

Summary of Testimony of Philip L. Verveer

on

“Wireless Innovation and Consumer Protection”

Subcommittee on Telecommunications and the Internet

Committee on Energy and Commerce

July 11, 2007

The mobile wireless industry is workably competitive and therefore largely deregulated. Its performance, from a consumer perspective, has been very good in terms of price, quality, and innovation. The industry’s performance is evidence of the success of the policies Congress adopted in Section 332 of the Communications Act.

Recently, a controversy has arisen over whether the “principle” of the 1968 Carterfone decision should be extended to the mobile wireless industry. Adoption of the asserted principle--that every wireless network should accommodate the interconnection of any apparently compatible terminal device--would be a mistake.

First, it is a mistake to think that Carterfone provides a legitimate precedent. The circumstances in which Carterfone arose and was decided were completely unlike those that surround today’s mobile wireless industry. Two differences among many are sufficient to show that Carterfone is inapposite. First, Carterfone arose in the context of a thoroughgoing, vertically integrated monopoly that dominated the telecommunications industry to a greater extent than any other firm has dominated any other industry before or since. Second, Carterfone arose in the context of a regulatory regime--since dismantled--that gave the network operator a rational incentive to discriminate against competitive terminal devices even if it diminished the use of the network.

Second, apart from issues of health and safety not implicated here, it is a mistake to intervene in the product and service design of an industry that is workably competitive. If a mobile wireless firm fails to respond to the initiatives of its competitors or diminishes the utility that consumers derive from its service, it risks the loss of customers and of revenue. Wireless carriers react to each others’ initiatives and to consumer demands because they must.

There are other reasons to decline to extend the asserted Carterfone analogy to today’s wireless industry--for example, the need to manage shared networks to optimize performance and to prevent free riding. But without regard to these other considerations, the principal reason is that the competitive process will more reliably produce consumer welfare than regulatory intervention in the circumstances of the contemporary mobile industry.

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Testimony of Philip L. Verveer

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Testimony of Philip L. Verveer

Good morning, Mr. Chairman, and members of the Subcommittee.

I appreciate the opportunity to present my views on innovation in today's mobile wireless industry. My testimony will focus on the apparently narrow subject of the relevance of the Carterfone "principle" to the contemporary wireless industry.¹ However, it is premised on realities that have broader implications for public policy. The mobile wireless industry is workably competitive and therefore largely deregulated, and its performance--from a consumer perspective--has been and continues to be very good. There is very little justification for changing the legal and regulatory framework within which it operates.

The FCC's 1968 Carterfone decision² held that telephone subscribers have the right to connect any device to the telecommunications network that is privately beneficial so long as it is not publicly harmful.

During the 1970s as an antitrust prosecutor at the Department of Justice and as an official at the Federal Communications Commission, I was involved in important initiatives that adopted and extended Carterfone. On the basis of years of close familiarity with the Carterfone precedent, I can say that mobile wireless is not a candidate for the very large extension of Carterfone that recently has been urged.

As a policy matter, the proposition that every wireless network should enable interconnection of any apparently suitable terminal device can be made to look like a simple application of consumer sovereignty. It isn't. Rather, it is a request for government intervention

¹ My firm has represented CTIA-The Wireless Association in connection with a petition filed by Skype Communications S.A.R.L. seeking the Federal Communications Commission's intervention with respect to cellphone terminal equipment. A copy of my firm's submission in connection with RM 11361 is attached to my testimony.

² *In re Use of the Carterfone Device in Message Toll Service*, 13 FCC 2d 420 (1968), *recon.* 14 FCC 2d 571 (1968).

into the product and service design of an industry that is workably competitive and that, largely because of competition, is as dynamic and progressive as any in the communications sector.

This is a very bad idea, precisely because it is much more likely to harm consumers than to help them.

As with all jurisprudence, Carterfone arose in the context of particular circumstances that constituted both the requirement for and the basis of the decision. Those circumstances were fundamentally unlike those that prevail in the contemporary wireless industry. The differences are extensive, but only two need to be considered to make the point.

First, in 1968 the provision of telecommunications transmission service was a thoroughgoing monopoly. If consumers didn't like the price or performance of the terminal equipment that the old Bell System provided, they had no recourse. In that sense, consumers were captive. Carterfone, and nearly ten additional years of industry-government skirmishing to implement Carterfone, changed that to the benefit of consumers. Today's wireless industry consists of four national carriers, additional regional carriers, some quite significant in size, and the prospect of additional entry by a cable television consortium that recently invested more than \$2 billion to acquire spectrum covering almost all of the country. Obviously, the situation of today's wireless consumers in terms of choice is different and dramatically better.

