Senate and House of Representatives. I received my undergraduate training at MIT, and I received a Ph.D. in economics from Stanford University. My resume is attached as Appendix A.

B. Purpose of This Reply Declaration

I have been asked by CTIA to review the economic basis for early termination fees (ETFs) for commercial wireless services and to evaluate the effects of such ETFs on consumers. I have not been asked for—and I offer no—views about the meaning of the term "rates charged" in Section 332 of the Communications Act and the other legal issues in this proceeding.

C. Findings

I find that ETFs are part of the rate structure of wireless services. Consumers have benefited from the absence of price regulation of wireless services. Restrictions on the rate structure of wireless services, including ETFs, have few if any identifiable consumer benefits but would impose substantial costs on consumers. Without considering any legal reasons for the Commission to adopt a specific position in this docket, there are no compelling economic or consumer reasons to reinforce or expand government limitations on the rate structure of ETFs for wireless services. Indeed, the opposite holds: limitations on the rate structure of wireless service contracts, including ETFs, clearly harm consumers.

I organize my comments around the following 11 findings:

1. Multiple wireless carriers vigorously compete for customers;

2. Consumer complaints are not a reflection of limited competition, and the FCC receives a relatively small and declining number of complaints plausibly related to ETFs;

3. Each wireless carrier has multiple offerings, including both prepay and hybrid plans without ETFs, designed to meet the needs of different consumers;

4. American consumers value the wide range of choices of wireless service plans both with and without early termination fees, and the vast majority choose plans with ETFs due to the benefits received;

5. ETFs are a common part of the unregulated rate structure of services in other industries;

6. Consumers pay less for wireless services and handsets with term contracts with ETFs than with plans without ETFs; consumers generally receive more minutes and services with ETF plans;

7. There is no economic reason to expect ETFs to be exactly the same, and the magnitude of ETFs for individual carriers is not unreasonably large relative to revenue or cost structure;

8. Rather than just a "false choice," American consumers have many attractive choices for wireless services with frequent opportunities to switch, and they frequently choose wireless plans with ETF;

9. Most American consumers never breach wireless contracts, never pay ETFs, and never complain about ETFs;

10. Prorating ETFs would not improve consumer welfare and is not a sensible form of regulatory intervention; and

11. Limiting the range of wireless service ETFs would substantially harm American consumers.

II. Multiple wireless carriers vigorously compete for customers

Each year since 1995, the Commission has released a Commercial Mobile Radio Service (CMRS) competition report.[1] The CMRS competition reports consistently demonstrate the American mobile wireless industry as competitive by many measures in practically all dimensions. The most recent report repeatedly refers approvingly to the competitive condition in the U.S. CMRS market.[2] The 107-page report refers to early

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[1] The most recent is the *10th Annual CMRS Competition Report*, WC 05-71, released September 30, 2005.

[2] "In this report the Commission concludes that even with fewer nationwide mobile telephone carriers there is still effective competition in the CMRS marketplace. Among the indicators of market structure that support this conclusion, we note that 97 percent of the total U.S. population lives in counties with access to three or more different operators offering mobile telephone service, the same level as in the previous year, and up from 88 percent in 2000, the first year for which these statistics were kept. The percentage of the U.S. population living in counties with access to four or more and five or more different mobile telephone operators also remained roughly the same as in the previous year. In contrast, there was a sharp decline in the percentage of the U.S. population living in counties with access to six or more different mobile telephone operators as compared with the previous year, due largely to the acquisition of AT&T Wireless by Cingular Wireless. This transaction resulted in the first drop in the number of nationwide competitors since the Commission began compiling these reports. Nevertheless, although the mobile telephone market has become more concentrated as a result of the merger of two nationwide carriers, none of the remaining competitors has a dominant share of the market, and the market continues to behave and perform in a competitive manner.

"3. With respect to carrier conduct, the record indicates that competitive pressure continues to compel carriers to introduce innovative pricing plans and service offerings, and to match the pricing and service innovations introduced by rival carriers. Price rivalry is evidenced by the proliferation of "family plan" offerings, and by the introduction of a variety of new prepaid plans, or entirely new brands (such as "Boost Mobile"), targeted at previously untapped segments of the market. The result has been a significant increase in the percentage of wireless users who subscribe to prepaid plans in the past year. In addition, the deployment of next-generation networks based on competing technological standards continues to be an important dimension of non-price rivalry in the U.S. mobile telecommunications market. Both Sprint and termination fees or early terminations of contracts in but one paragraph and in one footnote.[3] In its annual report and in other proceedings, the Commission has found neither the CMRS industry wanting for competition nor early termination fees as either a cause or a symptom of a shortage of competition.[4]

The American consumer does not need to read the annual *CMRS Report* (well-written though it is) to understand the competitive offerings for mobile wireless services.

Cingular appear to be making a concerted effort to match the mobile broadband service which Verizon Wireless launched in late 2003 and now offers in a number of major U.S. cities. To this end, in July 2005 Sprint began to deploy the same CDMA2000 1xEV-DO network technology that Verizon Wireless uses, whereas Cingular Wireless is planning to deploy UMTS (or WCDMA) with HSDPA (High Speed Data Packet Access) technology in a number of major U.S. markets by the end of 2005. In addition to investing in network deployment and upgrades, carriers have continued to pursue strategies designed to differentiate their brands from rival offerings based on attributes such as network coverage and service quality. A notable example of such an attempt at brand differentiation in the past year was T-Mobile's introduction of an interactive "Personal Coverage Check" feature to its Web site which enables customers to check the quality of network coverage where they live and work before they purchase service.

"4. Consumers continue to pressure carriers to compete on price and other terms and conditions of service by freely switching providers in response to differences in the cost and quality of service. Monthly churn rates average about 1.5 to 3.0 percent per month, a slight decline from the previous year. In addition, the implementation of local number portability ("LNP") beginning in November 2003 has lowered consumer switching costs by enabling wireless subscribers to keep their phone numbers when changing wireless providers. While the advent of LNP has not resulted in an increase in churn, analyst reports continue to suggest that LNP has put added pressure on carriers to improve service quality in order to retain existing customers and to avoid increased churn.

"5. Indicators of market performance show that competition continues to afford many significant benefits to consumers. In the 12 months ending December 2004, the United States mobile telephone sector increased subscribership from 160.6 million to 184.7 million, raising the nationwide penetration rate to approximately 62 percent of the population. Mobile subscribers continued to increase the amount of time they spend talking on their mobile phones, with average minutes of use per subscriber per month rising to more than 580 minutes in the second half of 2004 from 507 minutes in 2003 and 427 minutes in 2002. Moreover, although U.S. mobile subscribers still prefer to use their mobile phones to talk rather than to send text messages ("SMS"), the volume of SMS traffic grew to 4.7 billion per month in December 2004, more than double the 2 billion messages per month reported in December 2003. Evidence on mobile pricing trends remains somewhat mixed, with two different indicators of mobile pricing - revenue per minute and the cellular Consumer Price Index ("CPI") - continuing to show a decline in the price of mobile telephone service, and a third indicator based on the consumption patterns of hypothetical users showing a slight increase in the cost of mobile service in 2004. Nevertheless, international comparisons indicate that mobile voice calls are still far less expensive on a per minute basis in the United States than in Western Europe." Ibid., at 4-5.

[3] Ibid., Paragraph 184, Footnote 214.

