Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Cellular Telephone & Internet Association's	)	WT Docket No. 05-194
Petition for Declaratory Ruling Regarding	)	
Early Termination Fees in Wireless Service	)	
Contracts	)	

WRITTEN TESTIMONY OF PATRICK W. PEARLMAN
ON BEHALF OF NASUCA
EN BANC HEARING, JUNE 12, 2008

Good morning, Chairman Martin and Commissioners. My name is Patrick W. Pearlman. I am a Deputy Consumer Advocate with the Consumer Advocate Division of the West Virginia Public Service Commission and I am appearing on behalf of the National Association of State Utility Consumer Advocates ("NASUCA"), of which my office is a member. I am a member of NASUCA's Telecommunications Committee and one of the team of attorneys that drafted and filed written comments on NASUCA's behalf in this proceeding. I have also prepared a number of ex parte submissions from NASUCA to the Commission in this proceeding. On behalf of myself and over 40 other consumer advocates' offices, and the consumers we represent, I thank you for the opportunity to appear before the Commission in order to offer testimony expressing NASUCA's views on the matters presented by the Cellular Telephone & Internet Association's ("CTIA") petition, as well as other issues relating to early termination fees ("ETFs").

I. INTRODUCTION.

Early termination fees are commonly charged by wireless carriers when customers cancel service contracts before the expiration of the service term. The issue cited originally – and still – before the Commission in this proceeding is whether, under Section 332(c)(3)(A) of the Federal Communications Act, state laws that apply to wireless ETFs regulate "other terms and conditions of" commercial mobile radio service ("CMRS"), or whether such laws regulate "rates charged by" CMRS providers and are therefore prohibited under that section of the Act. I say "originally" because, over the past year or so, other issues have been raised in conjunction with this proceeding that members of the Commission have suggested they would like to consider, namely: (1) whether the Commission should promulgate regulations that would apply to wireless carriers' ETFs and related business practices; and (2) the growing use of ETFs in other communications industries subject to the Commission's jurisdiction, such as cable operators, broadband service providers and providers of IP-enabled communications services.

NASUCA's comments in this proceeding have, to-date, been almost entirely focused on the issue of preemption presented by CTIA's March 15, 2005 petition for declaratory ruling that was the subject of the Commission's May 2005 public notice.. Rather than try to summarize all the arguments NASUCA has submitted in its extensive comments filed with the Commission in response to CTIA's petition, I would like to focus my testimony on a couple of critical points in those materials that are probably most pertinent to today's hearing. Beyond the question of preemption, which has already been the subject of extensive comment and debate, the focus of NASUCA's testimony today addresses several critical points the Commission is considering in this hearing, such as whether to adopt standards limiting wireless carriers' ETFs and whether the spread of ETFs to other sectors of the communications industry is a cause for concern.

II. THERE IS NO BASIS FOR PREEMPTING STATE LAWS APPLICABLE TO ETFs.

As set forth more fully in NASUCA's comments and written submissions in this proceeding, the Commission must conclude that the application of state laws to wireless ETFs is not preempted by section 332(c)(3)(A) of the Act but rather is allowed under the states' authority to regulate "other terms and conditions" of wireless service that Congress expressly preserved. That ETFs are not rates but part of the "other terms and conditions" is shown by the manner in which wireless carriers describe ETFs in their marketing materials and service contracts, typically buried in the fine print and segregated from the description of charges consumers pay for actual service. Moreover, this conclusion is consistent with the plain and ordinary meaning of "rates," as understood and accepted in public utility law and previously articulated by the Commission. The legislative history of the 1993 amendments to Section 332(c)(3) of the Act compels the conclusion that state regulation of ETFs falls within the "other terms and conditions" of wireless service that are within states' authority to regulate rather than "rates" regulation that Section 332(c)(3) largely prohibits them from regulating.