The second difference is more arcane, but quite important. The prohibition on "foreign attachments" that Carterfone struck down was, in its economic motivation, mainly an effort to evade rate regulation. The Bell System telephone companies were subject to a particular type of rate regulation that had a profound effect on their incentives. Rate of return regulation prevented the companies from charging the monopoly price for service. This gave them an incentive to attempt to exploit the service monopolies in adjacent markets, such as terminal equipment, and

an equivalent incentive to protect their terminal equipment business without regard to whether doing so diminished the utility and the usage of their core transmission business. To the extent the prices they charged for terminal equipment or the prices they paid their affiliated manufacturer for terminal equipment were less regulated than the prices they charged for service, they were better off. Stated differently, the Carterfone-era telephone companies had a rational incentive to discriminate—that is, to decline to engage in otherwise profitable business as a function of the particular type of rate regulation to which they were subject. Today’s wireless industry is not exposed to equivalent incentives for the obvious reason that it is not rate regulated. There is no reason to suspect that wireless firms have a rational incentive to discriminate. They are free to charge as they wish for their transmission service, and over the history of the industry there have been enormous changes in the rates and rate structures the carriers have employed. The conventional inference—that their rates and rate structures are designed to maximize profitable usage of their networks—applies. If a wireless firm diminishes the utility that consumers derive from its service, it risks the loss of customers and of revenue. The companies may do this by mistake from time-to-time, but corporate mistakes not involving health and safety are not a justification for government intervention.

Apple’s much-admired new iPhone provides an example of why some believe the government should intervene and why I believe it should not. The concern is centered on the exclusive arrangement that Apple negotiated with AT&T. Why shouldn’t subscribers to other carriers have an opportunity to use the device? The answer to the question is that AT&T’s competitors will be compelled to respond if the iPhone comes close to meeting expectations. They already are, as shown by the contemporaneous introduction of a WiFi phone by T-Mobile. This kind of competitive thrust and parry has produced constant dramatic improvements in the

price and quality of cellphone service over its entire history. Wireless carriers react to each others' initiatives and to consumer demands because they must. This is pretty good evidence that consumers are sovereign. It also is a pretty good indication of why the burden of proof falls heavily on those that seek government intervention in wireless product design. The varied practices of the wireless companies may not please some consumers some of the time, but no one doubts the industry's dynamic character.

It seems to me that the present debate constitutes an instance of the very familiar tension between static efficiency and dynamic efficiency, between law and regulation designed to encourage reaching the lowest point on a cost curve and law and regulation designed to encourage the creation of new, lower cost curves. Three decades ago, the government policy activities affecting communications in which I was involved included the deregulation of terminal equipment and the determination that there should be more than one cellphone company in each market. These decisions were based on the view that competition and the dynamic efficiency it produces more reliably secure consumer welfare than regulation. There are instances in which government intervention surely is warranted—free markets are not found in nature—but where an industry is working as well as mobile wireless, the circumstances justifying regulation must be materially more aggravated than those described by interests seeking an extension of the Carterfone “principle.”

Thank you, again, for the opportunity to testify. I would be pleased to respond to any questions members of the Subcommittee may have.

**BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

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In the Matter of :
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Skype Communications S.A.R.L. :
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RM-
Petition to Confirm A Consumer's Right to Use :
Internet Communications Software and Attach :
Devices to Wireless Networks. :
:
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AN ANTITRUST PERSPECTIVE IN RESPONSE TO SKYPE'S PETITION

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“Experience has shown that government-imposed restrictions are among the most effective and durable restraints on competition.”³

Skype’s petition asks the Commission to intervene in a vibrantly competitive marketplace by resurrecting the visage — and vestige — of a hidebound monopoly. The contractual relationships among wireless providers, handset manufacturers and, most importantly, consumers have fostered an environment today that Tom Carter would not recognize: it is dominated by no one, it is replete with technical innovation, and it achieves ever broadening use and declining prices.

The application of antitrust principles to today’s wireless market supports no theory on which Skype can contend that the wireless carriers have engaged in anticompetitive conduct. Indeed, it supports the opposite — that relationships among carriers and handset manufacturers generate efficiencies that promote competition.

In addition, the wireless carriers do not have unlimited capacity and ability to accommodate all technologies. If Skype’s request is granted, it will not be without consequence. To the extent regulation requires carriers to adapt their businesses in ways that increase their costs or compromise their service, Skype may be happy but consumers will either pay more or get less. That is because, fundamentally, Skype wants the Commission to intervene to correct what it believes are bad business decisions by the wireless carriers; it wants the Commission to give priority to what Skype thinks the market desires and how Skype thinks the wireless carriers should manage their businesses, rather than let the competitive process determine the direction the market will take.