[4] See FCC 04-255, Order In the Matter of Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations File Nos. 0001656065, et al., rel. Oct. 26, 2004; FCC 05-138, Order In the Matter of Applications of Western Wireless Corporation and ALLTEL Corporation For Consent to Transfer Control of Licenses and Authorizations File Nos. 0002016468, et al., rel. July 19, 2005; FCC 05-148, Order In the Matter of Applications of Nextel Communications, Inc. and Sprint Corporation For Consent to Transfer Control of Licenses and Authorizations File Nos. 0002031766, et al., rel. August 8, 2005.

Instead, the American consumer sees competing wireless services vie for attention in advertisements in all forms of media, in store fronts in shopping malls, in the consumer electronic sections of thousands of stores, and even in grocery stores. For few other consumer products or services does the American consumer enjoy as much competition, and for no other telecommunications service. Consumers can purchase wireless services practically anywhere. The savvy consumer can even go online and compare wireless service offerings in a local community by zip code.[5]

The competitors are not just the five largest national facilities-based carriers (ALLTEL, Cingular, Sprint, T-Mobile, and Verizon). Dozens of regional facilities-based carriers (such as Dobson, Leap, Metro PCS, SouthernLINC, Cellular South and U.S. Cellular) as well as many smaller local facilities-based carriers compete as well. In addition, the resale market for wireless services is competitive, large, and growing. Mobile Virtual Network Operators (MVNOs) such as Boost, Virgin Mobile, ESPN and others add new dimensions to competition for wireless services. The typical American consumer has a choice among 3 to 6 different facilities-based carriers and even more resellers.[6]

Two aspects of the competition for wireless services are worth emphasizing:

- Consumers, not suppliers, are sovereign in a competitive market. Even in a competitive market, government may have a role with respect to externalities, supply or demand activities affected by an unrelated transaction and not reflected in the price of that transaction.[7] But, except as noted later in this section, government cannot

[5] See., e.g., www.myrateplan.com and www.cellguru.net.
[6] The Commission finds that 97 percent of U.S. population lies in counties with access to 3 or more carriers, presumably facilities-based carriers. *2005 Annual Report*.
[7] Examples may include universal service and 911 services.

make consumers better off with respect to the prices and terms and conditions of transactions in a competitive market. Any carrier that attempted to impose prices or terms or conditions that were not competitive with those offered by another carrier would unprofitably lose business. More specifically, if consumers had strong preferences against wireless plans with certain forms of ETFs in a competitive industry, consumers would choose plans without those certain forms of ETFs or without ETFs at all rather than merely object to them in consumer surveys.[8] In fact, consumers overwhelming choose plans with ETFs. The mere presence of competition disciplines firms to cater to the demands of consumers. If the CMRS market is as competitive as the Commission repeatedly finds, the current structure of wireless service prices with ETFs is already a competitive response to consumer preferences. Where markets are competitive, it is difficult to find a rational basis for economic regulation of prices such as limitations on the structure of contracts between suppliers and consumers.

- Much advertising is national, leading to the national carriers having relatively standard rates, terms, and conditions nationwide. In addition to advertising campaigns in every media, wireless rates are advertised at each carrier's web site. Because the national carriers tend to offer national rates, consumers in relatively

[8] Economists look at consumer behavior in terms of revealed preference, actual purchases and allocations in the market. The seminal work is P.A. Samuelson, "A note on the pure theory of consumer's behavior," *Economica*, 1938. Survey results of consumer preferences, to the extent they are inconsistent with actual consumer behavior in the market, should be viewed with some skepticism. See in particular, the recent survey results from MASSPIRG: D. Cummings and K. Smith, *Can You Hear Us Now*, (March 1, 2005) and E. Mierzwinski, K. Smith, and D. Cummings, *Locked In a Cell: How Cell Phone Early Termination Fees Hurt Consumers* (August 11, 2005). Prof. J. Hausman provides a detailed critique of these surveys. See Declaration of Prof. J. A. Hausman, October 19, 2005, at 20-28, attached to ex parte letter of Verizon Wireless, October 25, 2005.

isolated markets with even just one or two facilities-based carriers still benefit from the national pricing available in more contested markets.

The competitive condition of the wireless industry presents a difficult challenge for those suggesting that a regulatory body rationally should regulate a specific provision of wireless contracts, ETFs, separately and additionally to other forms of contract law. The usual economic finding that contracts are unambiguously beneficial has a few specific exceptions, and these exceptions are where governments can rationally limit contracts. It is useful to divide these exceptions into three groups: [9] (1) limitations on the enforceability of contracts regardless of specific parameters or market conditions;[10] (2) limitations on the "reasonableness" of specific parameters of the contract regardless of enforceability or market conditions;[11] and (3) limitations on the unrestricted offering of

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[9] These and the subsequent categories are my own but reflect contract limitations found in standard law and economics text books.

[10] Economists view the enforceability of contracts as mutually beneficial based on certain conditions such as the rationality of the contracting parties, reasonable access to information by the contracting parties, the limitation of the effects of a contract to the contracting parties and not third parties. When any of these conditions is not met, the economic basis for contracts may be compromised, and the government may reasonably intervene to limit the enforceability of the contract regardless of its specific parameters or prevailing market conditions. These limitations on enforceability can usefully be divided into at least four categories:

- The specific performance requirements of a contract Thus, contracts for unlawful activities (murder) are unenforceable and for economically harmful activities (e.g., externalities harming public safety or public health) are sometimes unenforceable.
- The identity of the parties to a contract Contracts where one of the parties is a minor or is mentally incompetent are often unenforceable.
- The structure of the contract Contracts with defective structures, such as the absence of consideration or the absence of authority to enter the contract, are usually unenforceable.
- Unreasonably asymmetric information Contracts where one party unreasonably hides relevant information from the other party, such as the fact that a bank has a lien on a car, are often unenforceable.

The issue before the Commission—the use of ETFs as part of long-term contracts for wireless services—does not appear to fall into any of these categories on the enforceability of the contract. The first three conditions clearly do not apply to ETFs. Asymmetric information, such as a failure by carriers to disclose fully the details of ETFs in contracts, does not appear to be an issue in this proceeding. I am not addressing issues of failure to disclose information or contractual fraud. These issues would clearly fall under relevant state contract law.

[11] State governments sometimes restrict the "reasonableness" of specific parameters of contracts independent of the enforceability of the contract or the competitive market conditions. Examples include interest rates on consumer loans and mandatory periods for consumers to reconsider major purchases.

contracts under specific market conditions regardless of enforceability or contract parameters.[12] The details of these exceptions do not plausibly apply to ETFs in wireless service plans.

III. Consumer complaints are not a reflection of limited competition, and the FCC receives a relatively small and declining number of complaints plausibly related to ETFs

The presence of some consumer complaints about ETFs is not by itself evidence either that the wireless market is less than competitive or that ETFs are not working

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These parameter restrictions are usually intended to enable consumers to avoid making major decisions impulsively that will later be regretted or from entering contracts with unscrupulous sellers.

Usually, these contractual parameter restrictions are based on specific statutory authority rather than the discretionary judgments of a government agency. These parameter restrictions typically apply: (1) to contracts closely monitored by the state such as real estate transactions or automobile transactions; or (2) to aspects of contracts with state residents that apply equally across all businesses such as interest rates on consumer loans or consumer credit. Moreover, these parameter restrictions usually are not focused narrowly on contracts for goods or services primarily or exclusively regulated by the federal government, such as securities regulated by the federal Securities and Exchange Commission or internationally traded goods and services. The state regulation of ETFs for contracts just for wireless services does not clearly fall within this category of parameter restrictions for reasonableness.

