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Public Knowledge

Testimony of

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On behalf of

**Consumers Union, Consumer Federation of America,
Free Press and Public Knowledge**

Regarding

**“A Discussion Draft on Wireless Consumer Protection
and Community Broadband Empowerment”**

Before the

U.S. House of Representatives Subcommittee on
Telecommunications and the Internet, Committee on Energy
and Commerce

On

February 27, 2008

Chairman Markey, Ranking Member Stearns, 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*), the Consumer Federation of America,² Free Press,³ and Public Knowledge.⁴

We would first commend the excellent work of the Telecommunications & Internet Subcommittee staff, who have here produced serious legislation that could both benefit consumers and stand a chance of passing in this Congress, with a bill that represents a sensible compromise between consumer and industry interests. The discussion draft aims at getting reliable information to consumers on wireless services—better information on hidden fees, coverage maps, and call quality. Better information means more efficient markets, more competition, and more innovation. We look forward to working further with staff to perfect the draft.

Today we will briefly survey cell phone company practices that concern consumers, and in that light provide our comments on this discussion draft—what we like, what we have questions about, and what we believe is missing.

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 The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

³ Free Press is a national, nonpartisan organization working to reform the media. Through education, organizing and advocacy, we promote diverse and independent media ownership, strong public media, and universal access to communications.

⁴ Public Knowledge is a Washington DC based public interest group working at the intersection of communications policy and intellectual property law. Public Knowledge seeks to ensure that all layers of our communications system are open and accessible.

Consumers are not as satisfied as they should be with the wireless industry as a whole. **In an annual consumer satisfaction survey⁵ of 20 industries conducted by our magazine, Consumer Reports, “cell-phone service” ranks near the bottom of the list (18 of 20), with only “computer makers’ tech support” and “digital cable TV service” receiving lower marks.**

U.S. consumers pay more for wireless service than consumers in just about any other country in the world. The wireless industry tries to deny this fact with a lot of irrelevant talk about prices per minute.⁶ **But it’s the cost to the consumer that matters, and U.S. consumers pay more—an average of \$506 each year**, higher than the OECD⁷ average of \$439, and way above countries such as Sweden (\$246), Spain (\$293), and Germany (\$371).

Early Termination Fees are ubiquitous in the wireless industry, with some carriers charging as much as \$200 if a customer wants to leave before their (generally two-year) contract is completed. While Verizon has adopted a policy of partially pro-rating these fees, the other carriers have only made announcements—we are still waiting on follow through—and one even seemed to be actively misleading consumers, telling would-be subscribers that they already pro-rate plans when they absolutely do not yet do so.

Question: Why does a customer of the wireless companies who gets no subsidy on a phone still get stuck with a \$175 early termination penalty?

We’ll call this the “iPhone problem.” Wireless carriers say consumers are getting huge subsidies, and as a result they’re forced to charge consumers early termination penalties. But we see consumers who get no subsidies still being charged the full penalty, such as iPhone purchasers or

⁵ Consumer Reports, “*Upfront: News, Trends, Advice*,” p. 8 (October 2007).

⁶ We love talking here in the U.S., so our average of 800 minutes of use each month indeed means lower per minute prices. Putting aside whether all that cell phone time is good for us, we see that all the carriers are rolling out unlimited plans at present. What might this tell us? That the wireless carriers have suddenly come down with a case of altruism? Or is it that this is a high fixed-cost industry, and per-minute pricing doesn’t mean much anymore? It’s what consumers pay in the end that hits them in the pocketbook. If the wireless carriers wanted to offer consumers rate plans with no flat fees and per minute billing at that “average” per minute rate of 7 or 8 cents, we would have a different outlook.

⁷ Organization for Economic Co-operation and Development, “OECD Communications Outlook 2007.”

customers who bring their own phones—and we don't see any accounting whatsoever about the real benefits consumers get. We're concerned that those benefits are lower than companies claim.

We say, “show us the money.” If consumers are getting great subsidies, terrific, account for them, tell us what they are, and charge us fees that reasonably relate to those so-called subsidies.

In landline phone service, if a consumer moves to another state, he or she just cancels service and picks up a new provider in the new state. No lock-in to long term contracts, no early termination penalties when I move. Why all the anti-competitive lock in with wireless phone service?

Unconstrained early termination penalties are at direct odds with federal policy on number portability. Congress decided that number portability was good public policy, and it was right when it made that judgment. Consumers *should* be able to keep their numbers so that competition and innovation thrive.