³ FTC, Prepared Statement to Congress: *An Overview of Federal Trade Commission Antitrust Activities*, March 7, 2007 at 24-27 (describing instances where the FTC has urged state and federal lawmakers to refrain from or limit regulation), available at <http://www.ftc.gov/os/2007/03/index.shtm> (last visited April 23, 2007).

The Current Market Structure Makes Anticompetitive Harm Unlikely

The root complaint of Skype's petition appears to be that wireless carriers are using their influence "to maintain an inextricable tying of applications to their transmission networks and are limiting subscribers' rights to run applications of their choosing." Petition at 2. Skype thus implicates two markets for consideration: the wireless network operators (the "primary" market) and the handset market (the "secondary" market). Petition at i.⁴ This relationship consists of bundling handsets together with the wireless service that makes them useful and can be characterized as a "vertical" relationship.

Consumer harm in vertical cases is measured by the degree of foreclosure in a defined market that the dominant firm can effect through its market position. As shown below, there is no such foreclosure, nor can there be. As an initial matter, *any* consumer harm in a vertical case requires market power in at least one market. *See, e.g.*, IIIA Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 756a, at 8 (2d ed. 2002) ("Without substantial market power at any relevant production or distribution stage, vertical integration lacks antitrust significance. It is either competitively neutral or affirmatively desirable because it promotes efficiency."); *id.* at 9 ("In the absence of market power, 'foreclosure' is inapt.").

Moreover, even in the presence of a monopoly, "[w]hen the primary market monopolist integrates into a competitive secondary market, no injury to competition is ordinarily apparent ... [this] is a clear candidate for a rule of absolute legality." *Id.* ¶ 759c, at 36. Today, no monopoly

⁴ Elsewhere in its petition, Skype describes a "permission-based" approach to innovation," at 13; and points to "handset locking," "terms of service limitations" and "lack of open development platforms," *id.* at 16-20. The thrust of Skype's petition seems to be that wireless carriers are using their position in the primary wireless market in order to restrain handset design, including handsets' compatibility with certain software applications. While it is not clear from Skype's petition whether handsets are a distinct market from the applications that run on them, the antitrust implication remains the same: absent market power in either market, as is the case, how the wireless carriers choose to compete should be left to their judgment and market forces, not dictated by the judgment of Skype and others.

exists in either the market for network services or the market for handsets. As such, anticompetitive harm *cannot* stem from vertical relationships among such firms.

The FCC's eleventh *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Radio Services* ("Eleventh CMRS Report") to Congress finds a robust and increasingly competitive landscape:

"[T]here is effective competition in the CMRS marketplace." FCC, *Eleventh CMRS Report*, 21 FCC Rcd 10947 at 4 (2006), available at <http://wireless.fcc.gov/crmsreports.html>.

"[C]ompetitive pressure continues to drive carriers to introduce innovative pricing plans and service offerings, and to match the pricing and service innovations introduced by rival carriers." *Id.*

"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 services." *Id.* at 5.

"In addition to the nationwide operators, there are a number of large regional players" *Id.* at 14.

The Commission found that 268 million people, or 94 percent of the U.S. population, "live in counties with four or more mobile telephone operators competing to offer service;" 145 million people, or 51 percent of the U.S. population, live in counties with "five or more mobile telephone operators competing to offer service;" and fifty million people, or 18 percent of the U.S. population, "live in counties with six or more mobile telephone operators competing to offer service." *Id.* at 20.

At year-end 2005, the top five wireless network operators together constituted approximately 89% of the market for wireless telephone services: AT&T/Cingular represents roughly 26%; Verizon has 25%; Sprint/Nextel has 22%; T-Mobile has 11%; and Alltel has 5%. *Eleventh CMRS Report*, app. A, tbls. 2 & 4. Twenty other providers, seven of which each served more than one million subscribers, constitute the remainder of the market. *Id.* In its petition at

21, Skype notes the U.S. market concentration in wireless had an average HHI of 2706.⁵

However, this level of concentration, in its proper context, indicates no potential for anticompetitive harm to consumers.⁶

Finally, irrespective of the level of concentration, the fact that effective competition exists is shown by dramatically increased usage rates and declining prices. The average minutes of usage per month among wireless subscribers has increased from 140 to 740 since 1993. *Eleventh CMRS Report*, tbl. 10. In the same period, the average revenue per minute has declined from \$0.44 to \$0.07. *Id.*