Restrictions on contract parameters are often based on concepts of "reasonableness," with government agencies deeming some parameter values as reasonable and others as not. The record in this proceeding, however, does not offer clear guidance on how to distinguish "reasonable" from "unreasonable" ETF terms. Even if there were such a basis to decide which ETFs are reasonable, and those that are not, government intervention could be reasonably warranted only where there were a class of consumers who had access only to wireless services that had "unreasonable" ETF terms. No such class of consumers exists. Practically every carrier offers a wide range of ETF terms with service contracts, including many contracts without ETFs, and practically all consumers have options to choose wireless service plans with rate structures with no ETFs. Consequently, it is implausible that a government agency could find that the current range of service plans available to consumers have pricing plans that are unreasonable.

ETF terms are among many terms of service that carriers and customers negotiate and trade off as part of wireless service contracts. For a government agency to limit wireless contracts to a specific parameter of an ETF would be equivalent to setting prices by regulation. Such exercises inherently lead to arbitrary results without consistent, unambiguous results. Further, regulating terms such as ETFs distorts production and investment decisions in a manner similar to rate regulation. Yet the Commission has consistently found that the wireless industry does not need rate regulation.

Recent scholarly research suggests that deference should be given to contractual terms proposed by a seller whose behavior is disciplined by market reputation and consequently may not fully enforce the terms of a contract if it would be perceived as unreasonable to consumers. *See* L. A. Bebchuk and R. A. Posner, "One-Sided Contracts in Competitive Consumer Markets," *Michigan Law Review*, forthcoming. This research also finds that consumers benefit from such deference to contractual terms rather than from government-imposed restrictions on contracts.

[12] Usually, these are issues of limited competition in the market. These conditions do not appear to apply to wireless markets.

well.[13] Even in competitive markets, products and services may occasionally fall short of customer expectations, and customers can and do complain. Many groups monitor consumer complaints regarding both manufactured goods such as automobiles and consumer electronics and services such as health care, restaurants, and plumbing services. The presence of consumer complaints and even the monitoring of those complaints do not by themselves indicate that an industry either lacks competition or suffers systemic quality problems.

In the 4th quarter of 2005, the Commission received fewer than 700 complaints on issues related to contracts including ETFs, or fewer than 3.5 complaints for every million wireless customers, and fewer than 4 complaints for every million wireless customers on a term plan with ETFs.[14] Some of these contract complaints presumably were not about ETFs. Complaints specifically about ETFs apparently have not been so consistent that the Commission has yet to establish a separate complaint category just for ETFs. The absence of such a separate complaint category begs the question of how serious a problem such ETFs complaints have been to the Commission. Moreover, at least some of the complaints about ETFs in the record in this proceeding are linked to quality of service complaints.[15] If there were no quality of service complaints, the number of complaints about ETFs would be substantially reduced.

[13] See, e.g., comments of National Association of State Utility Consumer Advocates at 28-29 and comments of Wireless Consumers Alliance at 38, fn 17.
[14] FCC, Fourth Quarter Report on Informal Consumer Complaints, February 2006. Total wireless customers exceed 200 million of whom 175 million have term plans with ETFs.
[15] See, e.g., Comments of Utility Consumers' Action Network.

IV. Each wireless carrier has multiple offerings, including both prepay and hybrid plans without ETFs, designed to meet the needs of different consumers

Few if any wireless carriers have a single CMRS offering to consumers. American consumers have different wireless needs and different abilities to pay, and wireless carriers craft different plans and offerings to meet the variety of consumer demands. To get a sense of the range of different offerings, one should look at the offerings available in a local geographic market. Appendix B, prepared by CTIA for this report, compiles information on the variety of service offerings available in Atlanta, Georgia; Anchorage, Alaska; Grand Rapids, Michigan; and other cities across America. Even with all of its columns and rows, Appendix B does not fully describe all of the combinations of services available, nor the frequency with which these service offerings change and expand. Appendix B was compiled in mid-January 2006. No doubt, actual service offerings, in response to competitive market conditions, have changed frequently since then.

The salient features of Appendix B are:

- Each carrier has multiple plans, and each plan has multiple options for phones and other equipment and features;
- The plans of each carrier are slightly different from those of other carriers;
- In practically every geographic market, many carriers compete, with dozens of different plans, and literally thousands of different variations to those plans; and
- The American consumer has many choices for wireless services.

V. American consumers value the wide range of choices of wireless service plans both with and without early termination fees, and the vast majority choose plans with ETFs due to the benefits received

American consumers value both the availability of plans with and without ETFs and the availability of a wide range of choices. With the variety of carriers, service plans, and options, pricing plans for wireless services tend to fall into one of three different categories:[16]

- *Term contracts* in which consumers agree to purchase wireless services over a fixed term, usually one or two years in exchange for low monthly rates billed to the consumer's residence, or paid monthly by direct deposit from a credit card or checking account;
- *Prepaid plans* in which the consumer receives a hand set and fixed number of minutes of service which can be refilled at the consumer's convenience, but not based on recurring monthly charges or direct billing;
- *Hybrid plans* involving a month-to-month non-contractual arrangement, in which the consumer pays a recurring monthly bill but for which the service can be cancelled at any time. Hybrid plans have the look and feel of plans with term contracts but do not have any long-term commitments.

Typically, ETFs apply to term contracts but not to prepaid or hybrid plans.

[16] These terms are used by the Yankee Group, one of the leading investment analyst groups examining the wireless sector. See, e.g., "For Prepaid to Grow, It Needs to Become a First-Class Wireless Service," Yankee Group, July 13, 2005. The division of payment plans into three groups is adopted by others including www.myrate.com. The exact boundaries between these groups vary by source.

Consumers have many choices of plans with and without ETFs. The best way to see these choices is to look at local markets. In Atlanta, the plans of selected carriers alone with different payment options facing a consumer can be seen in Table 1.[17]

Table 1
Service Offerings By Payment Plan of Selected Carriers in Atlanta*
December 2005-January 2006**

Carrier	Prepay	Hybrid	Term Contract
AARP	0	2	0
Cingular	2	4	30
Metro PCS	0	4	0
Net 10	4	0	0
Nextel	3	1	33
SouthernLINC	0	2	13
Sprint**	0	0	16
T-Mobile	4	1	13
TracFone	5	6	0
Verizon	1	2	13
Virgin Mobile	3	4	0
Total for Selected Carriers	22	26	118

* The same service offerings are available in most areas of the United States.
** As expected in a competitive market with rapid technological changes, service offerings frequently change, and the offerings reflected in this table, while current in December 2005-January 2006, are not necessarily current today. They are illustrative of the wide range of choices available to consumers.
***See Virgin Mobile, which markets Sprint services; does not include Boost resale of services with prepay and hybrid contracts.
Source: See Appendix B

As Table 1 illustrates, consumers in Atlanta can choose from at least 11 different carriers or resellers with at least 118 different term contract plans and at least 22 different prepaid plans and 26 different hybrid plans. Consumers in Atlanta who wish to avoid ETFs can choose such options from most major carriers. Boost, a directly-owned subsidiary of Sprint-Nextel, offers both prepaid and hybrid plans. Moreover, Sprint services are resold by many other carriers including Virgin Mobile, partly owned by

[17] It is possible that other carriers, particularly resellers, also serve Atlanta, GA.

Sprint. All of the other national carriers in Atlanta offer both prepaid and hybrid plans in addition to term contracts.