When Congress amended the Act in 1993 to include the preemption provisions of Section 332(c)(3)(A) of the Act, it did not define the relevant phrases "rates charged by" or "other terms and conditions of" CMRS. But while it may not have provided a statutory definition of these terms, Congress did provide a detailed description of the matters that fell within "other terms and conditions" of CMRS that are subject to laws and regulations enacted by states. The matters described by Congress in the legislative history of the 1993 amendments to Section 332(c)(3) make it crystal clear that the scope of matters subject to state authority was meant to be broadly defined, in contrast to the correspondingly narrow scope of preempted "rates" regulation:

> It is the intent of the Committee that the states would still be able to regulate the terms and conditions of these services. *By "terms and conditions," the Committee intends to include such matters as* customer billing information and practices and billing disputes and other consumer protection matters; facilities siting issues (i.e., zoning); transfers of control; *the bundling of services and equipment*; and the requirement that carriers make capacity available on a wholesale basis or such other matters as fall within a states lawful authority. *This list is intended to be illustrative only and not meant to preclude other matters generally understood to fall under "terms and conditions."*[1]

One matter that Congress expressly included within the scope of "other terms and conditions" of CMRS that states may continue to regulate is particularly relevant to the question presented by CTIA's petition, namely "the bundling of services and equipment" by wireless carriers. In its petition, CTIA admitted several times that wireless carriers employ ETFs to subsidize the costs of equipment and other accessories that are bundled together with a wireless customer's service. For example, CTIA's petition noted that:

> - An ETF is "an amount of money that the customer agrees to pay a wireless provider for the services *and equipment* previously provided by the carrier;"[2]
>
> - Wireless carriers' costs for acquiring new customers are significant because those costs "include the costs of *subsidizing goods and accessories*, including handset rebates and discounts;"[3]
>
> - ETFs enable carriers to offer customers "lower up front costs in exchange for a commitment to a term contract," and that "the longer

[1] H.R. Rep. No. 103-111, 103rd Cong., 1st Sess. (1993) *reprinted in* 1993 U.S.C.C.A.N. 378, 588, LEXSEE 103 H. Rpt. 111, at 4 (1993) (emphasis added).

[2] CTIA Petition at 11 (emphasis added).

[3] *Id.* at 12 (emphasis added).

> assured commitment under these term contracts enables the carriers *to reduce handset prices*."[4]

Other wireless carriers, in comments supporting CTIA's petition in this proceeding, likewise openly admitted that ETFs are part and parcel of their practice of bundling wireless service and equipment.[5]

Nor are the wireless industry's admissions limited to this proceeding; they have also been made to federal courts in the context of preemption arguments. For example, in a brief filed with the United States Court of Appeals for the Eighth Circuit, CTIA noted that wireless carriers enter into term contracts coupled with ETFs in order to provide wireless equipment at heavily discounted prices.[6] In that brief, CTIA further noted that term contracts and ETFs were endorsed by the Commission in its 1992 order concluding that "subsidizing wireless phones in this way 'is an efficient promotional device which reduces barriers to new customers.'"[7] Likewise, T-Mobile, which participated in this

[4] *Id.* at 15 (emphasis added).

[5] *See* Verizon Wireless Comments at 15 (fixed-term plans depend on ETFs to allow carriers to offer a substantial subsidy to offset the price of new handset equipment); Cingular Comments at 6 (ETF-supported term rate plans allow carriers to recoup expenses associated with customer acquisition and reduced handset prices); Dobson Comments at 2 (fixed long-term arrangements coupled with ETFs allow the carrier's handset subsidy to be amortized over a long term); Nextel Comments at 4-5 (in order to provide competitive offerings, Nextel bundled equipment and rate plans that included service agreements with an ETF); Sprint Comments at 2-3 (term plans, which include ETFs, allow customers to get free or heavily discounted phones and lower prices during the term); T-Mobile Comments at 5 (plans that include ETFs allow customers to be offered handsets or accessories at low or no cost and reduced rates for service).

[6] *See Cellco v. Hatch*, No. 04-3198, Brief for amicus CTIA at 12-13 (8th Cir., filed Nov. 12, 2004).

[7] *Id.* at 12, *citing In re Bundling of Cellular Customer Premises Equipment and Cellular Service*, Report and Order, 7 F.C.C.R. 4028, 4030 (1992) ("*Cellular Bundling Order*"); *see also id.* at 4029, ¶10 (discussing fixed term contracts).

proceeding, made the same concession to the United States Supreme Court in a petition for certiorari recently filed with the Court.[8]

CTIA's reference in its *Cellco* brief to the Commission's 1992 *Cellular Bundling Order* drives home a significant point – namely that, when adopting Section 332(c)(3)(A), Congress was fully aware of the wireless carriers' practice of bundling equipment and service together, and the central role ETFs played in furthering that practice. The Commission's *Cellular Bundling Order* was released on June 10, 1992 – over a year before Congress amended Section 332(c)(3)(A). As NASUCA noted earlier, by specifically including the practice that is the subject of CTIA's petition (*i.e.*, bundling equipment and service) within the matters it defined as "other terms and conditions" of CMRS, the ETFs that wireless carriers admit are central to that practice of necessity fall within the scope of matters states may continue to regulate after 1993.[9] Any other

[8] *See T-Mobile USA v. Laster*, No. 07-976, Petition for certiorari, pp. 6-7 (filed Jan. 23, 2007) ("Wireless service and phones often are sold together in 'bundled' transactions, in which consumers receive a free or significantly discounted phone in exchange for agreeing to wireless service contracts for a term of one or two years."); *available at* http://www.scotusblog.com/wp/wp-content/uploads/2008/05/07-976_pet.pdf. The Court ultimately declined to review the case.

