Virgin mobile

Pay As You Go

Universal Service Reform

Federal Communications Commission
June 9, 2006

1. Introduction to Virgin Mobile USA (VMU)

- Eighth largest wireless carrier in the U.S.
- Four million subscribers in four years since national launch (July 2002).
- Pioneered the MVNO (Mobile Virtual Network Operator) model in the U.S.
  - Allows VMU to control all aspects of our strategy and customer "touch points."
- Joint venture of Sprint Nextel and Sir Richard Branson's Virgin Group (50/50 ownership relationship).
  - Allows VMU to leverage both wireless network services from Sprint and the power of the global Virgin brand.
- Pioneered grab-and-go wireless service; does not require control of retail stores or sales process.

1. Introduction to VMU (cont'd)

- Nearly 20% share of prepaid market.[1]
- Leading brand in youth market with over 70% brand awareness.[2]
- Solid financial performance.
- Over 25,000 distribution points and 70,000 Top-Up locations, including Best Buy, Wal-Mart, Target and Radio Shack.
- Scalable IT infrastructure to keep pace with growth.

[1] Virgin Mobile management and Yankee Group, October 2004
[2] Gallagher/Lee, Virgin Mobile Brand Tracking Study, 4Q04

1. Introduction to VMU (cont'd)

Customer Profile

- 65% of VMU customers are new to wireless.
- High usage of SMS and data services (9% of 2004 service revenues from data).
- Many customer are from lower-income households that previously did not have access to an attractive wireless service.
  - 36% have household incomes under $35,000.
- VMU's customer base is diverse: minority representation is two times that of population.

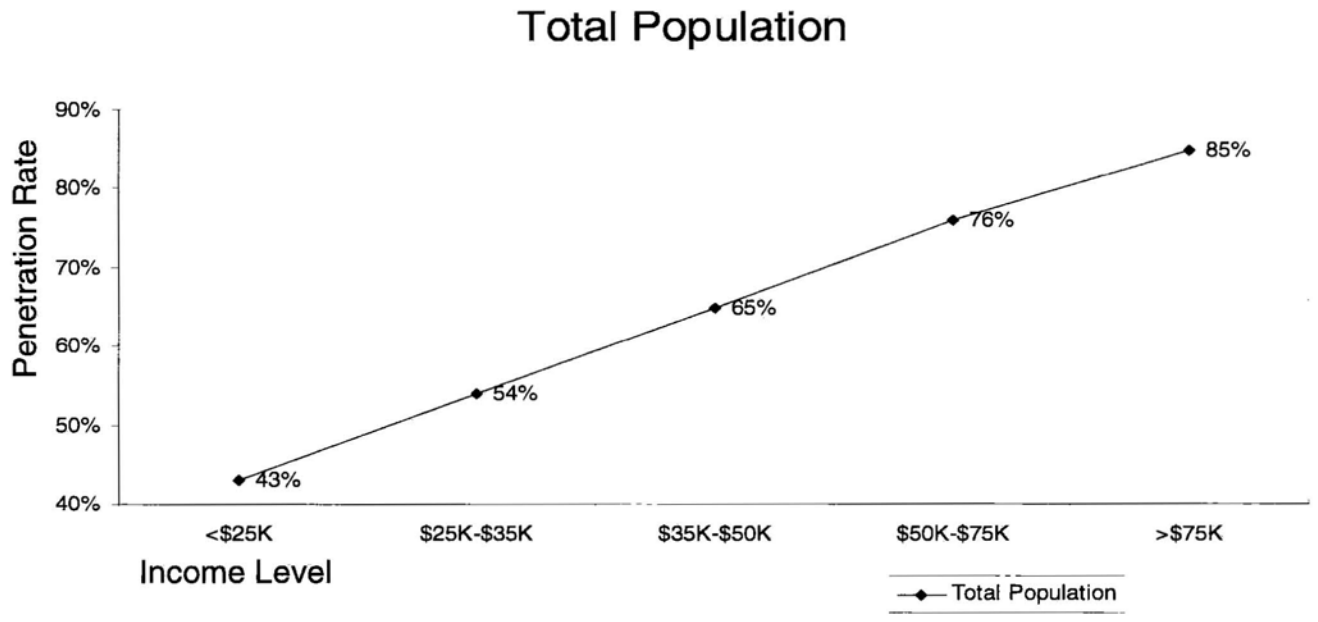
Customer Satisfaction

- Recognized in 2005 by J.D. Power and Telephia for outstanding customer satisfaction and care.
- 92% overall customer satisfaction.[1]
  - 72% recommend to friend or family member.
  - One-half live in household with other Virgin user.
  - 99% using text messaging are satisfied with the service.

[1] MSI Survey of Virgin Mobile Customers, Q4, 2004
Source: Virgin Mobile management

2. Facts About the Prepaid Market

- Most wireless operators focus on high-income subscribers because subscription to wireless services is highly-dependent on income level:



- Many prepaid customers are lower-usage, lower-income consumers.
- Lower-income consumers receive advantages from prepaid service: access to mobile services, value for their money, and access to emergency services on wireless devices.
- Prepaid services have expanded the availability of wireless services to customers not otherwise able to access wireless service.