For years, the wireless industry argued that consumers should not be able to keep their phone numbers, because nobody really *wanted* to keep their phone number anyway. After four or five delays, Congress and the FCC finally followed through, and number portability turned out to be a boon to competition and a benefit to innovation. We believe that eliminating or reducing early termination penalties to reflect actual costs will be similarly salutary.

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 a wireless customer decides to increase his or her bucket of minutes, the carrier may automatically extend the contract for another year or two, and saddle the customer with another Early Termination Fee if he or she decides to leave before the contract is up.

Mobile phone “locking” is another area of concern for consumers. In Europe, phones work seamlessly between networks and carriers do not exercise control over which phones subscribers can use. This has created a robust, independent market for mobile phones where users

have far greater choice than U.S. subscribers. In the U.S., analysts estimate that 90 to 95% of handsets are sold by the wireless carriers, whereas in some Asian markets approximately 80% are sold independently from the carrier.⁸

There are two basic kinds of mobile phone locking:⁹ software locks (which actually disable the phone when the user leaves), and “approved phones only” policies (which do not allow users to activate phones they purchase through the network operator, even when independent phones are technologically compatible with the network).

Imagine that a consumer purchased an expensive new television set and decided to switch cable or satellite providers, but the provider said “I’m sorry, your new TV will not work on our cable system, you’ll have to purchase a new one—from us.” Policymakers would not tolerate this behavior for long, yet this practice has been pervasive in the wireless industry for several years now. We would like to see the House draft mirror the provisions in the Senate bill that the FCC study this issue of mobile phone locking.

Application and functionality blocking is another practice that costs consumers money, and denies our economy the dynamic benefits of innovation. As a Wall Street Journal article¹⁰ noted, handset manufacturers have been trying to offer consumers services for free on new handsets, but network operators 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 (manufacturer of the Blackberry) wanted to offer a free mapping service to customers who buy the Blackberry, but AT&T refused, because they had a service that they wanted to charge users \$10 a month for.

⁸ Marguerite Reardon, “Will ‘unlocked cell phones’ free consumers?” *CNET News.com*, January 24, 2007, available at: http://news.com.com/Will+unlocked+cell+phones+free+consumers/2100-1039_3-6152735.html?tag=st.prev.

⁹ For more information on mobile phone locking, see Professor Wu’s paper, “*Wireless Net Neutrality: Cellular Carterfone and Consumer Choice in Mobile Broadband*.” New America Foundation Working Paper #17, Wireless Future Program (February 17, 2007).

¹⁰ Jessica Vascellaro, “*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).

Yet another instance of troubling conduct is the slow rollout of mobile phones that 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 the FCC noted in a USA Today article,¹¹ “[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. We can buy cell phones 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.

We are pleased to see that some carriers with problematic practices are turning towards openness. We hope that those promises will see follow through, and we commit to working with the carriers to make it so.

In sum, we are concerned that the wireless industry has become a cozy cartel of a few dominant providers characterized by consumer lock-in and limited device offerings. Instead of engaging robust competition, these carriers are charging consumers unconscionable Early Termination Fees and thwarting real choices in the marketplace. Action from policymakers is sorely needed.

¹¹ Cauley, Leslie. “*New Rules Could Rock Wireless World: Consumers, not carriers, may get to choose devices.*” USA Today, (July 10, 2007).

Comments on the discussion draft

Allow me to note the provisions of the bill we believe will benefit consumers, pose some questions we have, and suggest ways the bill might be improved.

First, the bill requires clear disclosure of the terms and conditions of mobile phone service. Efficient markets are predicated on consumers having reliable information about the services they buy. The discussion draft would provide better coverage maps, better information on dropped calls and call quality, and better information on “subsidies” that consumers receive.

We’re enthusiastic about section 101 (a)(1)(d), which requires that consumers be given notice about the terms of any subsidies they receive. We think the bill could go farther by requiring wireless companies to account for the *actual* subsidy each consumer is receiving. In an ideal world, companies would show consumers exactly what they’re getting in return for getting locked into a two-year deal with a \$175 early termination penalty. We’re suspicious that consumers may not be getting as much as the wireless phone companies claim in return for getting locked in, because consumers who buy phones with no subsidy (such as the iPhone) are getting charged exactly the same penalty. No subsidy, full penalty—something doesn’t compute.

