



Consumer Federation of America



Testimony of

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On behalf of

Consumers Union, Consumer Federation of America, and Free Press

Regarding

“Wireless Innovation and Consumer Protection”

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Telecommunications and the Internet, Committee on Energy
and Commerce

On

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Chairman Markey, Ranking Member Upton, Vice Chairman Doyle and esteemed members of the Committee, thank you for the opportunity to testify again before you on behalf of Consumers Union¹ (non-profit publisher of Consumer Reports), Free Press, and the Consumer Federation of America.

The wireless industry today is gouging consumers with early termination Fees² and impeding innovation by preventing valuable new applications from reaching consumers. We urge this Committee to consider whether some legislative action is necessary to address these issues and help level the playing field for consumers.

Early Termination Fees are ubiquitous in the wireless industry, with some carriers charging as much as \$200 if a customer would like to leave before their (generally two-year) contract is completed. While Verizon has adopted a policy of pro-rating these fees, the other carriers have not even taken this minimal pro-consumer step.

Let me give a few brief examples of how wireless carriers are applying Early Termination Fees. Consumers who buy a family share plan from a wireless company are in for a rude shock if they try to terminate their plan, as each family member will be liable for the full Early Termination Fee. For instance, let's say a family of five wanted to leave for

¹ Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* (with approximately 4.5 million paid circulation) regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions that affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

² In fact, courts in California and elsewhere have found these Early Termination Fees to be illegal in a number of class action lawsuits (to be more precise, the fees were found to be unconscionable "penalties," rather than "damages" which are acceptable for them to charge under the Uniform Commercial Code). The wireless industry wants the FCC and Congress to preempt these lawsuits. But why should the FCC or Congress provide protection when courts are finding that certain carriers in the wireless industry are breaking the law with improper contracts? The object lesson this would provide the industry is that the solution to anti-consumer behavior is not to remedy the behavior, but instead to go seek protection from policymakers.

another carrier with better service. That family could face nearly \$1000 in termination penalties if they haven't completed their two-year contract. This is certainly a strong deterrent to competition.

Another problematic practice is when carriers extend contracts for any change in service plan—whether the change benefits the wireless carrier or not. In other words, if I am a wireless customer and I decide to increase my bucket of minutes, my carrier may automatically extend my contract for another year or two, and saddle me with another Early Termination Fee if I decide to leave before the contract is up.

The wireless industry will claim that their reason for charging Early Termination Fees is because they offer substantial subsidies or discounts to consumers. AT&T's recent release of the iPhone illustrates why this is transparently false. Consumers who purchase the \$600 iPhone—for which they are not likely receiving one dime of subsidy—will still face a penalty of as much as \$175 to end a two-year contract early.

Furthermore, wireless carriers simply do not offer the option to consumers of paying full retail for their phone in order to avoid getting locked into a multi-year contract. So clearly, “subsidy” is no excuse for these Early Termination Fees.

Having lost the “subsidy” fig leaf, the wireless industry then turns to other costs as the reason they must charge the penalties, such as the cost of customer acquisition and the cost of maintaining a network. These are typical costs borne by many other businesses in America, yet other businesses manage to cover such costs from their rate base. Instead, the wireless industry chooses to penalize consumers who may want to change carriers for better service or lower prices. This is nothing more complicated than throwing gravel in the gears of competition.

The wireless industry also professes that Early Termination Fees are in the best interests of consumers, because it helps keep costs down for service as well as for handsets. But we should be skeptical of the industry's claims that consumer welfare is their primary motive—as a recent Wall Street Journal article³ notes, handset manufacturers have been trying to offer consumers services for free on new handsets, but network operators such as AT&T and Verizon have said “no” to those free services because they compete with services that the wireless carriers want to charge for.

According to the article, RIM (which manufactures the Blackberry) wanted to offer a free mapping service to customers who buy the Blackberry, but AT&T said no, because they had a service that they wanted to charge users \$10 a month for.