Wireless Carriers' Relationships With Handset Manufacturers Promote Efficiency

In today's wireless marketplace, as in other vertical arrangements, bundling clearly has a *pro-competitive* effect. As discussed above, vertical relationships do not run afoul of antitrust laws where the integrating firms lack market power in their respective markets. Rather, it may be "affirmatively desirable because it promotes efficiency." Areeda & Hovenkamp, *supra*, ¶ 756a(1), at 8. This is especially true "as products become more technical and specialized and as an ongoing relationship between bargaining opposites requires increasing amounts of coordination" *Id.* ¶ 757c, at 26-27 (discussing transactional efficiencies). In this context it is widely recognized that:

⁵ Skype acknowledges that "applications like Skype have been uncoupled from the underlying Internet access network and can operate across heterogeneous broadband platforms." Petition at 2. This suggests that a more appropriate market definition includes all broadband providers, which yields a much lower HHI of approximately 1110. Christopher S. Yoo, *Network Neutrality and the Economics of Congestion*, 94 Geo. L.J. 1847, 1893 (2006). The courts endorse this approach. *See, e.g., United States Telecom Ass'n v. FCC*, 290 F.3d 415, 428 (D.C. Cir. 2002) (finding the Commission "completely failed to consider the relevance of competition in broadband services coming from cable (and to a lesser extent satellite)."). However, as this memorandum shows, there is no problem even under the narrower market on which Skype's petition is based.

⁶ It is significant that in 1992, when the Commission clarified its policy allowing bundling of cellular service and CPE, the wireless HHI was 5000; the market constrained by a duopoly. *Bundling of Cellular Customer Premises Equipment and Cellular Service*, Report & Order, CC Docket No. 91-34, FCC 92-207, 7 FCC Rcd 4028 at ¶ 11 & n.21 ("CPE Bundling Order"). Moreover, even with an average HHI of 2706, the Commission noted the North American market is less concentrated than, for example, in Western Europe, excluding the United Kingdom. *Eleventh CMRS Report* at 23.

“In the absence of any purpose to create or maintain a monopoly, the [Sherman Act] does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.”

United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

The critical efficiency of bundling is that it provides easy access to Customer Premises Equipment (CPE). Skype points to the low, “highly subsidized” cost of CPE as a “consumer harm,” Petition at 13, without specifying what that harm may be. In fact, the FCC already has endorsed this efficiency, finding the low cost of CPE that results from bundled services only benefits consumers: “[T]here appear to be significant public interest benefits associated with the bundling of cellular CPE and service [because] *the high price of CPE represents the greatest barrier to inducing subscription to cellular service.*” *CPE Bundling Order* ¶ 19 (emphasis added). Nor did the Commission limit its endorsement based solely on the absence of harm to competition: “[O]ur policy to allow the bundling of cellular CPE and cellular service furthers the Commission’s goal of universal availability and affordability of cellular service and thus promotes the continued growth of the cellular industry.” *Id.* at ¶ 20.

An equally important effect of bundling is that it allows the wireless carriers more effectively to compete with each other. “Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of its products.” *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 54 (1977). The Supreme Court in *Continental T.V.* also recognized that, even where market power exists, interbrand competition “provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.” *Id.* at 52 n.19. As noted above, the FCC recognized in the *Eleventh CMRS Report*, at 5, such interbrand competition is vigorous, driven by consumers “freely switching providers.”

Another pro-competitive justification of bundling is the elimination of “free riders,” those firms — either upstream or downstream — that seek to capitalize on the infrastructure investments made by others.⁷ Here, the development of the wireless infrastructure has cost, and continues to cost, tens of billions of dollars. To the extent the networks are able to manage applications like Skype from consuming scarce network capacity and bandwidth without paying, competition law allows such a return on investment. *United States Telecomm. Ass’n v. FCC*, 290 F.3d 415, 424 (D.C. Cir. 2002) (“If parties who have not shared the risks are able to come in as equal partners on the successes, and avoid payment for the losers, the incentive to invest plainly declines.”).

Free riders do not merely discourage investment by individual firms competing with the free rider, they undermine the existence of the infrastructure itself. Investment disincentive produces “a deterioration of the system's efficiency because the things consumers desire are not provided in the amounts they are willing to pay for. In the extreme case, the system as a whole could collapse.” *Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 221 (D.C. Cir. 1986) (citing the elimination of free riders as the “chief efficiency” that justified purportedly anticompetitive conduct), *cert. denied*, 479 U.S. 1033 (1987).