[9] *See, e.g.*, *Cellular Bundling Order*, 7 F.C.C.R. at 4029 ("Finally, *insofar as bundled offerings of cellular CPE and cellular service require that customers obtain service from a specified carrier for a fixed term*, we asked whether such agreements might be discriminatory or be used to eliminate competition within the cellular market.") (emphasis added); *id*. at 4030 ("Finally, the record reveals that *an integral part of any packaged offering of cellular CPE and service is the mandatory service requirement*. As we noted in the Notice, carriers can use the minimum service commitment as a vehicle for predatory pricing or other anticompetitive conduct only if they can eliminate competition and monopolize the cellular market. . . . There is no evidence that this has occurred or is even possible, particularly because the minimum service periods of three months to one year, identified by evidence in the record, are relatively short.") (emphasis added).

conclusion would be in contravention of Congress' "clear and manifest" intent not to preempt state authority to regulate such matters.

NASUCA emphasizes this point for two reasons. First, to impress upon the Commission the need to consider and implement the clear intent of Congress, expressed in the legislative history of Section 332(c)(3), on this issue. And second, to point out the fact that, insofar as NASUCA can discern, not a single wireless carrier in this proceeding has bothered to discuss the legislative history of the 1993 amendments to 47 U.S.C. § 332(c)(3), let alone rebut NASUCA's reading of that history. While the wireless industry may choose to ignore Congress' clearly expressed intent, the Commission cannot.

III. ADOPTING STANDARDS GOVERNING ETFs BEFORE REEXAMINING THEIR ECONOMIC JUSTIFICATIONS AND EFFECTS ON COMPETITION WOULD BE UNWISE AND LIKELY ARBITRARY.

Next, NASUCA will address another issue that has been the subject of much press of late, namely that the Commission may be considering adopting standards regulating, to some extent, wireless carriers' ETFs.[10] Press accounts typically indicate that such standards are being considered as some sort of *quid pro quo* for preempting states' authority over wireless ETFs, and that this "deal" has been shopped around to certain consumer groups. With regard to these press accounts, there are two initial points that NASUCA must address.

First, NASUCA has not been approached with such a proposal and thus has no basis upon which to assess the accuracy of the press accounts or the parameters of such a proposal. Second, and more importantly, NASUCA is opposed to the notion of accepting

[10] *See, e.g.*, John Dunbar, "FCC Chief Wants Cell Phone Cancellation Fees Regulated," Associated Press (May 23, 2008); available at http://ap.google.com/article/ALeqM5hFmVAv-IB4T3cDSapIMM3NMf-lWAD90RG9100.

the preemption of state laws that may be asserted to protect consumers from unreasonable wireless ETFs and related business practices, in exchange for some degree of federal regulation ameliorating, perhaps, some of the more egregious aspects of such fees. NASUCA's position, and that of its individual members, has been consistent and well-known throughout this proceeding.

While NASUCA is opposed to any effort to preempt the authority Congress clearly intended states to continue to exercise in the 1993 amendments, NASUCA is not necessarily opposed to the promulgation of federal standards regulating wireless carriers' ETFs and other business practices related to such fees in the absence of such preemption. Federal standards governing wireless ETFs may provide some protection against unreasonable, unfair, deceptive or misleading business practices from which consumers in a few states or U.S. territories may not presently be protected. Moreover, such standards may promote consumers' ability, in a competitive marketplace, to reap the benefits of competition by being able to shop for the best price and best quality service. To coin an oft-repeated and usually inaccurate phrase, such standards may well represent a "win-win" situation for American consumers. Of course, all this depends on the standards that are actually proposed, the mechanisms and resources dedicated to their enforcement and the willingness of federal government to enforce those standards. Quite frankly, NASUCA's experience – and that of countless individual consumers – with federal enforcement efforts cautions against optimism.

