LOSING THE FOREST FOR THE TREES:
PROPERLY CONTEXTUALIZING THE USE OF EARLY TERMINATION FEES IN THE CURRENT WIRELESS MARKETPLACE

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1. **INTRODUCTION**

Properly assessing competition and consumer welfare in the wireless market has long been a point of contention. Indeed, despite data from a variety of sources that the wireless market is providing consumers with innovative new services and robust price competition, there remains an element that considers this otherwise vibrant marketplace to be anti-consumer. Recently, some have seized on wireless early termination fees (“ETFs”) as the primary symbol of an industry that they allege is not looking out for its consumers, despite the fact that ETF clauses provide for enhanced consumer choice and are commonly used in a wide array of contracts.

To this end, some advocates and policymakers have offered a number of prescriptive measures to alter the use of ETFs by wireless carriers. A handful of bills have been introduced in Congress over the last few years that have sought to address potential legal and policy concerns surrounding ETFs.\(^1\) An open docket before the Federal Communications Commission (“FCC”) calls on the Commission to issue the exact regulatory classification of an ETF.\(^2\) State regulatory groups have also weighed in on this issue,\(^3\) notwithstanding that a majority of states definitively lack jurisdiction over most aspects of wireless

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\(^2\) *In the Matter of CTIA Petition for Expedited Declaratory Ruling on Early Termination Fees*, WT Docket No. 05-194 (“CTIA ETF Petition”).

service. Class action lawsuits have been filed seeking repayment to subscribers of allegedly unreasonable ETFs, and a handful of reports have been issued that decry the use of ETFs as unfair.

Despite this activity, an examination of the wireless market shows that customers are the beneficiaries of a number of welfare gains—including better service quality, enhanced customer service, innovative new products, robust data services, and lower prices—because of intense competition among carriers. Moreover, with over 270 million wireless subscribers in the United States, which represents a penetration rate of 87 percent, carriers have intensified their focus on customer retention in a rapidly shrinking market for new subscribers. As a result, wireless carriers are providing consumers with an array of options for obtaining service. Contracts with ETFs are now only one service option, but remain one of the most popular because a large percentage of customers seem to strongly prefer the initial cost advantages (e.g., a deeply discounted or free handset, low monthly service plan, etc.) of signing a contract with an ETF. As discussed in this Essay, the legal, economic, and social rationales of ETFs demonstrate that these contract terms are mutually beneficial to both the contract holder and the wireless carrier.

This Essay attempts to properly contextualize the use of ETFs in the current wireless marketplace. Part Two provides the context by examining the current wireless market from the consumer perspective. By nearly every measure, carriers have been responsive to the needs of their customers. Across the sector, the quality of service and customer care has increased, there has been a proliferation of different types of service plans, and prices have steadily decreased. Prompted by intense head-to-head competition, carriers are investing billions of dollars in their networks and in support services to provide more individualized service options that fit the needs of different lifestyles and

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4 According to the national regulatory framework implemented in 1993, states only have regulatory jurisdiction over the “terms and conditions” of wireless service. See generally Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 6002(b), 107 Stat. 312, 392 (codified at 47 U.S.C. § 332). The state reservations clause can be found at Section 332(c)(3)(A).


budgets. As a result, customers are increasingly satisfied with their wireless service.

Part Three focuses specifically on ETFs and discusses why these common contract clauses are of value to both the wireless subscriber and the carrier. Term contracts with ETFs remain the most popular service plans for many consumers, largely because they make economic sense. Consumers who agree to a contract with an ETF often pay less for their monthly service and receive a discounted or free handset in exchange for providing carriers with certainty that their investment in a subscriber will be recouped over time. The ETF structure has also changed over the past few years in direct response to consumer demand; most ETFs are now pro-rated and decrease the longer subscribers remain in their contracts.