The explosive growth of technology is another efficiency that the relationships between network providers and handset manufacturers has fostered. This growth cannot be squared with Skype’s bald assertion that wireless carriers’ influence with handset design creates an “innovation bottleneck.” Petition at 13. At least one court has found the notion logically

⁷ These infrastructure investments are not limited to wireless technology, but are an important component of the larger broadband infrastructure. In that context, the FCC has expressly recognized the procompetitive efficiencies of limiting free-riders and allowing business arrangements that ensure a return on investment: “The record shows that the additional costs of an access mandate diminish a carrier’s incentive and ability to invest in and deploy broadband infrastructure investment.” *Appropriate Framework for Broadband Access To the Internet Over Wireline Facilities*, Report & Order, CC Docket No. 02-33, FCC 05-150, ¶ 44 (“*Appropriate Framework for Broadband Access*”).

unsound. In *In re Wireless Telephone Services Antitrust Litigation*, 385 F. Supp. 2d 403, 429 (S.D.N.Y. 2005), which is discussed further below, the court pointed out that “[s]ince the defendants do not manufacture handsets, and compete with each other through offering handsets with service, it is against each defendant’s self-interest to discourage competition among handset manufacturers” The same court found that terms of service limitations, which Skype complains “go beyond a carrier’s reasonable business interests,” Petition at 19, also foster innovation in the handset market:

“As a matter of logic, the need for consumers to buy new handsets when they switch plans should increase competition in the handset market. Defendants contend and plaintiffs do not disagree that the defendants use their offers of handsets at the lowest possible prices to compete with each other. The increased sales of handsets that result from this practice and *the incentive to use handset innovations as a draw* to bring new customers to a new service provider foster competition in the tied product market.”

385 F. Supp. 2d at 430 n.40 (emphasis added).

Assuring the quality of the network is perhaps the most practically significant efficiency of a close relationship between network operators and handset makers or, for that matter, applications writers. Wireless carriers’ ability to constrain or restrain certain design characteristics in handsets benefit the network at both ends of the technology spectrum. At the low end, mandating certain capabilities insures that handsets are of high quality and do not burden the network with inferior connectivity or capability. At the high end, restricting the use of certain bandwidth-intensive features insures that “one customer’s usage of the network [does not] degrade the quality of service that other customers receive.” Yoo, *supra* note 2, at 1852. Indeed, *Carterfone* itself supported this efficiency of vertical integration, as the FCC relied primarily on the *absence* of harm to the network in invalidating the tariff. *In re Use of the Carterfone Device in Message Toll Tele. Serv.*, 13 F.C.C.2d 420, 423 (June 26, 1968).

In today's wireless marketplace, mandating or restricting the applications that run on handsets is the most economical means of managing the network. Yoo, *supra* note 2, at 1852-53. This is because, with certain applications, there is no effective way to meter bandwidth usage to insure that low-bandwidth users are not in effect subsidizing high-bandwidth users. This efficiency is particularly apt concerning Skype. First, Skype's applications (including video teleconferencing, file transfers, and "Skypecasts," or "*live, moderated conversations with up to 100 people*," eBay Inc., 2006 Annual Report (2007) ("eBay 2006 Annual Report") at 8, are inherently bandwidth intensive. Second, Skype's peer-to-peer methodology has succeeded without significant infrastructure investments through its model of creating "supernodes." A supernode uses its subscribers' bandwidth even when that particular user is not actively using the network, *i.e.* the user is an unwitting host to other Skype users' calls. Saikat Guha, et al., *An Experimental Study of the Skype Peer-To-Peer VoIP System* (2006).⁸

Together, these characteristics hinder the ability of a network operator economically to meter the usage of a finite resource, bandwidth, for purposes of tiered pricing.⁹ As Professor Yoo summarizes:

"[T]ransaction costs associated with a usage-sensitive pricing system can consume all of the economic benefits associated with a shift to usage based pricing The indeterminacy of the problem justifies adopting policies that do not foreclose network operators from experimenting with

⁸ Available at http://209.85.165.104/search?q=cache:zImPT-SK_icJ:iptps06.cs.ucsb.edu/papers/Guha-skype06.pdf+%22Experimental+Study+of+the+Skype%22&hl=en&ct=clnk&cd=1&gl=us (last visited April 21, 2007).

⁹ The Commission has acknowledged the metering problem in another context, by exempting VoIP communications from state regulation on the grounds that complying with a state's requirements to identify a VoIP call's geographic end-points is impossible. *See Minnesota PUC v. FCC*, No. 05-1069, No. 05-1122, No. 05-3114, No. 05-3118, 2007 U.S. App. LEXIS 6448, at *14 (8th Cir. Mar. 21, 2007) (citing *In re Vonage Holdings Corp.*, 19 F.C.C.R. at 22418 ¶ 23 ("the significant costs and operational complexities associated with modifying or procuring systems to track, record and process geographic location information as a necessary aspect of the service would substantially reduce the benefits of using the internet to provide the service, and potentially inhibit its deployment and continued availability to consumers.")).

any particular institutional solution absent the demonstration of concrete competitive harm.”