However, adopting federal regulations governing ETFs without first re-examining their economic and public interest justifications would be unwise, if not arbitrary, action on the Commission's part. There is a fundamental question the Commission must address before moving on to establishing limits on ETFs or related practices, namely whether ETFs are reasonable or justified in the first place. The wireless industry no doubt would like to skip over this particular issue in promoting the notion that prorating current ETFs is the cure for consumers' malady. The Commission, however, must not and cannot ignore this issue. Only after the Commission satisfies itself that wireless carriers' ETFs are economically justified, and reasonable from a public policy standpoint, should the Commission proceed to consider such standards in the proper procedural context.

A. THE ECONOMIC JUSTIFICATIONS FOR, AND EFFECTS ON COMPETITION OF, ETFS FIRST NEED TO BE MORE CLOSELY EXAMINED.

In considering formulae for prorating ETFs, the Commission is acting upon an assumption that such fees are justified in the first place, an industry proposition that is all too often accepted by government officials as fact without ever having been demonstrated as true. Before the Commission adopts any formula for prorating ETFs, it must determine whether ETFs are economically justified and serve the public interest, something the Commission has not done to-date. The Commission has not seriously examined the fundamental rationale for wireless ETFs since its 1992 *Cellular Bundling Order* and, quite frankly, even in that Order the Commission's analysis regarding ETFs was virtually non-existent.

In response to CTIA's petition in this proceeding, NASUCA urged the Commission to re-examine the economic and policy justifications underlying its 1992 decision approving wireless carriers' bundling of service and equipment. NASUCA cited abundant evidence that wireless customers are dissatisfied with carriers' widespread use of ETFs and noted that the wireless industry – and wireless market – has changed dramatically since issuance of the *Cellular Bundling Order*.[11] For example, in 1992 there were only 11 million wireless users nationwide[12] and there was little evidence of consumer harm or dissatisfaction associated with lengthy service contracts coupled with ETFs. Indeed, when the FCC issued its *Cellular Bundling Order*, most cellular carriers' service contracts were usually for terms of less than one year.[13] Today, there are over 260 million wireless users in the United States, many carriers utilize one- to two-year minimum service contracts that are often extended for minor changes in service, and the Commission and states receive thousands of complaints regarding such practices each year.[14]

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[11] NASUCA Comments, pp. 32-34; NASUCA Reply Comments, pp. 27-28.

[12] *See* Wireless Competition Bureau, Federal Communications Commission, *Twelfth Annual CMRS Report*, Table A-1 (Feb. 2008) ("*12th CMRS Report*").

[13] *See Cellular Bundling Order*, 7 F.C.C.R. at 4029, ¶12.

[14] The thousands of individual comments from consumers received by the Commission in this and other Commission proceedings provides ample evidence of consumers' widespread dissatisfaction with wireless ETFs. The problems identified by Debra Edwards in her now-withdrawn cross-petition for declaratory ruling in WT Docket No. 05-193, which involved issues virtually identical to those raised in this proceeding, are symptomatic. Ms. Edwards' state court class action lawsuit against SunCom alleged that the wireless carrier imposed, or sought to impose, ETFs on customers long after their term contracts expired. *See In re: SunCom Operating Company, LLC's Petition for Declaratory Ruling*, Opposition and Cross-Petition of Debra Edwards, WT Docket No. 05-193, pp. 8 & 12 (filed March 4, 2005). Likewise, in *Beckermeyer v. AT&T Wireless*, 69 Pa. D. & C.4th, 2004 Pa. D. & C. 117 (Common Pleas Court, Oct. 22, 2004), the complaint focused on both AT&T's and Panasonic's refusal to provide the plaintiff with information necessary to program his handset to operate on another carrier's network, despite the fact such changes could readily be made by changing the system operator code. These sorts of matters exemplify the problems that the Commission indicated would prompt it to reconsider its 1992 order. *See Cellular Bundling Order*, 7 F.C.C.R. at 4030, ¶18 ("Nevertheless, if in the future, it comes to our attention that carriers' exclusive distribution agreements with CPE manufacturers are resulting in anticompetitive abuse, we will not hesitate to revisit this area."); *id.* at 4035, ¶31 ("While we recognize the customer benefits of CPE discounting as a part of the sale of cellular service, we intend to monitor the bundling of cellular service and cellular CPE. Our continuing interest is based on our intention that bundling not be used anticompetitively. If parties can

Moreover, as NASUCA pointed out, the economic and policy assumptions that may have justified the Commission's *Cellular Bundling Order* have radically changed since 1992. The telecommunications industry, including wireless, is widely recognized as a declining cost industry.[15] Furthermore, the wireless industry has become increasingly concentrated in the hands of a few carriers and equipment manufacturers.[16]

Recognizing these dramatic changes in the wireless market, both NASUCA and the National Association of Regulatory Utility Commissioners ("NARUC") adopted resolutions last year, calling on the Commission to take a fresh look at the economic and public policy assumptions upon which the 1992 *Cellular Bundling Order* was based. Copies of those resolutions are attached to NASUCA's testimony as Attachments 1 and 2.