Part Four articulates a set of policy considerations for policymakers regarding ETFs and the broader wireless market. This section provides a brief overview of how the wireless market has evolved since the early 1990s and discusses how the market thrives when there is regulatory certainty. The rapid evolution of the wireless market and the many consumer welfare gains it has produced are a direct result of certainty and caution against the hasty imposition of policies that purport to protect the consumer but that would serve only to slow innovation and investment by carriers, all to the detriment of subscribers.

Ultimately, wireless consumers have the ability to drive change in the wireless sector, making them the best regulators of the market. Consumer demand has led to a change in the ETF structure, to a diversity of service options, and to the deployment of advanced services across the country. Given the high levels of competition in this increasingly saturated market, carriers have ample incentive to cater to their customers in order to keep their churn rates down and attract new customers. In sum, the wireless market is thriving and policies should be implemented that foster this competitive and innovative environment.

2. COMPETITION & THE WIRELESS MARKET: THE CUSTOMER EXPERIENCE AND CONSUMER WELFARE ISSUES

The most recent FCC report examining the state of the wireless industry concluded that “U.S. consumers continue to reap significant benefits—including low prices, new technologies, improved service quality, and choice
among providers—from competition in the [wireless] marketplace.”

Competition in the wireless market is evidenced by a number of metrics:

- Wireless carriers invested over $20 billion in network infrastructure in 2008.9
- The number of wireless subscribers currently stands at over 270 million, up from just 109 million in 2000.10
- More than 95 percent of the U.S. population lives in census blocks with at least three mobile telephone operators competing to offer service.11
- By December 2008, over 20 percent of households relied on wireless phones as their sole means of voice communication, up more than 50 percent from December 2005.12
- Recent reports indicate that, for the first time ever, the number of wireless-only households has surpassed the number of wireline-only households.13

Consumers are now using their wireless devices for many non-voice applications, including text and photo messaging, email, and other activities enabled by high-speed service. Wireless services are thus playing an “increasingly significant role” in the lives of American consumers.14

In light of these trends and a shrinking market for new customers, carriers are focused on retaining subscribers. Many carriers have developed and implemented comprehensive customer care and service initiatives in order to keep churn rates, or customer turnover, low. Since 30 percent more subscribers

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9 CTIA Wireless Quick Facts.

10 Id.

11 13th CMRS Report at p. 5.


13 Id.

14 13th CMRS Report at para. 1.
ported their numbers to another wireless carrier in 2007 than in 2006, carriers are increasingly creative in their responses to consumer demand. Examples include a spectrum of handsets and calling plans available to consumers, an array of data packages to suit different needs, enhanced customer service, customer loyalty programs, more expansive service, and an overall commitment to ensuring a reliable user experience.

This section analyzes the current wireless market from the consumer perspective. Data indicate that, by nearly every measure, wireless carriers are responsive to the individual needs of their customers. Across the industry, quality of service and customer care has increased while prices have decreased. In addition, customer choice vis-à-vis service plans continues to increase and diversify as wireless carriers offer customers more choices. Those who are focused on wireless ETFs are missing the forest for the trees when it comes to overall consumer welfare in the wireless market.

2.1 Consumer Welfare in the Wireless Market: The Impacts of Competition on the Customer Experience

This section focuses on five aspects of wireless service: quality of service; customer service; customer satisfaction; price; and customer choice. Taken together, these five categories represent the spectrum of a wireless consumer’s interaction and experience with a carrier. By most measures, customers are the beneficiaries of robust competition among carriers and a renewed focus on customer retention.

2.1.1 Quality of Service

Quality of service often refers to network quality (e.g., call clarity) but also encompasses other aspects of wireless service like coverage and data speeds. In terms of network quality, data indicate that consumers are increasingly satisfied with their wireless service.

According to recent surveys conducted by J.D. Power & Associates regarding wireless call quality, consumers are experiencing fewer and fewer “problem calls” (e.g., dropped calls, static, etc.) and report more consistent user experiences across the survey’s six geographic regions. Indeed, according to the most recent study, J.D. Power found that as “the wireless services industry becomes more competitive, the gap in call quality performance between the

15 Id. at p. 10.
16 Id. at para. 214.
highest and lowest ranked carriers is smaller compared with previous year.”

In 2008, J.D. Power found that wireless consumers reported the lowest number of problem calls in the history of its survey.