The same pattern of consumer choices illustrated in Table 1 is available in practically every community around the country.[18] The services of every facilities-based carrier are offered directly or on a resale basis by a carrier offering prepaid services, hybrid services, or both. Thus, where a facilities-based carrier is present, consumers have choices of plan options not only from the facilities-based carrier, but from resellers as well. Even in locations with few if any of the national carriers, substantial choices are available from regional and local facilities-based carriers as well as resellers.

Table 2 presents the choice of service offerings in Anchorage, Alaska, where there are 5 facilities-based carriers and at least one reseller. The pattern of offerings is not much different from the much larger Atlanta market: more term contract offerings than other plans, but still a substantial choice of prepaid and hybrid plans.

Table 2
Service Offerings By Payment Plan of Selected Carriers in Anchorage

Carrier	Prepay	Hybrid	Term Contract
ACS Wireless	0	0	11
Alaska DigiTel	6	1	9
Cellular One/Dobson	0	0	15
GCI	0	10	10
MTA Wireless	0	3	11
TracFone	5	6	0
Total for Selected Carriers	11	20	56

Source: See Appendix B

[18] From Appendix B, facilities-based carriers operating outside Atlanta that offer prepaid and hybrid plans include ALLTEL and Leap. Many regional and smaller carriers are not included in Appendix B.

Consumers in Atlanta, Anchorage, and communities around America select wireless service plans with ETFs not because they have no other choice, but precisely because they have many choices and choose those plans with ETFs. Of course, there are some isolated communities with few if any wireless carriers, but in these communities it is the absence of any service—rather than the availability of services with and without ETFs—that limits consumer options.

An underlying principle of economics is that individuals and firms improve their situations through exchanges. These exchanges may vary by such factors as the types of assets exchanged, the use of currency and other financial instruments, and the use of contracts to bind as part of the exchange. Contracts are a particularly useful form of economic exchange.[19] Unlike a simple instantaneous barter exchange, a contract can bind parties to terms and conditions that may extend for days, weeks, or years. Contracts facilitate exchanges and promote economic welfare by enabling each party to make plans in reliance on the performance of the other party to the contract.

Contracts that are mutually beneficial, and where negotiation and transactions costs are less than the expected benefits of the contracts, develop between private parties without government mandates; a private party does not willingly enter a contract not perceived as beneficial relative to the alternative of declining the contract.[20] Where negotiation costs are high, such as for mass market consumer services like wireless,

[19] For an overview of the economics of contracts, see R. Posner, *Economic Analysis of Law*, (Boston: Little Brown & Company) 1973, Chapter 3; or S. Shavell, *Foundations of Economic Analysis of Law*, (Cambridge: Belknap Press of Harvard University Press) 2004, Section III.

[20] This is a variation on Coase's theory of social welfare from transactions. See R. Coase, "The Problem of Social Cost," *Journal of Law and Economics*, 3, 1960.

boilerplate contract offerings are widely available to consumers.[21] If the option of wireless service contracts with some or all ETFs were prohibited in the market, carriers would be forced to resort to other methods of offering services, presumably at higher costs to carriers than those contract offerings with ETFs,[22] and presumably with terms less favorable to consumers than those presently available to consumers.[23] Consumer welfare consequently would be diminished.

Consumers value not merely the availability of a *single* contract for goods and services, but a *choice* of contract options for those goods and services where the range is more likely to match the specific preferences of a consumer. If all consumers were identical and had the same preferences and the same capabilities to pay for goods and services, a range of choice would be of little additional benefit. But consumers are not identical either in taste or in ability to pay. For example, consumers prefer to have a wide choice of brands, models, options, and even colors for automobiles as well as a choice of payment plans. If the government were to limit any of theses aspects of consumer choices for automobiles, including payment plans, some consumers would be worse off. For example, if the government were to prohibit leasing arrangements for automobiles, those consumers today who lease cars for fixed terms would be worse off. Even those consumers who do not lease cars today but who might consider leasing in the future would be worse off. Consumers by their behavior are revealed to be willing to pay for choices, and using governmental regulatory power to prohibit choices actually made by

[21] See L. A. Bebchuk and R. A. Posner, "One-Sided Contracts in Competitive Consumer Markets," *Michigan Law Review*, forthcoming.
[22] If carriers could at lower cost offer comparable terms and conditions without ETFs to consumers, carriers would already be doing so.
[23] Given that there currently are no restrictions on the types of terms that carriers can offer consumers, and given that today there is a wide range of such terms, a carrier that could profitably offer more favorable terms to consumers would already be doing so.

consumers without a clear showing of harmful consequences to others, harms consumers.[24]

Carriers offer wireless services currently without regulatory limitation on either the length of the term of services or the use of ETFs. ETFs are part of the rate structure of wireless services. As will be seen in Section VI below, for long-term contracts with ETFs, rates are reduced; monthly contracts or hybrid plans have higher rates; prepaid services without contracts have higher rates still.

Consumers value the opportunity to choose among different carriers, different service plans, different handsets, and different payment plans including those with ETFs. Arbitrarily removing one or more of these consumer choice options reduces consumers' welfare, and any benefits of such a reduction in consumer choices should be weighed against these losses. Faced with the alternative of plans without ETFs, consumers who choose fixed-term wireless service contracts with ETFs clearly benefit from such agreements. These voluntary agreements enhance social welfare.[25]

The selection of a longer term contract rather than prepaid service is not an arbitrary choice for consumers. Many consumers have reasons to prefer longer term contracts including the following: search costs of choosing a new carrier and plan; the transaction costs of signing up for a new plan; and the benefits of a stable carrier relationship such as familiarity with functions, services, and billing arrangements. Moreover, many carriers provide substantial inducements for longer term contracts such as lower monthly rates, bucket-of-minute plans, carry-forward provisions for minutes,

[24] Consistent with the economics of revealed preference, if the alternative choices available after regulation were preferable, they would have been chosen by consumers under the unregulated conditions. As noted in Section II above, there are conditions when such restrictions may be economically rational, but the record does not demonstrate these conditions for wireless services.
[25] R. Coase, 1960.

and inclusion of other service costs and equipment costs in the monthly charges. Few if any of these benefits are available on a purely prepaid basis.

On the other hand, other consumers have reasons to prefer prepaid plans or short-term contracts. These include consumers who are transients, such as college students, lacking a permanent or fixed address. Rapid technological change for equipment and rapid changes in service offering may discourage some consumers from entering long-term contracts for wireless services and encourage short-term contracts instead. The variety and ever-changing nature of competing plans as well as local number portability facilitate changing services plans or carriers for those consumers who choose shorter term plans.

VI. ETFs are a common part of the unregulated rate structure of services in other industries

ETFs are a common pricing mechanism in contracts over extended time periods in other industries. A one-year newspaper subscription, for example, may require the resident to pay in advance; the reputation of the newspaper, and its reliance on advertising, ensures deliveries. Bank loans have collateral—a house or a car—that becomes the property of the bank if the borrower breaches the contract by failing to meet loan payments over time. Still other long-term contracts, such as office leases or automobile leases, require one party to pay the other a fee for breaching the contract before its maturity. This fee is sometimes called an early termination fee. ETFs are a common component of the rate structure of services, and ETFs as a form of rate structure are rarely subject to specific price regulation.