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demonstrate that carriers' incentive offerings lead to anticompetitive abuses, the Commission will be open to further action.").

[15] *See, e.g., Cellular Bundling Order*, 7 F.C.C.R. at 4031, ¶23 n.39.

[16] The Commission's own reports make clear the degree to which the wireless service market has become increasingly concentrated in the hands of a few carriers. According to its latest report on wireless competition, the top five carriers (AT&T Mobility, Verizon Wireless, Sprint Nextel, T-Mobile and Alltel, including carriers recently acquired by these five) controlled 84% of the wireless market. *See 12th CMRS Report*, Table A-4. The market looks like it will only become increasingly concentrated, with Verizon Wireless' recent announcement that it intends to acquire Alltel, reducing the number of major carriers to four and giving Verizon Wireless alone a 28% share of the wireless market. *See* Marguerite Reardon, "Verizon Wireless To Buy Alltel," *C/Net News* (June 5, 2008); available at http://news.cnet.com/8301-10784_3-9960664-7.html.

The wireless equipment market is similarly, though marginally less, concentrated. For example, in 2005, Strategy Analytics estimated that Nokia has a 32.2% share of the worldwide wireless market, while Motorola has an 18% share and Samsung holds 13% of the market. In other words, three handset manufacturers hold over 63% of the market. Three other manufacturers (LG Electronics, Samsung and Sony Ericsson) accounted for another 17% of the market. *See* Mike Dano, "Biggest Handset Makers Take More Market Share," *RCR Wireless News* (July 28, 2005).

In addition, testimony and sworn declarations submitted by economists in this proceeding and in pending state court proceedings suggest that the Commission is on shaky ground if it continues to simply assume, without adequate empirical support, that wireless ETFs are justified (if they ever were), from either an economic or public policy perspective. For example, in this proceeding, economists Allen Rosenfeld and Lee Selwyn have both submitted declarations raising serious questions about the validity of the economic justifications or benefits advanced by wireless carriers in support of ETFs.[17]

In addition, Dr. Selwyn recently testified in a class action lawsuit against Sprint Nextel in California state court regarding the economics of Sprint Nextel's ETFs and related practices. Among other things, Dr. Selwyn testified that the average wholesale cost of a wireless handset in 2006 was $115, according to the U.S. International Trade Commission, while the average retail price of a handset in 2006 was $65.67, according to CTIA. Dr. Selwyn's analysis suggested that, after adding Sprint's $35 service activation fee to the $65.67 average handset price paid by consumers, Sprint's average handset subsidy amounted to only $14.33 – or approximately 1/14th of Sprint's current $200 ETF.[18] Dr. Selwyn's analysis further undermined assertions by Sprint and other wireless carriers that the carriers "give away" some handsets. Dr. Selwyn concluded that it was reasonable to assume that Sprint's $35 activation fee exceeded its out-of-pocket cost for

[17] *See* USPIRG ex parte, Declaration of Allen Rosenfeld (July 6, 2006); Wireless Consumers Alliance ex parte, Declaration of Lee L. Selwyn (May 11, 2006).

[18] *See Ayyad, et al. v. Sprint Spectrum, L.P.*, Case No. RG03-121510 (Cal. Super. Ct., Alameda County), Reporter's Transcript of Proceedings, pp. 399-404 (May 22, 2008). A copy of the relevant portions of Dr. Selwyn's testimony is provided as Attachment 3.

lower-end handsets purchased at wholesale prices and thus allows Sprint to turn a profit on its activation fee alone.[19]

Further, Dr. Selwyn calculated that Sprint's profit margin on its contractual – as opposed to optional – service was roughly $0.70/month, meaning that Sprint lost approximately $9.24 in revenue using the carrier's estimate of the average number of months remaining (13.2) when its customers terminate service early.[20] Using this figure, Dr. Selwyn calculated that the total revenue losses associated with the 1.9 million class members who terminated service amounted to roughly $17.6 million. At the same time, Dr. Selwyn noted, Sprint charged those customers $283 million in ETFs – roughly 13-14 times the carrier's actual losses stemming from the customers' early termination of service.[21]

While the wireless industry no doubt will ignore or downplay this data, the Commission must not. Given the Commission's express commitment to review its *Cellular Bundling Order* should new information come to light, such figures compel a much closer examination by the Commission of the economics of wireless ETFs, something it has not heretofore done.