The data also indicate a clear upward trend in quality of service, which in large part stems from an ongoing commitment by wireless carriers to reinvest revenues into their networks in order to provide subscribers with more reliable voice service and with faster and more innovative data services.

To this end, carriers are rapidly deploying sophisticated third-generation network technologies that are capable of delivering broadband-level Internet connectivity. For example, T-Mobile, which owns a significant portion of advanced 3G spectrum, is rapidly upgrading its network to deliver faster data transmission speeds. Currently, 64 million wireless users have 3G-capable devices and over 40 million wireless users regularly access the Internet on their mobile handsets. A number of carriers are also preparing to deploy the next generation of networks that can support even faster Internet speeds. One standard being used is WiMAX, which will be deployed nationwide by a


19 J.D. Power 2009 Survey (quoting Kirk Parsons, senior director of wireless services at J.D. Power and Associates, as saying “As carriers continue to invest heavily in infrastructure upgrades and improvements, the differences in their network performance has truly resonated with customers...The expansions in coverage will become increasingly important as carriers continue to roll out next-generation technologies.”).


consortium led by Sprint Nextel and Clearwire.\textsuperscript{23} Long-term Evolution (“LTE”) is another such standard, which will be deployed over the next few years by Verizon and AT&T.\textsuperscript{24}

These and other investments provide consumers with assurance that their carrier is committed to providing a consistent user experience and continued innovation at the network level. As a result, quality of service and customer satisfaction has increased while prices have decreased.

\subsection*{2.1.2 Customer Service}

Since it is estimated to be 12 times more costly for a carrier to acquire a new customer than it is to retain a customer,\textsuperscript{25} carriers have a significant incentive to respond to the demands and preferences of existing subscribers in order to bolster customer retention. Carriers are thus investing substantial money and other resources in how they treat customers and address problems, which have resulted in more effective in-store experiences, robust online resources, better billing practices, and an array of help desk services.

Specifically, many carriers are hiring more customer service representatives and spending more on training in order to ensure that their services and billing practices are transparent and fully disclosed to customers at the point of sale.\textsuperscript{26} A recent report on customer service issued by J.D. Power & Associates supports the conclusion that customer service is now a point of competition among carriers. Carriers are competing to improve overall customer care performance,


including in-store experience and interaction with sales associates. These efforts have a direct economic impact on carriers. For example, T-Mobile, the top performing carrier in the J.D. Power survey, has successfully leveraged its reputation for customer service to increase its customer base. Other carriers are following suit. Sprint Nextel, for example, is focusing on customer service in its strategy to recoup some of the nearly 6 million customers it has lost since 2007. Its recent efforts to spur growth have revolved, in part, around its “Ready Now” program, a campaign that uses in-person help to explain and “demystify” its products and services, and to ensure that each customer gets the personal attention they need to understand the service.

2.1.3 Customer Satisfaction

Indicative of increasing customer satisfaction in the wireless market is the fact that the number of complaints received by the FCC from subscribers regarding a variety of aspects of service are decreasing. Although the data do not encompass every single consumer complaint, it is perhaps the most representative of overall trends in the market, since many states do not have jurisdiction over wireless service. The FCC is thus a central repository for wireless complaints from across the country.

According to the most recent data available from the FCC, the total number of wireless subscriber complaints decreased by 26 percent between the third and fourth quarters of 2008. The vast majority of the complaints revolved around issues that fall within the purview of the Telecommunications Consumer

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28 Id. (quoting an author of the survey as saying that “Much of T-Mobile’s success can be attributed to its ability to reach the customer very quickly.”).


