

TESTIMONY

Thomas W. Hazlett

Federal Communications Commission

Public Hearing on Early Termination Fees (in mobile service contracts)

Date: 12 June, 2008

1. The issue of early termination fees, or ETFs, found in many mobile service contracts, is sometimes framed as an opportunity for pro-consumer regulation. If ETFs are reduced, all else equal, customers will gain greater control over their mobile service choices and competitive forces will increase. Critically, however, all else is not equal when contracts are regulated in this manner – and the single entry book keeping approach is fundamentally flawed.

In fact, regulating ETFs will limit contracts that supply extremely valuable options to customers, as revealed in the fact that the overwhelming majority of U.S. wireless users elect to forego the opportunity to buy their own phone and to then separately purchase minutes of use – a competing offer to the mobile service contracts that embed both handset subsidies and ETFs. These competitive contracts are popular with customers for obvious reasons; they have driven the cost of both handsets and network access down, such that in the 4th quarter of 2007, average U.S. revenue per minute of use (reported by Merrill Lynch) was just \$0.04 – the lowest for any developed nation.

2. Why are ETFs in place? They are an efficient mechanism for awarding subsidies for handsets; when ETFs are constrained, handset subsidies are reduced or eliminated. But operator financing of the radio devices solves a very thorny set of coordination problems. Simply put, handsets are part of the network, as wireless engineer and policy expert Charles Jackson puts it. Operators actively seek to upgrade the technologies that their customers use because they internalize many of the gains from network effects and spectral efficiencies that, as individual purchasers, their customers often do not. The market evolves to favor handset subsidies and ETFs precisely because networks that use these devices are better networks, and customers are more attracted to them.

3. We have empirical evidence to back this up. Regulators in some markets have blocked the bundling of handsets with mobile services. It should first be noted the ostensible reason for this: saving operators' money on subsidies. This anti-competitive motive has been explicit in markets like South Korea, where rolling subsidy “black-outs” have prohibited one of the three operators from subsidizing handsets for a few weeks, whereupon the prohibition shifts to another of the operators. This lessens competition and increases carrier profits. It would be illegal for U.S. carriers to arrange to implement this practice in, for example, a hotel room at the Watergate.

Markets that have historically prohibited handset bundling have not exhibited higher levels of output as a result. Moreover, all of the countries that have done this, so

far as I am aware, have eliminated the anti-bundling regulations for 3G. This has been done to promote technology deployment, which was seen to be lagging due to regulation. In Finland, for instance, a leading manufacturing market and the early leader in GSM use, 3G take up was very slow. Researchers there blamed this on the prohibition of bundling, and the policy was reversed. A recent Finnish study¹ notes:

The Finnish Parliament allowed bundling excluding 2nd generation, starting April 2006. In practice this has led to consumers buying subsidised 3G handsets. In Finland 3G has taken off because of bundling. There is a clear cause and effect relationship between allowing bundling and 3G becoming popular in Finland.²

In short, deregulation has proven the pro-consumer policy. So, too, here.

*

Thomas W. Hazlett is Professor of Law & Economics, George Mason University.

¹ Ville Saarikoski, *The Odyssey of the Mobile Internet* (2006); http://www.tieke.fi/mp/db/file_library/x/IMG/20156/file/Saarikoskivaitoskirja.pdf.

² Other papers reach the same conclusion, that Another paper “handset bundling has proved to be an effective driver of 3G adoption.” Marko Repo, *Regulation of Wireless Stakeholders* (2006); http://www.netlab.tkk.fi/opetus/s383042/2006/papers_pdf/B2.pdf.