Likewise, evidence of the anticompetitive effects of wireless carriers' ETFs serves as another, independent but related basis for taking a hard look at these fees. In their declarations filed with the Commission, both Drs. Rosenfeld and Selwyn examined the effect ETFs had on wireless carriers' customer "churn" rates – which in turn reflects

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[19] *Id*. at 404-05.

[20] *Id*. at 442-52.

[21] *Id*. at 452-53.

the relative freedom consumers have to seek the wireless service that best fits their needs in terms such as cost and quality. Dr. Rosenfeld noted, for example, that much of the churn rates experienced by the wireless industry (18-42% annually) were accounted for by customers who switched carriers when their service contracts expired. Dr. Rosenfeld concluded that the annual churn rates would have been significantly higher if ETFs had not deterred customers still under contract from switching.[22]

Dr. Rosenfeld's findings corroborate those found in surveys conducted by both the U.S. Public Interest Research Group ("USPIRG") in August 2005, and by the Government Accountability Office ("GAO") in April 2003. USPIRG's survey[23] found that ETFs were a substantial factor in reducing voluntary "churn" by wireless customers. For example, USPIRG found that only 10% of wireless customers paid an ETF during the preceding three years (2002-2004), meaning that if one assumes a customer would pay such a fee only once during that period, only about 3% of wireless customers per year pay the fees to change service – substantially less than the overall annual churn rates identified by the FCC.[24] Based on this survey result and an estimated weighted average

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[22] USPIRG ex parte, Rosenfeld Declaration, pp. 6-8.

[23] Edward Mierzwinski, "Locked in a Cell: How Cell Phone Early Termination Fees Hurt Consumers," *MASSPIRG Education Fund Report* (August 2005); available at http://www.masspirg.org/uploads/DK/Ji/DKJih9bWf5ElRF9_MDigzQ/_Locked_In_A_Cell_.pdf. The survey was actually conducted by IPSOS North America, a nationally-recognized polling firm.

The Commission's own reports corroborate – though in understated fashion – the findings of the GAO, USPIRG and Drs. Selwyn and Rosenfeld. In its most recent report on the status of competition in the wireless market, the Commission noted that wireless "[p]roviders have been attempting to differentiate themselves through exclusive arrangements to reduce churn" and that "ETFs may also be a way to reduce churn" and are used "to curb contract cutting." *12 CMRS Report*, p. 85, ¶188.

[24] *See 12th CMRS Report*, p. 84, ¶187.

early termination fee of $170 per phone (during the time period in question), USPIRG estimated that wireless customers paid approximately $837 million dollars a year in ETFs.[25] Moreover, the USPIRG study found that 36% of survey respondents indicated that they considered switching carriers during the term of their contracts but were discouraged from doing so by their carrier's ETF.[26] Similarly, in a survey appended to the GAO's 2003 study, 28% of respondents indicated that, at some point, they had wanted to change wireless carrier but did not – and of these respondents, 70% indicated that the ETF imposed by their wireless carrier was either a "very important" or a "somewhat important" factor in deciding not to switch.[27]

Dr. Selwyn's recent testimony in the California class action suit against Sprint likewise showed a strong correlation between the carrier's ETF and reduced customer churn. In his testimony, Dr. Selwyn noted that Sprint reported in its 2002 10-K report to the Securities and Exchange Commission ("SEC") that its monthly churn rate first increased dramatically (from 2.6% to 3.3%), after it loosened its credit and deposit standards to attract lower end customers, but then decreased just as sharply (from 3.3% to 2.7%) after it began enforcing its ETFs much more rigorously, among other things.[28]

Finally, in its 2005 study, USPIRG offered a basis to quantify the enormous anticompetitive costs that ETFs have imposed on wireless customers in the United States.

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[25] "Locked in a Cell," p. 14.

[26] *Id*. at 19.