30 For more information, please see http://readynow.sprint.com.


Protection Act (e.g., Do Not Call). Of the 12,464 complaints recorded by the FCC during the fourth quarter of 2008, only 501, or four percent, were related to ETFs. Over the last few years, the number of ETF-related complaints to the FCC has tended to fluctuate between 300 and 500 per quarter, but with the number of wireless subscribers continuing to increase over this time the percentage of complaints per million consumers has continued to fall. To this end, the 501 complaints reported in the fourth quarter of 2008 amounted to approximately two ETF-related complaints per 1.1 million customers.

This data and the previously discussed J.D. Power reports regarding overall quality of service and customer service indicate that subscribers are increasingly satisfied with their wireless service. Competition has shifted the focus of wireless carriers towards customer retention, which increasingly hinges on enhancing the overall customer experience and maximizing customer satisfaction. Another key aspect is the price of wireless service, which continues to decrease.

2.1.4 Price

Price is typically the first aspect of wireless service considered by a potential subscriber. Unlike just a few years ago, the price of wireless service now encompasses an array of different items. Originally the cost of wireless service included only voice service, which was typically priced on a per-minute basis. Current plans, however, often contain a number of voice and data options, including text messaging, Internet, and email packages, most of which are priced at a flat rate. The FCC has observed that “wide variations in the non-price terms and features of wireless service plans make it difficult to characterize the price of mobile telephone service.” Yet the FCC has also observed a long-term trend towards lower prices and concluded that prices continue to decrease as a result of “price competition in the market.”

33 Id. at p. 3. It should be noted that these “do not call” complaints are not actually complaints against wireless carriers. Instead, they are complaints against entities that make telemarketing calls to wireless phones.

34 According to CTIA – The Wireless Association, there were approximately 270.3 million wireless subscribers in the U.S. at the end of 2008. CTIA Wireless Quick Facts.

35 There are, of course, per-minute charges assessed on subscribers who exceed the contract limits of minutes or data used per month. However, as discussed infra, many carriers now offer unlimited voice and data plans.

36 13th CMRS Report at para. 188.

37 Id.
In general, the price of the individual elements of wireless service continues to decrease. For example, the cost per minute of voice service declined substantially from the mid-1990s to the early 2000s, dropping from $0.57 per minute in 1993 to $0.12 per minute in 2002.\textsuperscript{38} Ever since, the price of voice service has continued to steadily decrease, from $0.10 per minute in 2003 to $0.06 in 2007.\textsuperscript{39} Over this same period of time, the average number of minutes used per month by subscribers has increased from 140 in 1993 to 769 in 2007.\textsuperscript{40} The FCC has also found that the price per minute of voice service in the United States is significantly less expensive than in Western Europe and Japan.\textsuperscript{41}

The price of wireless data services also continues to decrease. For example, the price per text message is declining\textsuperscript{42} as the number of texts per month reached 110 billion in December 2008.\textsuperscript{43} However, rather than price each individual element of a data package, most wireless carriers provide consumers with the ability to purchase unlimited data plans, which usually include unlimited text messaging and Internet access. This is an increasingly popular option for subscribers. Indeed, the number of consumers who subscribe to unlimited monthly mobile Internet plans increased by 40 percent between the first quarter of 2007 and the first quarter of 2008.\textsuperscript{44} Price competition and customer retention efforts are evident across the marketplace as carriers compete to provide consumers with innovative handsets and cheaper data plans.

For example, a strategy being employed by Sprint Nextel to regain market share is to substantially cut prices. To this end, the company recently attracted attention when it announced a $50 per month unlimited calling and texting plan for its Boost Mobile subsidiary.\textsuperscript{45} It is estimated that this plan could save consumers close to $700 per year.\textsuperscript{46} Sprint also recently announced an unlimited calling and data package that is priced at $99 per month, currently the lowest

\begin{flushleft}

\textsuperscript{39} 13\textsuperscript{th} CMRS Report at p. 8.

\textsuperscript{40} Id. at Table 12.

\textsuperscript{41} Id.

\textsuperscript{42} Id. at para. 194.

\textsuperscript{43} CTIA - Wireless Quick Facts.