Yoo, *supra* note 2, at 1852-53.

Faced with Skype’s disproportionately high bandwidth usage and elusive, transitory system of supernodes — both of which may adversely affect other users’ use of the network — a business arrangement that limits¹⁰ Skype’s access to the network through handset design or terms of service limitations is an efficiency that inures to the benefit of all network users. Finally, while addressing the security concerns posed by applications like Skype is beyond the focus of this response, a brief survey of Skype’s security bulletins indicates that the question of “what harms the network?” is significantly more complex today than it was in 1968.¹¹

In sum, Skype’s model of bandwidth usage is perhaps the best illustration of the need for limiting the functionality of handsets, a limitation without which the wireless networks and the service that they provide would be degraded.

Without Question, Such Efficiencies Have Been Passed On To Consumers

It is important to highlight that even Skype acknowledges the fact that there have yet been no anticompetitive effects caused by the conduct alleged in its Petition. Petition at 5 (“*Before* anti-consumer practices take root and innovation suffers, the Commission should examine the policies that have guided the industry to date ... to *keep* wireless communication

¹⁰ It bears emphasis that a network operator, by limiting the capability of its own handsets, only restricts Skype’s access to the network; it does not prevent it. Skype itself markets Wi-Fi capable handsets and any consumer who wishes may choose a Skype phone and calling plan. See Marguerite Reardon, “Skype Intros New Wi-Fi Phones,” CNET News.com (July 20, 2006), *available at* http://news.com.com/Skype+intros+new+Wi-Fi+phones/2100-7351_3-6096681.html (last visited Apr. 18, 2007).

¹¹ See, e.g., SKYPE-SB/2006-002 (Oct. 3, 2006), *available at* <http://www.skype.com/security/skype-sb-2006-002.html> (“In some circumstances, a Skype URL can be crafted that, if followed, could cause the execution of arbitrary code on the platform on which Skype is running.”) (last visited Apr. 21, 2007); SKYPE-SB/2006-001 (May 19, 2006), *available at* <http://www.skype.com/security/skype-sb-2006-001.html> (“In some circumstances, a Skype URL can be crafted that, if followed, initiates the transfer of a single named file to another Skype user.”) (last visited Apr. 21, 2007); SKYPE-SB/2005-003 (Oct. 27, 2005), *available at* <http://www.skype.com/security/skype-sb-2005-03.html> (“Skype can be remotely forced to crash due to an error in bounds checking in a specific networking routine.”) (last visited Apr. 21, 2007).

open to innovation and competition.”) (emphasis added). This is no slip — Skype must acknowledge that these efficiencies and resulting cost savings to consumers are the direct result of what can only be described as a dynamically competitive marketplace.

As the discussion above establishes, there is little or no likelihood of consumer harm that *could* follow vertical arrangements between non-dominant carriers and non-dominant handset manufacturers. The theory has been borne out in practice in two fora that have applied specific facts — one in the courts, the other in the marketplace itself.

Skype asserts, citing no authority, that “[t]he wireless industry remains the only widely-used communications network in which the network operators exercise effective control over the devices used by consumers.” Petition at 8. Providing a specific rebuttal of this contention, in a case on all fours with Skype’s petition, is *In re Wireless Telephone Services Antitrust Litigation*, 385 F. Supp. 2d 403 (S.D.N.Y. 2005). In *Wireless Telephone*, plaintiff consumers sued AT&T, Cingular, Sprint, Verizon and T-Mobile, complaining that “the practice of requiring customers to purchase an approved handset in order to subscribe to [each] defendant’s wireless telephone services constitutes an unlawful tying arrangement.” Granting summary judgment for defendants, the court found no evidence “that any one of the defendants had sufficient power in the market for wireless service to ‘force’ consumers, within the meaning of the antitrust laws, to purchase unwanted handsets.” 385 F. Supp. 2d at 417.¹²

First, the court found that no wireless carrier possessed a market share of 30%, “the minimum sufficient by itself to confer market power.” 385 F. Supp. 2d at 418. Second, even assuming that “all handset sales flow through the carriers’ distribution system,” the court found, as a matter of law, that this was a choice of handset manufacturers, not a condition imposed upon

¹² The court also expressly found that “the use of term contracts cannot be said to exclude competition,” *id.* at 423 (addressing another of Skype’s concerns); *see* Petition at 18-19.

them. 385 F. Supp. 2d at 426 (“To find that such a choice is not a choice at all but instead proves an anticompetitive impact defies logic.”). The court also considered the absence of entry barriers in either the network market, *id.* at 420, or the handset manufacturing market, *id.* at 424, in granting summary judgment for defendants.