Advanced purchase commitments are one form of ETFs in contracts. Advanced-purchase commitments enable sellers to better predict future demand for services and enable consumers to purchase services at lower average prices. Thus, businesses ranging from airlines to entertainment companies sell tickets in advance at lower prices than they sell the tickets closer to a scheduled event. Consumers usually pay in advance for advanced-purchase agreements, and the consumer often forfeits the advanced-purchase price if the purchased service is canceled or not used regardless of the extent of prior notice and regardless of whether someone else takes the place of the canceled party. For example, for many advanced-purchase airline tickets, a consumer pays a large penalty or even receives no compensation for canceling a ticket, regardless of whether the ticket is canceled one month in advance of the flight or one hour before the flight, and regardless of whether another passenger ultimately takes the canceled seat.

Businesses often do not refund any of advanced purchase price because customer acquisition costs are high. Moreover, the purpose of the advanced purchase is to enable better planning for future demand, a purpose frustrated by cancellations. This is equally true of wireless networks which are capital intensive and must be constructed over extended periods (the addition of a single cell site, for example can take eighteen months to be engineered, clear zoning approvals, and be constructed). Knowledge of expected demand can help carriers provide better coverage and service with less wasted capital and expense to consumer. Most of these ETFs are accepted by consumers as part of the bargain of getting lower prices for advanced purchases. Table 3 lists examples of businesses offering advanced purchase discounts and ETFs.

Table 3

Examples of Consumer Services
That Offer Consumers Greater Discounts for Advanced Purchases in Exchange for ETFs

Airline tickets
Sports event tickets
Entertainment event tickets
Hotels
Advanced leases for commercial office space*

* The discount here is for early subscription to a commercial development

I am not aware of any government regulation of the general rate structure, much less the specific form of ETF used within the rate structure, for any of the industries listed in Table 3 that commonly use ETFs for advanced purchases.

ETFs are also used in long-term contracts which often involve lower average prices to purchasers in exchange for longer-term commitments of making purchases. For example, a newspaper can offer a one-week subscription for home delivery at one average price, and a one-year, prepaid subscription for home delivery at a much lower average price. If the resident cancels the annual contract before its maturity, the resident may lose some or all of its residual value, an implicit ETF. A resident can accept either the one-week or the one-year contract for delivery, or alternatively the resident can purchase the newspaper at news stands and bear the risk that the price of the newspaper may increase over the next year. Long-term contracts are mutually beneficial to the parties to the contract. Newspapers often offer lower rates to long-term subscribers who in return give the newspaper a predictable base of subscribers and lower customer acquisition costs. Indeed, long-term provisions are common to many consumer contracts from bank loans to service agreements, as shown in Table 4.

Table 4

Examples of Consumer Services
That Offer Consumers Greater Discounts for Long-Term Contracts in Exchange for ETFs

Newspaper subscriptions
Magazine subscriptions
Life insurance policies
Auto leases
Health club memberships
Some forms of mortgages
Cable and satellite television services
Broadband services
Wireless telecommunications services

I am not aware of any government regulation of the general rate structure, much less the specific form of ETF used within the rate structure, for any of the industries listed in Table 4 that commonly use ETFs for contracts for long-term services.

VII. Consumers pay less for wireless services and handsets with term contracts with ETFs than with plans without ETFs; consumers generally receive more minutes and services with ETF plans

Consumers typically pay less on a per-minute basis for wireless services with term contracts with ETFs than with plans without ETFs. Table 5 illustrates the differences in selected plans for prepay, hybrid, and term contracts. On a per-minute basis, rates for prepay plans tend to be substantially higher than rates for hybrid plans, and rates for hybrid plans tend to be substantially higher than rates for term contracts.[26] Although each rate plan is slightly different from other rate plans, most of the term contracts tend to offer services in the range of $0.05 per minute, and most hybrid plans

[26] One exception is GCI Wireless which offers the same rates for term contract as it does for month-to-month, hybrid plans. With GCI Wireless, only handsets are more expensive on hybrid plans. See http://www.gci.com/forhome/cellular/gsmfaqs.htm, accessed February 1, 2006.

tend to be in the range of $0.10 per minute, and most prepaid plans tend to be in the range of $0.15 per minute.

Table 5

Comparison of Rates for Prepay, Hybrid, and Term Contracts
For Selected Plans Major National Carriers
(Unless otherwise indicated, free nights and weekends for all plans)

Carrier	Minutes	Rate	Rate Per minute at maximum of plan	Months term contracts	ETF
			Prepaid Plans		
Cingular	500[a]	$80.00	$0.16	0	0
Sprint/Virgin Mobile	500[bc]	$60.50	$0.12	0	0
T-Mobile	400[b]	$50.00	$0.13	0	0
Verizon	500[a]	$80.00	$0.16	0	0
			Hybrid Plans		
ALLTEL	700[d]	$69.99	$0.10	0	0
Cingular	650	$69.99	$0.11	0	0
Sprint/Virgin Mobile	350[e]	$49.99	$0.14	0	0
Verizon	700	$70.00	$0.10	0	0
			Term Contracts		
ALLTEL	1000	$49.99	$0.05	1	$200
Cingular	900	$59.99	$0.07	2	$150 or $240
Sprint/Virgin Mobile	1000	$55.99	$0.06	2	$150
T-Mobile	1500	$49.99	$0.03	1	$200
Verizon	900	$59.99	$0.07	1	$175

Source: Appendix B

[A] assumes 30 days at $0.99 per day, and $0.10 per minute during peak hours.

[b] No free nights and weekends

[c] assumes 30 days at .35 per day and 0.10 per minute during all hours

[d] 3000 night and weekend minutes

[e] 1000 night and weekend minutes

Customer equipment costs are not the only or even necessarily the largest cost for either the consumer or the carrier. Customer equipment costs are usually much smaller than customer acquisition costs and other fixed costs of service. As can be seen in Appendix C, all carriers offer some handsets for less than $100 even on prepaid plans. Cingular and Net 10 offer handsets for as little as $29 on prepaid plans. Nonetheless, handset costs tend to be less for term contracts than for other plans without ETFs.

Consumers with term contracts and ETFs sometimes receive greater discounts on purchasing handsets than consumers with prepaid or hybrid plans. Nevertheless, the primary purpose of the ETF appears to be related to customer acquisition and retention costs. Appendix C presents recent prices for handsets available from different carriers with different plans. Some carriers that offer both term contracts and hybrid or prepaid options offer greater discounts on handsets to term contract customers.[27] GCI Wireless is quite specific in its handset discounts for term contracts relative to hybrid plans: $30 for a one-year contract, and $70 for a two-year contract.[28] Carriers without term contracts sometimes have higher handset prices than those with term contracts.[29] Term contracts that permit the lower handset prices have many components, but ETFs are a central part of the rate structure of the term contracts.

[27] See particularly handset prices for ALLTEL, Cingular, SouthernLINC, T-Mobile and Verizon. Carriers with term contracts tend to have lower prices for the same handset than carriers without term contracts.
[28] http://www.gci.com/forhome/cellular/gsmphones1.htm, accessed February 1, 2006. In addition, GCI Wireless offers discounts on handset of up to $150 for 2-year contracts plus subscription to one of their non-wireless services.
[29] For example, the Audiovox 8910 is available to ALLTEL term contract customers for $19.99 after discounts but only $139 after discounts from MetroPCS which has no term contracts.