Another example is Verizon's Worldphone by RIM, which has the capability built in to work on cellular networks in Europe, as well as to work on other GSM networks here in the States. Yet Verizon locks down the device so that they can charge users extra fees for the privilege of phones working as they were actually designed to work. That is, the GSM capability built into the \$600 handset simply won't work unless a user pays Verizon for a more expensive “international plan.” As a user who does a lot of international travel, I don't need their international service plan—I just need my phone to work as it was designed.

Yet another instance of troubling conduct is the slow rollout of mobile phones that also do Wi-Fi—these phones allow consumers to use the Internet when they are near a Wi-Fi Internet “Hotspot.” Most U.S. carriers are not making these phones available to consumers, although T-Mobile is currently offering these handsets. But as the Chairman of

³ Vascellaro, Jessica. “Air War: A Fight Over What You Can Do on a Cell Phone – Handset Makers Push Free Features for Which the Carriers Want to Charge.” Wall Street Journal, June 14, 2007.

the FCC noted in a recent USA Today article,⁴ “[i]nternationally, Wi-Fi handsets have been available for some time, . . . but they are just beginning to roll out here. . . . I am concerned that we are seeing some innovations being rolled out more slowly here than we are in other parts of the world.”

Indeed, in Europe and Asia, wireless consumers have better choices. I can buy a cell phone in London, and simply swap out a small card (called a SIM card) in the back of the phone and it works across any other European network. This decoupling of networks and handsets has created a vibrant European handset market, where manufacturers innovate relentlessly to keep customers loyal. In stark contrast, the U.S. handset market lags European and Asian markets, precisely because wireless operators have the power to dictate which phones will interoperate with their networks, keeping out the competition.

Instead of innovating, the wireless industry has become a cozy cartel of a few dominant providers with limited device offerings. Instead of facing robust competition, these carriers are charging consumers unconscionable Early Termination Fees and deterring consumers from making real choices in the marketplace.

Today I would like to issue three broad challenges to the wireless industry:

1. **Stop charging consumers undue Early Termination Fees.** Early Termination Fees should be eliminated, or no more than the cost of one month’s service. I can get out of a lease for a home or apartment with one month’s rent—why should I be penalized at the cost of nearly half a year’s service to terminate a wireless contract?
2. **Stop crippling mobile phones.** Consumers who pay hundreds of dollars for a new phone should fully expect that phone to do all the things the manufacturer designed it

⁴ Cauley, Leslie. “*New Rules Could Rock Wireless World: Consumers, not carriers, may get to choose devices.*” USA Today, (July 10, 2007).

to do. Network operators who lock down the functionality of mobile phones to better suit their business interests should be scrutinized by the FCC and Congress.

3. **Stop preventing new applications from reaching consumers.** Wireless carriers are locking out competitive applications because they don't want "revenue leakage." This kind of anti-innovation protectionism flies in the face of a century of open communications policymaking.

Wireless Internet services will increasingly become the way that consumers connect to the Internet. If we allow these blatantly anti-consumer, anti-innovation practices to continue, we should expect our international broadband rankings to continue to slide, innovation to be less robust, and our mobile phone markets to continue to lag behind Europe and Asia.

In conclusion, I'll note that the FCC is getting ready to auction off the 700 MHz spectrum, and is rumored to be considering auction rules that would require some degree of openness for devices and applications. This is a positive development and we would encourage the agency to apply that openness not just to a small part of the 700 MHz spectrum. Without open access to the full range of wireless services and devices, consumers will continue to face unfair charges for service modification or termination, inability to use innovative applications, devices that have been hobbled to minimize competition, and other troublesome practices currently used by the dominant cell phone and broadband providers.

At the very least, failing broad openness across 700 MHz, the FCC and Congress need to act to make it easier and less costly for consumers to switch to cell phone providers who offer lower prices and better service.

Mr. Chairman, I'm grateful for the opportunity to testify before your Subcommittee today. Thank you.