Finally, the court noted the amount of “churn,” or turnover from one carrier to another, as evidence that anticompetitive conduct, if possible, was unavailing in the marketplace: “The enormous amount of churn in this industry eviscerates the suggestion that consumers do not view these brands and the services underlying them as essentially interchangeable.” *Id.* at 420.

A more practical illustration, provided by the marketplace itself, lies in Skype’s own cited authority. Skype, in passing, points to the exclusive relationship between Apple and AT&T/Cingular to show the influence of network providers over handset manufacturers. Petition at 16 & n.30 (noting “the extraordinary effort that Apple made to break the hold of wireless carriers in order to develop the iPhone.”).¹³ An examination of that relationship, however, shows that Skype has the balance of power backward. In fact, Apple’s effort is illustrative both of the level of competition that prevails in the wireless marketplace and the influence that handset makers — those who invest in a compelling product — have over sometimes captive network operators.

While Skype accurately points out the iPhone works only on AT&T’s Cingular wireless network, it overlooks the fact that this is at *Apple’s* insistence, not Cingular’s. Sharma, et al., *supra* note 11, at A1. Apple imposed other conditions as well: Cingular had to agree not to place its brand on the body of the phone; it had to abandon “its usual insistence” that its software be installed on the phone; and it agreed “to share with Apple a portion of [its] monthly revenue

¹³ Skype quotes, but does not cite the article by Amol Sharma, Nick Wingfield & Li Yuan, *Apple Coup: How Steve Jobs Played Hardball in iPhone Birth*, Wall St. J., Feb. 17, 2007, at A1.

from subscribers.” *Id.* Moreover, Cingular agreed to these terms before more than three people at the company even got to see the iPhone — throughout development, Cingular teams were isolated to specific tasks “without knowing what the other teams were up to.” *Id.* At least one other network provider was approached by Apple but decided not to “play ball” under such restrictive terms. *Id.* (Verizon “balked at the notion of cutting out its big retail partners, who would *not be allowed* to sell the phone.”) (emphasis added).¹⁴

Under Skype’s theory that “network operators exercise effective control over the devices used by consumers,” Petition at 8, such influence by a handset manufacturer over the largest network operator should be impossible. Indeed, the reality negates Skype’s entire proposition and shows the marketplace operated exactly as it should — Apple, a firm new to both the handset and network markets, invested a great deal of time and money to develop a product it thought consumers would demand.¹⁵ The product was compelling enough that it caused Cingular to scuttle any semblance of “effective control” over its development.¹⁶

Will Apple’s Steve Jobs someday stand along Tom Carter as a giant in the telecommunications industry? The question may be irrelevant to Skype’s petition, but the answer will speak volumes because of the forum from which it stems: Tom Carter depended on the courts and the FCC for the Carterfone’s acceptance; the success of the iPhone will be

¹⁴ See also Leslie Cauley, “Verizon Rejected Apple iPhone Deal,” *USA Today* (Jan. 29, 2007) (“balking at Apple’s rich financial terms and other demands,” Verizon declined “to be the exclusive distributor of the iPhone.”), available at http://www.usatoday.com/tech/news/2007-01-28-verizon-iphone_x.htm (last visited Apr. 13, 2007).

¹⁵ While no doubt the iPhone was expensive to develop, such start-up costs are universal characteristics and not “impairment” in the antitrust sense. See *United States Telecomm. Ass’n v. FCC*, 290 F. 3d 415, 427 (D.C. Cir. 2002).

¹⁶ The iPhone also was compelling enough that, even before it has become available, competitors are answering the call with their own next generation, multifunction wireless devices. See, e.g., Gary Krakow, “iPhone Has a Two-Faced Challenger,” *MSNBC.com* (April 23, 2007) (announcing Samsung’s aptly-named “UpStage” handset), available at <http://www.msnbc.msn.com/id/18091591/wid/11915829> (last visited April 24, 2007).

determined solely by the *marketplace*. Today, unlike 1968, any firm has the same opportunity to leverage the fruits of its innovation.

There Is No Risk of Competitive Harm on Which to Justify Government Regulation

The above analysis shows that Skype, in the guise of consumers, has chosen the FCC as its forum precisely because it cannot show that there has been any anticompetitive harm to consumers. The proposition that regulation should not lead where no harm to competition exists is well established by the courts. *See, e.g., Verizon Comms. Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004) (“just as the 1996 [Telecommunications] Act preserves claims that satisfy existing antitrust standards, it does not create new claims that go beyond existing antitrust standards.”); *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 242 (2d Cir. 2003) (“the proper inquiry is whether there has been an *actual* adverse effect on competition as a whole in the relevant market.” (citation and internal quotation marks omitted)); *In re Wireless Tel.*, 385 F. Supp. 2d at 424 (citing *Roy B. Taylor Sales, Inc. v. Hollymatic Corp.*, 28 F.3d 1379, 1385 (5th Cir. 1994) (“Speculation about anticompetitive effects is not enough.”)).