VIII. There is no economic reason to expect ETFs to be exactly the same, and the magnitude of ETFs for individual carriers is not unreasonably large relative to revenue or cost structure

As only one part of the rate structure for competitive wireless services, there is no economic reason to expect ETFs to be exactly the same across carriers, and they are not. The magnitude of ETFs can be compared with both the average revenue a carrier receives from a customer and the average costs that a carrier incurs to attract a customer. In comparison to both revenues and costs, the ETFs for term contracts are not unreasonably large.

A. ETFs are not large relative to average revenues

The ETFs for term contracts listed in Table 5, and those charged by other wireless carriers, are not large relative to the monthly revenues a carrier receives from a customer. Although most consumers who subscribe to term contracts abide by contract terms and thus never pay ETFs, it is entirely possible that for some consumers a rational strategy is to breach a contract and pay the ETF. Consumers would choose to breach a contract and pay an ETF only if the expected benefit to the consumer after paying the ETF is greater than the expected benefit of continuing with the contract. Although the Commission collects no systematic information on the number of consumers who breach contracts and pay ETFs, anecdotal evidence suggests that many consumers make such choices.[30] At least for these consumers, the ETF is not large enough to deter a breach of contract.

[30] E.g., E. Mierzwinski, K. Smith, and D. Cummings of MassPIRG in their survey find that10 percent of wireless customers paid an ETF for wireless services in the prior three years. *Locked In a Cell: How Cell Phone Early Termination Fees Hurt Consumer*, at 24. No governmental organization has data to verify the MassPIRG findings.

ETFs are not a large multiple of customer average revenue per user (ARPU) —a commonly used measure of customer costs. Table 6 illustrates ARPUs for the major national carriers as well as the standard ETFs.

Table 6
ARPUs and Standard ETFs for Major Carriers

	Average Monthly Revenue per Subscriber 3rd quarter, 2005	Standard ETF in December 2005 and January 2006
ALLTEL	$53.97	200
Cingular	$49.62	150 or 240
Sprint	$66.04[a]	150
Nextel	$72.47[a]	150
T-Mobile	$53.15	200
Verizon	$50.13	175

[a] 2nd quarter, 2005.
Sources: Appendix B and UBS Warburg, *US Wireless 411*, December 28, 2005, at 40.

B. ETFs are not large relative to cost structure

In a competitive market, prices reflect underlying costs, and those costs for wireless carriers are heavily fixed, invariant with the level of usage. These fixed costs can be divided into two broad categories: (1) those invariant to marketing and the number of customers; and (2) those costs related customer acquisition. The first category includes the costs of acquiring spectrum, leasing access to cell towers, purchasing network equipment, and other fixed costs associated with operating a wireless system. These fixed costs are the same regardless of the number of customers and the intensity with which those customers use the network. A carrier will seek to cover this first set of fixed costs based on available market demand, whether with short or long-term arrangements. These costs tend to range from $20 to $45 per customer per month and are reflected in consumer rates.[31]

Customer acquisition costs do not vary with the intensity of network usage, but are related to the churn or turnover of the customer base. Less churn means that less marketing and advertising are necessary to generate and retain a customer base of a specific size. In addition, each new customer addition or change requires substantial labor-intensive review from local sales and customer support personnel. The same factors that encourage customers to switch plans and carriers—rapid technological change, competitive offerings, and local number portability—exacerbate customer acquisition costs for carriers. For wireless carriers, customer acquisition costs are substantial, ranging from $130 to $480 per gross addition or new customer, with most reported costs above $300.[32] With more churn, customer acquisition costs increase. These customer acquisition costs reflect between 8 and 30 percent of the total revenue a carrier will receive from a customer.[33] Interestingly, ETFs for carriers tend to be much less than their customer acquisition costs. That is, in the event of breach of contract by a customer, carriers do not use ETFs to fully recover the cost of acquiring a customer.

It is reasonable that a carrier would seek to retain customers to recover fixed costs of service including customer acquisition costs.[34] A carrier reasonably can seek to recover these costs as part of monthly payments with longer term contracts. Even carrier costs that vary in the long run—billing and collection, customer support, maintenance,

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[31] UBS Warburg, *US Wireless 411*, December 28, 2005, at 55.
[32] Ibid., at 57.
[33] Ibid., at 58.
[34] Facilities-based carriers tend to have both prepaid and post-paid service plans. Many carriers that specialize in reselling the prepaid services of other carriers based on paying that carrier a monthly fee not surprisingly charge their retail customers a monthly fee for a prepaid service.

and equipment inventories—do not vary in the short run. Many carriers reasonably seek to recover even these quasi-fixed costs through long-term contracts. Alternatively, as shown in Table 5, a carrier can try to recover all costs, both fixed and variable, with higher average rates on a prepaid or short-term basis.

In network industries with substantial fixed costs of service, it is not uncommon for businesses to use either advanced-purchase agreements or long-term contracts to have predictable volumes of service for load management. The cost structure of such a business is much easier to manage with predictable loads. Thus, the businesses listed in Table 3 use advanced purchase agreements because of the cost structure of their industry; similarly, the industries listed in Table 4 use contracts and ETFs because of the cost structure of their industries.

IX. Rather than just a "false choice," American consumers have many attractive choices for wireless services with frequent opportunities to switch, and they frequently choose wireless plans with ETFs

Some critics have inaccurately suggested that American consumers have only a "false choice" with respect to ETFs: attractive plans with ETFs and unattractive plans without them. This characterization is exactly the opposite of actual market conditions.

Faced with the many options for wireless services described in the preceding pages, more than 200 million wireless subscribers in the United States choose plans that best meet their needs.[35] The Commission does not maintain information on subscriptions by type of plan, but the Yankee Group, a leading investment analysis firm for the wireless industry, estimates that 13 percent of wireless subscribers, or approximately 26

[35] Merrill Lynch, *US Wireless Matrix 4Q 05*, Table 5, March 24, 2006, estimates year-end 2005 subscribership of 207,717,842.

million American subscribers, in 2005 chose prepaid or hybrid plans.[36] The share of those two types of plans is expected to grow to 23 percent by 2009.[37] The prepaid and hybrid customers subscribe to both MVNOs as well as the major facilities-based national carriers.[38] Consequently, nearly 175 million Americans, faced with the myriad of choices illustrated in Appendix B including many prepaid and hybrid plans, instead choose term contracts.

If all or nearly all Americans were hopelessly locked into long-term contracts for wireless services,[39] one would expect to see little advertising to attract their attention to competing wireless services. The opposite is the case: Americans are bombarded daily with marketing for competing wireless services. The reason is that, at some point in each year, the vast majority of wireless customers do not face ETFs of binding term contracts and are free to choose a new wireless plan.

Consider the year 2006. The current 26 million prepaid and hybrid subscribers do not face ETFs and can costlessly switch to a new plan. Even the nearly 175 million Americans with term contracts are not locked into permanent arrangements. Consumers who in 2005 signed up for a 12 month term contract, or who in 2004 signed up for a 24

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[36] "For Prepaid to Grow, It Needs to Become a First-Class Wireless Service," Yankee Group, July 13, 2005. Other groups estimate a slightly smaller share of wireless customers do not have term contracts. For example, CTIA estimates 8.2% of facilities-based operator customers are prepaid and some hybrid plans. See, *CTIA's Profile of Prepaid Wireless Service in the United States: A Special Report from CTIA base on CTIA's Semi-Annual Wireless Industry Survey Results, Mid-Year 2005 Results*, released January 2006, at 13.

[37] "For Prepaid to Grow, It Needs to Become a First-Class Wireless Service," Yankee Group, July 13, 2005.