3. Overview

- Virgin Mobile supports USF reform to decrease USF contribution obligations from <u>all</u> carriers while preserving the viability of the USF.
- Carriers should be permitted to contribute to USF based on their actual revenue.
- Connection-based solutions discriminate against providers of prepaid wireless services.
  - Connection-based USF reform proposals would constitute a regressive regime that disproportionately harms lower-income, prepaid customers with lower usage.
  - If the FCC does adopt a connection-based approach, it should provide alternatives for prepaid wireless providers:

    Charge $0.75 connection fee only to "Active Prepaid Handsets" - those generating more than $30 voice ARPU.

    USF fee waived for prepaid handsets with revenue less than $30.

4. Effect of USF Obligations on Lower-Income, Lower-Usage Customers

- Unlike local telecommunications services, demand for wireless services, especially prepaid services, is highly elastic: as prices increase, demand falls.
- Lower-income, prepaid customers are particularly sensitive to the adverse impact of higher USF contribution obligations.
  - Increased USF contribution rates may cause lower-income, prepaid customers to drop their wireless phone service altogether. (Many VMU customers are new to wireless.)
- Regulatory policies should spur increased wireless usage rates among lower-income consumers to drive overall wireless penetration higher.

5. Effect of USF Obligations on Virgin Mobile

- Increasing USF contribution obligations threaten innovative business models, especially prepaid wireless services.
  - Currently, Virgin Mobile does not pass-through regulatory fees and taxes to most customers. As a result, Virgin Mobile must build regulatory fees and taxes into its cost structure.
  - In contrast, postpaid wireless carriers pass through USF fees.

    The burden of increased USF contributions on postpaid carriers, therefore, is partially offset by the corresponding increase in revenue.

- USF obligations impair the range of pay-as-you-go wireless service for the lower-income customers it was designed, in part, to benefit.

6. USF Contribution Base

- The current pool of contributors cannot satisfy the increasing demands placed on the USF. Large classes of carriers are exempt from USF contribution obligations.
- VMU supports elimination of the exemption for VOIP (wireline and cable) services.
  - As VOIP usage grows, USF contribution base decreases accordingly, requiring increased contributions from existing contributors to cover shortfall.
  - VOIP revenue will increase while traditional telecommunications providers face a concomitant decline.

7. USF Contribution Level

- Virgin Mobile has no fundamental objection to increase in wireless safe harbor.
- Carriers should continue to be permitted to base their USF contributions on their actual interstate revenue.
  - The FCC has historically preferred contributions based on actual carrier revenues rather than a safe harbor percentage.
  - Providing carriers with the flexibility to contribute based on actual revenues is consistent with Section 254(d) of the Act.

8. Connection-Based Solutions Adversely Affect Prepaid Providers

- Lower-income, prepaid customers would pay a disproportionate amount of a $1/month/connection USF fee.

  Hypothetical postpaid subscriber with $58 ARPU.
  - $1 fee = 1.7% of monthly bill.

  Hypothetical prepaid customer with $24 ARPU.
  - $1 fee = 4.3% of monthly bill.
  - Many VMU customers have less than $10 in ARPU.

- Connection-based proposals would require lower-income, prepaid customers to pay into the USF - <u>even if they had no interstate usage in a given month</u>.
- Prepaid providers would have to recover costs and fees through increased rates or assess a surcharge upon customers.

- **A connection-based approach would be a regressive tax that would place a disproportionate burden on lower-income, prepaid customers, forcing them to subsidize higher-income, higher-volume users.**

9. Alternative Connection-Based Solutions

- If the Commission does adopt a connection-based solution, it should take into account the discriminatory effect that a connection-based approach would have on providers of prepaid wireless services and lower-income, low-usage customers.
- Option to reduce the discriminatory burden:
  - Impose $0.75 connection fee only on "Active Prepaid Handsets"

    generate at least $30 carrier voice revenue in a month; and,

    make at least one interstate call in a month for which the fee is due.
- The FCC waives other regulatory fees for low-income customers:
  - Subscriber line charge.
- Other carriers (e.g., Verizon Wireless and T-Mobile) support alternative approaches similar to Virgin Mobile's.

10. Conclusions

- Fundamental reform is vital to achieving the pro-consumer and pro-competitive goals of the USF system.
- Reform should expand the base of contributors to increase USF revenue (problem only increases as VOIP usage grows):
  - Include VOIP (wireline and cable) providers.
- Carriers should be permitted to base USF contributions on actual revenues.
- Any connection-based solution should take into account the discriminatory effect on providers of prepaid wireless services and their lower-income, lower-usage customers:
  - Impose $0.75 connection fee only on Active Prepaid Handsets.
  - USF fee waived for prepaid handsets with less than $30 in revenue.