[27] Report to Congressman Anthony Weiner, "FCC Should Include Call Quality in Its Annual Report on Competition in Mobile Phone Services," GAO-03-501, Appendix II, Results of Survey on Mobile Phone Service, Qts. 23-24 (April 2003).

[28] *See Ayyad v. Sprint Spectrum,* Reporter's Transcript of Proceedings, pp. 405-414 (May 22, 2008).

Based on its survey results and estimated costs associated with those customers who , actually paid ETFs, those who did not switch carriers because they could not afford the ETFs, and those customers who did not switch carriers because the ETFs exceeded any benefit of switching, USPIRG calculated that ETFs cost American wireless consumers over $4.6 billion from 2002 through 2004 alone.[29]

No doubt the wireless industry will disagree with the findings and analysis contained in the foregoing materials and can offer, as Verizon Wireless has in this proceeding,[30] contrary findings and conclusions of their own economists. That there is conflicting data or analyses is not the issue, however. The issue is that there are clearly genuine and serious questions regarding the economic justification for wireless ETFs in the first place. There are also genuine and serious questions regarding the effect of ETFs on consumers' ability to make competitive choices between carriers based on price and quality. Again, the Commission has not seriously studied these questions in the sixteen years since its *Cellular Bundling Order*. It is high time for it to do so, and certainly it is appropriate to study these questions before adopting any proration formulae or standards based on untested assumptions.

In short, the Commission is "buying a pig in a poke" if it simply concludes that it is enough to adopt some proration of current ETFs without first satisfying itself that ETFs are reasonable and justified in the first place. Prorating a $200 ETF over a wireless service contract's term, according to some formula adopted by the Commission, does neither the consumer nor the market any good if the $200 ETF is not economically

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[29] *Id*. at 18-21.

[30] *See* Verizon Wireless ex parte, Declaration of Jerry Hausman (Oct. 25, 2005).

justified in the first place. If, and only if, wireless carriers demonstrate that their current ETFs and related practices are economically justified and that the need for such fees outweighs their negative effects on consumer choice in a competitive market, should the Commission consider moving on to the question of setting standards governing ETFs or any scheme for prorating those fees. By no means are we there yet.

With regard to preserving consumer choice in a competitive market, NASUCA offers one final point, namely the anti-consumer, anti-competition synergy that results from coupling ETFs with wireless providers' and wireless equipment manufacturers' practice of "locking" handsets and thereby forcing consumers to buy new equipment every time they change carrier. Handset "locking" simply raises the bar that much higher for consumers already faced with steep wireless ETFs. For that reason, NASUCA supported Skype Communications' petition to apply the *Carterphone* decision to the wireless industry.[31] Any serious effort to eliminate the barriers that stand in the way of consumers reaping the full benefits of a competitive wireless market therefore must also address handset "locking."

B. IN ANY EVENT, THIS PROCEEDING IS NOT THE PROPER VEHICLE FOR ADOPTING FEDERAL STANDARDS GOVERNING ETFS.

Regardless of any possible benefit to consumers that may result if the Commission adopts standards limiting, to some extent, wireless carriers' ETFs, this proceeding is not an appropriate vehicle for such action by the Commission. In its May 1, 2008 *ex parte* submission to the Commission, Verizon Wireless expressed its view that the Commission cannot, at present, adopt any standards or regulations in this proceeding

[31] *In re Skype Communication S.A.R.L.,* Petition to Confirm a Consumer's Right to Use Internet Communications Software and Attach Devices to Wireless Networks, RM-11361 (Feb. 20, 2007); *see also* n. 14, *supra*, discussing *Beckermeyer*.

because such action would amount to a rulemaking that has not been the subject of public notice and comment.[32] On this point, at least, NASUCA and Verizon Wireless agree.[33]

The Commission cannot adopt any rules associated with wireless carriers' ETFs until after it initiates a proper rulemaking proceeding and provides public notice thereof. The Commission's public notice issued in response to CTIA's petition makes it clear that this proceeding is limited to the issue of whether, under Section 332(c)(3)(A) of the Act, ETFs are "rates charged by" wireless service providers and therefore not subject to state regulation, or whether ETFs constitute "other terms and conditions of" wireless service expressly subject to continuing state authority.[34]

Standards or regulations governing wireless carriers' ETFs and business practices relating to these contractual penalties would be legislative rules that may only be adopted by the Commission *after* providing adequate public notice of its proposed rules and a meaningful opportunity for public comment on those rules, in accordance with the Administrative Procedure Act.[35] Nor does the public notice of this hearing give the public adequate notice and opportunity to comment upon any standards or rules governing wireless ETFs. Furthermore, adoption of federal standards governing wireless ETFs under the circumstances of this proceeding cannot be considered the "logical outgrowth" of CTIA's petition since the development or adoption of such standards does not logically flow from the issue whether such fees are "rates" or "other terms and conditions" of wireless service under Section 332(c)(3)(A).