[38] The precise allocation of customers among term contract, hybrid, and prepaid is not available for all carriers. Last summer, the Yankee Group estimated that the national carriers had 41 percent of the prepaid and hybrid market, "For Prepaid to Grow, It Needs to Become a First-Class Wireless Service," at 3. Prepaid and hybrid are growing in importance for some of the national carriers. Direct prepaid subscriber additions amounted to 47 percent of all subscriber additions to Sprint Nextel in the first quarter of 2006. "First Read: Sprint Nextel, Mixed 1Q06 Results; Wireless OIBDA Lower," UBS Investment Research, April 26, 2006.

[39] The sense of many Americans being locked inescapably into contracts with wireless carriers pervades the MassPIRG studies. See also reply comments of Consumers Union, National Association of State PIRGs, and National Consumer Law Center, August 25, 2005, at 2-4.

month term contract, will have their term obligations expire in 2006. They can costlessly switch to a new plan. Many customers continue with their expired term contracts on a month-to-month basis after their term has expired. These customers can costlessly switch to a new plan. Finally, many new consumers will enter the market as several million new wireless consumers have entered the market every year for the past two decades The only consumers who will be bound by an ETF on a term contract throughout 2006 are those consumers who entered a two-year contract in 2005. Those are likely to be a small share of the total population of wireless subscribers.[40]

More than 100 million Americans will either choose to remain with their current wireless plan or choose a new wireless plan in 2006.[41] Each month, more than 2 percent of American wireless consumers switch their plans.[42] Practically all will have a choice of plans with and without ETFs. Many will choose a prepaid or hybrid plan. But the vast majority of these Americans will choose a term contract for 12 or 24 months with lower monthly rates and lower equipment costs and with an ETF.[43] These Americans will make these choices not because they have no alternatives but precisely because they have dozens of alternatives from which to choose. These Americans will choose term contracts not because they lack information but precisely because they have a wealth of

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[40] Of the carriers reviewed, only Centennial and Cingular offer term contracts of only 24 months. All other carriers with term contracts offer some 12 month contracts. See Appendix B.

[41] UBS Warburg estimates gross additions (churn plus net new additions) to the wireless industry of 18 to 20 million per quarter. UBS Warburg, *US Wireless 411*, December 28, 2005, at 23. The UBS data do not include those consumers who decide to remain with their current carrier.

[42] See measures of industry churn. Ibid., at 26. It is difficult to compare churn rates across industries because residential changes should be netted out of churn rates. See particularly H. Vogel, *Entertainment Industry Economics: A Guide for Financial Analysis*.

[43] Two-thirds of net additions in the 3rd quarter of 2005 were term contracts. UBS Warburg, *US Wireless 411*, December 28, 2005, at 22.

information.[44] They will choose term contracts not because they are incapable of weighing the benefits and costs of various alternatives but precisely because they are perfectly capable of making informed decisions themselves. Statements in this proceeding suggesting that consumers are dissatisfied with ETFs[45] are at odds with economics[46] and at odds with the repeated observation that most American consumers consistently choose wireless plans with ETFs. Leaving consumers to make decisions for themselves in a competitive market is at the heart of every aspiration to make consumers better off. For wireless services, those aspirations are realities today.

X. Most American consumers never breach wireless contracts, never pay ETFs, and never complain about ETFs

Although it is an integral part of the rate structure of wireless services that helps to reduce the rate structure for all consumers, an ETF is an additional charge or fee that is actually paid by few consumers. Only consumers who actually breach their wireless contract pay an ETF.[47] The vast majority of the nearly 175 million wireless consumers on term contracts will receive lower rates as a result of a term contracts but will not breach those contracts and will not be subject to ETFs.

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[44] Consumers are exposed to substantial marketing information about wireless services in all media: television, radio, print, Internet, billboard, etc. Consumers seeking comparisons of wireless service offerings can consult any number of web sites listed by a search engine wit the terms “wireless” “plan” and “comparison.”

[45] See *Ex Parte* of AARP, Feb. 2, 2006, particularly at 28-31.

[46] See fn. 7 above.

[47] Note the survey results from MassPIRG of 10 percent of wireless consumers paying an ETF in the prior three years. I have found no other source of information to verify these findings.

XI. Prorating ETFs would not necessarily improve consumer welfare and is not a sensible form of regulatory intervention

The record in this proceeding notes that most carriers do not prorate the ETF.[48] Some wireless carriers already prorate ETFs. Cellular One/Dobson in Anchorage charges an ETF of $20 per month remaining on the contract.[49] The ACS Wireless plan is prorated at $25 per month until the term contract ends.[50] Thus, if there were 4 months left on the contract, the ETF would be $100; 8 months remaining, the ETF would be $200; and the ETF would be $300 at 12 months. Whether the constant ETF of the national carriers is lower or higher than the prorated ETF of ACS Wireless depends on the number of months remaining on the term contract. For a small number of months, the prorated ETF is lower; if many months are remaining on the contract, the constant ETF is lower.

If a regulatory body were to limit ETFs to a prorated formula without restricting the level of ETFs, the result might well be a form similar to the ACS Wireless ETF. If a regulatory body were to engage in rate regulation and restrict not merely the structure of ETFs to a prorated scale but also the precise level of these ETFs, the result would likely be that carriers would likely recover the fixed costs of term contracts by other means. Appendix B has more than 20 different columns, each column reflecting one of the ways in which a wireless plan can vary.[51] One example of a wireless carrier's hypothetical response to a regulatory restriction on the structure, rate, or even existence of ETFs

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[48] See, e.g., Consumers Union, National Association of State PIRGs, and National Consumer Law Center comments at 10.
[49] See Appendix B.
[50] See http://www.acsalaska.com/Cultures/en-US/Personal/Wireless/Unlimited+Wireless/Terms+and+Conditions.htm, accessed on January 28, 2006.
[51] See Appendix B.

would be to increase activation fees which tend to be approximately $35 for the term contracts of major wireless carriers.

Simply because a contract permits a carrier to collect an ETF as a result of a customer breach does not mean that the entire ETF is actually collected with each breach. The record in this proceeding does not appear to address the extent to which carriers actually enforce ETFs in the event of a breach. Recent scholarly research suggests substantial efficiency advantages, when individual negotiation costs are high as in the case of mass market consumer services, of letting sellers impose boilerplate terms and conditions including ETFs for contract breaches.[52] The sellers in turn have reputations to protect, and therefore have strong incentives to be reasonable in the enforcement of ETFs, even forgiving them where reasonable. That discretion appears to apply to wireless carriers as well.

XII. Limiting the range of wireless service ETFs would substantially harm American consumers

The record in this proceeding does not provide an economic foundation for limiting the range of wireless service ETFs. The regulation of the rate structure of ETFs for wireless services would limit consumer choices in a competitive market and thereby reduce consumer welfare.[53] Whether those restrictions are imposed by federal or by state government, the loss in consumer welfare would be the same. Either state or federal government may have legal reasons to impose restrictions on ETFs for wireless service

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[52] See Bebchuk and Posner, 2006.
[53] See R. Coase (1960).

contracts, but government officials should not be misled with arguments that consumers would benefit from restricting ETFs. The opposite is the more likely outcome.

No credible measure of consumer benefits from restricting ETFs is presented in the record.[54] Any potential benefit from such a limitation on contracts should be weighed against the substantial harms to consumers. The balancing of benefits and harms from limitations on ETFs can be examined geographically in three steps:

- Net losses to consumers in an individual state restricting ETFs;
- The indirect losses to consumers in other states still permitting ETFs; and
- Net losses to consumers if ETFs were restricted in all states.