The maxim has been repeated by regulators, too: “While interested parties will always lobby for policies that benefit them, we do consumers the best service when we ensure that markets are competitive and do not impose unnecessary barriers or restrictions on free competition through our own policies.” *Protecting Consumers in the Next Tech-Ade, Hearing Before the Federal Trade Comm’n*, No. P064101 (Nov. 6, 2006) (testimony of Deborah Platt Majoras, Chairman of the Federal Trade Comm’n) at 13. As the Federal Trade Commission has recognized: “Experience has shown that government-imposed restrictions are among the most effective and durable restraints on competition.” *See supra*, n. 1.

The FCC expressly endorses — and should continue to espouse — the theory. Indeed, the FCC’s “guiding principle” is to “allow[] competitive markets to be driven by market forces,

rather than unnecessary regulatory requirements.” 1998 *Biennial Regulatory Review*, FCC 98-258 at 4. The Commission also has stated that “[w]e agree with the FTC Staff and the DOJ that the most efficient government policy is to allow firms the ability to choose how to distribute their own products ... the possibility that one type of retailer may be harmed does not provide a basis for a rule that limits the use of a potentially efficient contract or retail distribution system.” *CPE Bundling Order* ¶ 28 (internal quotations and citation omitted).

It is axiomatic that “there is no duty to aid competitors.” *Trinko*, 540 U.S. at 411. In this context it is important to distinguish harm to a competitor from harm to competition. Even if Skype’s business opportunities are foreclosed by the relationships between network providers and handset manufacturers (despite no evidence that this is so), it does not follow that consumers will suffer any harm. *See Areeda & Hovenkamp, supra*, ¶ 756a(2), at 10. Indeed, nothing prevents Skype from competing for its own sake. “If competitors can reach the ultimate consumers of the product by employing existing or potential alternative channels of distribution, it is unclear whether such restrictions foreclose from competition *any* part of the relevant market.” *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1163 (9th Cir. 1997). Or, like Apple, a firm may simply force open the channels of distribution by making network providers an offer they can’t refuse.

Skype has available to it the tools it needs to compete in the marketplace, but it would rather ride for free.¹⁷ Its place at the table has been confirmed by the Commission’s recent order, granting wholesale telecommunications carriers the right to interconnect and exchange traffic

¹⁷ Moreover, Skype’s business model suggests not that it may be harmed by network operators’ practices, but that it seeks to extend an already unfair advantage. First, Skype already plays on an unlevel field, as shown in the public documents of its parent company, eBay: “Skype’s voice communications products are currently subject to very few, if any, of the same regulations that apply to traditional telephony and to VoIP-based telephone replacement services.” eBay 2006 Annual Report at 19. Moreover, “[s]uch regulations could result in substantial costs depending on the technical changes required to accommodate the requirements, and any increased costs could erode Skype’s pricing advantage over competing forms of communication.” *Id.* at 19-20.

with incumbent local exchange carriers, specifically for VoIP applications. Memorandum Opinion & Order, DA 07-709, FCC Docket No. 06-55, Mar. 1, 2007. The court in *Wireless Telephone* noted the same fact. 385 F. Supp. 2d at 420 (“to compete with [the five largest wireless carriers], a seller of wireless services does not even need an FCC spectrum license, as the growth of the mobile virtual network operator has shown.”).¹⁸ Finally, we have found no indication that Skype, its parent company eBay, or any company affiliated with it chose to participate in the Commission’s recent Advanced Wireless Services Auction.¹⁹

Conclusion

From an antitrust perspective, this response assumes that bundling exists in the wireless marketplace, as Skype’s petition implies. The foregoing shows that even with the benefits of a relationship between network operators and handset manufacturers, the future harm about which Skype is worried is not likely to follow. Unlike the days of *Carterfone*, in a marketplace for contractually bundled products, firms today compete at both levels to be part of the “bundle.” Such competition is vigorous and it ought not be replaced by premature regulation, however well-intended.

¹⁸ “A mobile virtual network operator orders handsets from a large handset manufacturer and resells network capacity leased at wholesale rates from a major wireless service provider.” 385 F. Supp. 2d at 420 n.23.

¹⁹ FCC, *Auction 66 Advanced Wireless Services (AWS-1)*, All Bidders Spreadsheet, available at <http://wireless.fcc.gov/auctions/66/charts/66bidder.xls> (last visited Apr. 13, 2007).