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[32] Verizon Wireless ex parte, pp. 3-5 (May 1, 2008).

[33] *See* NASUCA ex parte, pp. 3-4 (May 20, 2008).

[34] *See* Public Notice, DA 05-1389 (May 18, 2005).

[35] *See, generally*, 5 U.S.C. § 553.

Finally, as Verizon Wireless has noted, any standards that the Commission might adopt would apply only prospectively and would not serve as a basis for retroactive liability of wireless carriers.[36] NASUCA agrees but notes that, by the same token, any standards that the Commission might adopt should not retroactively shield wireless carriers from liability in ongoing state proceedings.

IV. ETFs IMPOSED FOR OTHER COMMUNICATIONS SERVICES.

The use of ETFs has been spreading rapidly to other sectors of the communications industry, such as cable operators, broadband providers and providers of IP-enabled communications services. Some NASUCA members, such as myself, are not involved in the regulation of cable, broadband or IP-enabled communications services and thus NASUCA's experience with ETFs charged by these entities is somewhat limited. That said, however, there is certainly growing cause for alarm.

There is a growing body of information indicating that ETFs are becoming increasingly popular among cable operators, Internet service providers, and IP-enabled services providers.[37] Chairman Martin himself has expressed concerns regarding the

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[36] Verizon Wireless ex parte, p. 3 (May 1, 2008).

[37] **Broadband service:** *See* John Dunbar, "Pulling Plug on Net Service Not Easy," *USAToday* (April 9, 2007); available at http://www.usatoday.com/tech/techinvestor/industry/2007-04-09-net-fees_N.htm?POE=TECISVA; Bob Williams, "The Next Big Thing in Broadband: Early Termination Fees," *HearUsNow.org* (April 9, 2007) available at http://www.freepress.net/news/22281.

Satellite Television: *See* "DirectTV Will Not Refund Early Termination Fee," *pissedconsumer.com* (April 19, 2008); available at http://directv.pissedconsumer.com/directv-will-not-refund-early-termination-fee-20080419118458.html; "DirectTV Complaint – Bogus Early Termination Fee," My3cents.com (Jan. 11, 2008); available at http://www.my3cents.com/showReview.cgi?id=31934.

spread of ETFs to other communications industries.[38] NASUCA shares such concerns.

Based on its experience with the wireless industry, which apparently is the "model" being followed in these other industries, NASUCA believes that the growing use of ETFs and longer service contracts is driven less by the service providers' need to recover their costs of subsidizing equipment and more by their desire to stymie customers' freedom to seek, in a competitive market, the best price and service for their needs.

Accordingly, just as NASUCA urges the Commission to take a fresh look at the economic justifications and anti-competitive effects of wireless carriers' ETFs in a rulemaking, so it urges the Commission to take an initial look at the same issues in conjunction with other communications providers' growing use of ETFs, also in a rulemaking. In the meantime, the Commission should not interfere with states' and individual consumers' efforts to obtain protection from such practices under existing state laws.

Bundled service: *See* "Comcast Triple Play, Now With 24-Month Contract and ETF," The Consumerist (May 7, 2007); available at http://consumerist.com/consumer/contracts/comcast-triple-play-now-with-24-month-contract-and-etf-258444.php; Phuong Cat Le, "Consumer Smarts: Know what the fine print says about early termination fees," seattlepi.com (April 14, 2008); available at http://seattlepi.nwsource.com/lifestyle/358990_consumer15.html.

[38] *See, e.g.*, Cecilia Kang, "Scrutiny of Phone Fees May Broaden to TV, Internet," *Washington Post*, p. D01 (May 31, 2008); Martin H. Bosworth, "FCC, Congress May Limit Cable, Cell Phone Termination Fees," *consumeraffairs.com* (Sept. 12, 2007); available at http://www.consumeraffairs.com/news04/2007/09/fcc_etc.html.

V. CONCLUSION.

Thank you for your consideration of NASUCA's views regarding these issues. I look forward both to your questions today and to the opportunity to provide further input into future inquiries on these topics.

Respectfully submitted,

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