A. Net losses to consumers in an individual state

If one state were to regulate the prices of wireless services by limiting the range of available ETFs, wireless carriers would necessarily modify and even abandon some of their current service offerings in that state, and consumers in that state would consequently face a smaller range of service offerings. Those consumers whose current service plan would still be available, such as those without ETFs, would presumably be no worse off, although even many of these consumers may prefer to retain at least the option of the availability of a lower-priced, long-term plan with ETFs.

Those consumers whose wireless service plan would be modified but not abandoned would be worse off if they do not breach. Hypothetically, a carrier might respond to a prohibition or a limitation on ETFs in contracts by raising initialization fees.

[54] The clearest estimate of consumer losses from ETFs is $4.6 billion over three years, presented in E. Mierzwinski, K. Smith, and D. Cummings, *Locked In a Cell: How Cell Phone Early Termination Fees Hurt Consumers* (August 11, 2005) at 18-22. Prof. J.A. Hausman reviews and rebuts these estimates in Declaration of Prof. J.A. Hausman at 20-28.

Consumers who would breach service contracts would be better off; those who would not breach the contract would be worse off.

If the term contracts available after the imposition of economic regulation of ETFs provided net benefits to consumers with no additional cost to carriers, those contracts would already be available in a competitive market. Unless there are exceptional circumstances for regulation in a competitive market as discussed above, the options available to consumers after rate regulation in a competitive market are necessarily inferior to those without rate regulation.

Those consumers in that state whose current wireless service plan would no longer be available would be unambiguously worse off. They would be forced to choose a different term contract plan with a different ETF structure or a plan without an ETF, one that each consumer already had available but found inferior to alternatives with ETFs. Exactly how much consumers in a state would be harmed by limitations on wireless ETFs is an empirical matter, and no empirical studies have been submitted in the record to provide a basis to infer the magnitude of consumer losses in a state from losing some or all wireless plans with ETFs.

B. Net losses to consumers in other states

Restrictions on ETFs in one state may have at least two unintended consequences in other states. First, restrictions on ETFs in one state will increase churn and customer acquisition costs in that state. Most carriers, however, track revenues and costs on a national rather than a state-by-state basis. Thus, higher customer acquisition costs in one state will be perceived by the carrier as higher customer acquisition costs nationwide. Because most national carriers establish nationwide pricing plans, the net result of higher customer acquisition costs in even one state could be higher rate structures nationwide, possibly extending to all plans. Alternatively, higher customer acquisition costs in one state may result in the abandonment of one or more rate plans altogether.

Second, customers in states with restrictions on ETFs will have access to nationwide marketing information that will reveal lower rates with ETFs available to customers in other states. Although it is possible to maintain price differences across state boundaries for relatively immobile goods and services (e.g., a house) or for goods and services that can be consumed only in one location (e.g., electricity), it is far more difficult to maintain price differences for services that by definition are mobile such as mobile wireless services. Particularly if price differences are large enough, consumers will discover methods to purchase wireless services across state boundaries, essentially arbitraging the price differences. Indeed, it is the very mobility of the wireless services that places them in federal jurisdiction. Ironically, state efforts to impose economic regulation of wireless services by restricting rates or limiting contract terms will merely increase incentives for consumers to avoid those regulations by purchasing services in other states.

C. Net losses to consumers nationwide

The issue currently before the Commission is whether ETFs are "rates charged" within the meaning of Section 332 and the potential preemptive effective of a decision on that issue, and whether state courts can restrict ETFs in the pricing of wireless service plans. If, however, ETFs were to be restricted nationwide, the losses would be substantial. Currently, the vast majority of Americans have a wide range of choices of wireless services without ETFs and substantial choices of wireless services with ETFs.

Approximately 26 million Americans choose wireless plans without ETFs, but more than 175 million American wireless consumers choose plans with ETFs and usually with much lower average prices. These consumers would have their rate plans altered if ETFs were restricted or even eliminated.

As seen in Table 5, rates for prepaid and hybrid plans tend to be higher than term contract plans. Regulatory restrictions on ETFs will not necessarily mean the end of term contracts, but the current benefits of ETFs would be shifted to other portions of the contract, to the detriment of many if not most consumers. Some carriers hypothetically might choose to shift cost recovery to other unregulated areas of contracts, such as activation fees. Other carriers might resort to raising monthly rates. Even a $1 per month increase in term contract rates would result in more than $2 billion annually in higher consumer bills and, given the shape of consumer demand curves, substantially more in lost consumer welfare. Abolition of ETFs entirely could result in even higher rate increases and lost consumer welfare. Prof. Jerry Hausman estimates annual consumer welfare losses from the loss of term contracts at nearly $70 billion.[55]

There possibly are other estimates of the consumer welfare gains and losses from government restrictions on ETFs in wireless contracts. Ultimately, it will be difficult to show net consumer benefits from limiting widely popular consumer choices where the only alleged beneficiaries of restrictions are the individual consumers themselves.

[55] Declaration of Prof. J. A. Hausman, at 28.

Harold Furchtgott-Roth

Washington, DC

June 6, 2006

Appendix A

Resume of Harold Furchtgott-Roth

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American Enterprise Institute, Visiting Fellow (2001-2003).

Federal Communications Commission, Commissioner (1997-2001).

> One of five commissioners responsible for U.S. communications policy, rulemaking, enforcement, and adjudication. Among other responsibilities, reviewed all major mergers in communications sector. For statements, speeches, and other information, see http://www.fcc.gov/commissioners/previouscommish.html

Committee on Commerce, U.S. House of Representatives, Chief Economist, (1995-1997).

> One of the principal staff for the Telecommunications Act of 1996, Balanced Budget Act of 1995, and electricity deregulation legislation for the105th Congress.

Economists Incorporated, Senior Economist (1988-1995).

Center for Naval Analyses, Research Analyst, (1984-1988).

Experience (continued)	Stanford University, Research Assistant, and Teaching Assistant for public finance, (1980-1983).
	U.S. Department of Energy, Conservation and Renewable Energy Program, Research Assistantship, (1981-1982).
	Office of Management and Budget, Intern, (Summer 1980).
	Congressional Budget Office, Assistant Analyst, (1978-1979).
	U.S. Department of Labor, Pension and Welfare Benefits Program, Intern, (Summer 1977).
	MIT, Center for Transportation Studies, Research Assistant, (1976-1978).
	U.S. Senate Committee on Appropriations, Internship sponsored by MIT Political Science Department, (Summer 1976).
Education	Ph.D., Stanford University, Economics, 1986
	S.B., Massachusetts Institute of Technology, Economics, 1978.
	University of South Carolina, 1973-1974.
Honors	Awards for FCC achievements from various civic and business groups
	Visiting Fellow, University of Warwick, (Summer 1984).
	Research Fellow, Brookings Institution, (1983-1984).
	National Merit Scholar, MIT, (1974).
Professional Societies	American Economics Association Econometrics Society Federalist Society

Boards

Corporate

MRV Communications
Oneida Communications

Other

Washington Legal Foundation
Legal Policy Advisory Board
Telecommunications Policy Research Conference,
Chairman
University of Richmond School of Law
Intellectual Property Institute Advisory Board
KMB Video Journal Advisory Board
Member of panel to support National Security Agency study, "Protecting the U.S. Telecommunications Infrastructure—The Way Forward," (2003 – 2004).

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