\textsuperscript{44} 13\textsuperscript{th} CMRS Report at para. 122.

\textsuperscript{45} See Jason Gertzen, Cellphone Competition Heats up with Sprint’s $50 Plan, Feb. 28, 2009, KAN. CITY STAR.

\textsuperscript{46} Id.
\end{flushleft}
among the major carriers. AT&T, T-Mobile, and Verizon Wireless also offer unlimited calling and data plans (see Table 1). Such one-upmanship further supports the FCC’s observation that the market is competitive and that competition is forcing carriers to compete on a wide array of terms, including, among many others, price, the number of service options available, and network capabilities.

Despite the recent economic downturn, wireless carriers continue to add subscribers. Indeed, the total number of wireless subscriptions increased 4.4 percent in 2008, which signals healthy competition among carriers and persistent demand for wireless service among consumers. However, the economic downturn has underscored the importance of price and of diversity in the number and type of wireless plans available. As discussed in the next section, perhaps the greatest measure of consumer welfare gains in the wireless market over the last several years is the expansion in the number of service options available to consumers, many of which do not include an ETF.

2.1.5 Choice of Service Plans

Price competition has led to the creation of a wide range of service plans to meet the needs of all types of consumers. Table 1 provides an overview of the types of plans that are available to consumers via the major carriers and smaller carriers. Plans offered include: individual and family plans containing prorated ETFs; monthly plans with no ETF; prepaid services; and a number of other hybrid and individualized options. The diversity of plans demonstrates that wireless carriers are responsive to consumer demand for price and plan options. Although the lowest priced plans (on a per-minute basis) tend to be those that contain ETFs, there are a number of similarly priced options for those consumers who do not want to lock in to a one- or two-year contract. In addition, all major carriers now prorate ETFs, meaning that the longer a customer stays in a contract, the less of an ETF they would pay should they wish to break their contract (ETFs are discussed more thoroughly in Part Three). The range of options included in Table 1 supports the FCC’s finding

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that the “continued rollout of differentiated pricing plans also indicates a competitive marketplace.”

A growing number of consumers have opted for pre-paid service, which allows a customer to purchase wireless service without a contract (and hence, without an ETF). In addition to responding to consumer demand, pre-paid service has allowed smaller carriers and resellers to enter the market as niche competitors. An increasing number of these carriers are establishing themselves as viable competitors. For example, carriers like MetroPCS and Leap are thriving in the pre-paid market, so much so that MetroPCS added 684,000 new customers in the first quarter of 2009. Sprint is also using the pre-paid market to add new users. According to one estimate, “more than 10 million people have unlimited-calling prepaid plans” and the potential market for this service is “about 45 million to 60 million people.” Across the entire sector, eighty percent of new subscriber growth in the first quarter came from prepaid plans.

Carriers also offer an array of other hybrid and individualized plans. T-Mobile, for example, has a FlexPay plan that provides consumers with more service options than prepaid plans. In particular, customers have a wider range of handset choices and the ability to add on additional features, all while paying by the month and not being subject to an ETF. Verizon Wireless and AT&T offer senior citizens specially designed plans that cater to the needs of older users. Both offer seniors plans that include 200 anytime minutes, 500 night and

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49 13th CMRS Report at para. 111.


51 Id.

52 Id.


54 Additional information regarding the Flex Pay Plan can be found at http://www.t-mobile.com/templates/faq.aspx?PAsset=Pln_Pop_FlexPayFAQ&CAsset=howsign#howsign.


weekend minutes, and unlimited in-network calling for less than $30 per month.

In general, the wide variety of service plans provides consumers with the flexibility to upgrade or downgrade plans. This flexibility has been important to consumers during the current economic downturn. Indeed, one recent study found that “39 percent of Americans with contract-based cellphone plans were likely to downgrade their plans to save money.” 57 This study also found “that 26 percent of consumers with a contract plan were considering switching to prepaid and pay-as-you-go cellphone plans because of job losses and concerns about the tumultuous economy.” 58 Thus, the range of service options available to consumers is extremely valuable at a time when one in five wireless users has considered cutting back or otherwise modifying their service. 59

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58 Id.