Second, the bill aims to eliminate junk fees on mobile phone bills, which we applaud. Many providers charge an unspecified “regulatory fee” that allows them to advertise lower prices and then pad the bill at the end of the month with these mystery charges. This bill would sensibly require that any so-called “regulatory fee” be explicitly authorized by a federal, state or municipal authority.

Third, the discussion draft gives consumers a penalty-free trial period and disallows contract extensions without explicit subscriber notice, which we support. Our survey data showed that contract extensions and the associated early termination fees were among consumers’ biggest annoyances. The problem here is that some wireless companies were extending consumers’ contracts by 2 years for every change they made in a rate plan. Let’s say a consumer decided to give the cell phone company more money each month and increase the number of minutes in their plan.

Even though this change in plan benefitted the carrier, some carriers would extend the contract for another two years, just because they can. We're glad to see that many of the carriers have ended this practice, and this section of the bill cleans up the marketplace for those remaining holdouts.

Fourth, we appreciate that this bill acts to preserve municipal authority to provide broadband service to citizens. The network providers can't have it both ways. On one hand they don't want to be forced to provide service anywhere they don't see an economic case for it—so they squashed anti-redlining legislation. On the other they have sought special treatment to protect themselves from competition, passing legislation in some states that ties the hands of municipalities who are fed up waiting for network operators to provide service to *all* their residents, rather than seeing network operators cherry pick the wealthiest, most convenient to serve ones.

The provisions of this bill that preserve competitive options for municipalities are well drafted, requiring that municipalities providing broadband do so in a competitively neutral manner. It also requires notice to and input from the community on the costs and benefits to municipal broadband projects. This is a balanced approach that we think any reasonable operator would find difficult to quibble with.

We support the provisions of the draft in Title III which require the FCC to work harder to use radio spectrum as efficiently as possible, paving the way for innovative new technologies like smart radio that promise enormous consumer benefit.

Perhaps our central question as the discussion draft moves forward is if we federalize the regulatory model of wireless, is it a floor or a ceiling, and does it come with unintended consequences? Before we scale back state authority to help tackle the next generation of problems that consumers may face, we need to consider the full effects of doing so. A few years ago, nobody ever heard of long term contracts, and consumers could get a simple cell phone plan for \$20-30. Today the entry price is 25-50% higher than that, and discounts only come after consumers are locked into a bunch of conditions they don't necessarily understand.

What might be the unintended consequences of preemption? The law as it stands today says liquidated damages clauses have to be related to actual costs. There are active complaints in several states alleging that these companies are breaking the law by charging early termination penalties that have little or no relation to actual costs. If by imposing constraints and conditions on early termination penalties we are tacitly justifying them when they were otherwise illegal, this may be a net negative for consumers. Our fear is that this draft will become watered down and laden with provisions that actually harm consumers.

We're seeing more advertising on mobile phones, and while we're not predicting anyone will be scammed, history instructs us to at least consider who will defend consumers if problematic practices emerge. Do we want greater power in the hands of an already overworked, underperforming Federal Communications Commission? Or do the states have a useful role in investigating new kinds of fraudulent and deceptive practices?

This question is especially salient considering the wireless industry's exemption from Federal Trade Commission (FTC) oversight. The FTC is the federal front line investigating and prosecuting unfair and deceptive advertising practices. Why should the wireless carriers benefit from less state oversight when they're not subject to the full range of federal scrutiny? **We believe that before Congress can consider scaling back state authority, it should consider eliminating the FTC's common carrier exemption.**

What's missing from the bill? As we mentioned above, we believe that **the draft needs to address the cell phone locking and application blocking problems** referenced above. Even a provision as light-handed as Senator Klobuchar's cell phone locking study would be better than not addressing this problem at all.

The FCC tacitly acknowledged that the next generation wireless Internet should be every bit as open as today's Internet when it applied openness conditions in the C block of the 700 MHz auction. We applaud the agency for its leadership in that instance—but what about the 250 million

mobile phone subscribers in the U.S. today? If this is enough of a problem to warrant action in a forward looking way on new spectrum, surely the agency should do something to act on abuses with the quarter of a billion mobile phone subscribers in the U.S. today.

Wireless Internet services will increasingly become the way that consumers connect to the Internet. If we allow anti-consumer, anti-innovation practices to continue—such as unjustified early termination penalties, application blocking and handset locking—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.

Free markets and competition can help solve many of the problems noted above, but only when consumers are armed with reliable information about the services we buy and when we don't encounter undue obstacles to voting with our feet and pocketbooks.

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