59 Cellphones and the Economy at p. 4.
## Table 1—Overview of Service Plans Offered by Wireless Carriers

<table>
<thead>
<tr>
<th>Carrier</th>
<th>Plans w/ ETFs</th>
<th>Trial Period</th>
<th>Pre-Paid</th>
<th>Unlimited Plan</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT&amp;T</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>Offers a specially designed plan for senior citizens: 200 Anytime Minutes, 500 Night &amp; Weekend Minutes for $29.99/month.</td>
</tr>
<tr>
<td>Sprint Nextel</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>Even though Sprint lost over 1 million postpaid subscribers in the first quarter of 2009, it did add over 600,000 prepaid customers.</td>
</tr>
<tr>
<td>T-Mobile</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>T-Mobile offers a FlexPay option, which is a monthly plan without an ETF. T-Mobile also offers its post-paid monthly plans on a no-contract basis with no ETF.</td>
</tr>
<tr>
<td>Verizon Wireless</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>Verizon Wireless was the first carrier to pro-rate its ETFs starting in November 2006.</td>
</tr>
<tr>
<td>US Cellular</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
<td>Offers a “wide area” plan for those who make calls primarily from areas close to your hometown and nearby cities.</td>
</tr>
<tr>
<td>MetroPCS</td>
<td>N/A</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
<td>Offers flat rate plans, unlimited minutes, no contracts, no activation fees, and the first month is free.</td>
</tr>
</tbody>
</table>
2.2 CONCLUSIONS

By every significant measure, consumer welfare gains in the wireless market have increased from the 1990s to the present. Moreover, due to an increasingly saturated market and intense competition among service providers, carriers are tailoring service offerings to meet the individual needs of their subscribers in order to retain them. The data support a number of trends:

- The quality of wireless service and the overall customer experience continues to improve as carriers reinvest revenue into their networks and their customer service.
- Prices continue to decrease as service offerings become more diverse, numerous, and robust.
- Competition is driving innovation at the network level, the application level, and the device level. Consumers now have an array of choices for making calls, sending texts, and surfing the web.
- Consumers have a number of options for purchasing wireless service, including yearly contracts with ETFs, pre-paid service, month-to-month service, and a number of other hybrid plans. ETF contracts are now only one of an array of options available to consumers.

3. AN ANALYSIS OF EARLY TERMINATION FEES IN THE CURRENT WIRELESS MARKET

As discussed in Part Two, firms in the wireless market are competing more intensely on the many aspects associated with the customer experience. Customers have a growing universe of options available to them for obtaining wireless service. Indeed, as outlined above, the sheer diversity of these service options evidences a desire by carriers to cater to the individual needs of subscribers. Yet, a minority of advocates and policymakers continue to focus on ETFs as the primary symbol of what they deem to be an anti-competitive, anti-consumer wireless market.

Part Three addresses these claims. In particular, this section analyzes why these commonly used contract terms make economic sense for both the carrier and the consumer. Moreover, this section will detail the evolution of ETFs in the wireless market and highlight the market’s move toward a more flexible, prorated structure for these fees. When viewed in the proper context, ETFs are neither anti-competitive nor anti-consumer.
3.1 The Role of ETFs For Carriers & Consumers

An ETF is a mutually agreed upon provision in some service contracts that requires customers to pay a fee should they opt out of their contract before the end of the term. These provisions allow a service provider to recoup a portion of the revenue it would lose if a customer decides to end the contract early. Similarly, ETFs provide consumers with certain economic incentives (e.g., better pricing plans and initial discounts on wireless devices) to enter into a contract containing an ETF clause and to remain in that contract for the entire term. This *quid pro quo* provides benefits on both sides of the agreement and are thus economically sensible for a variety of reasons.

In general, ETFs allow wireless carriers to subsidize better pricing plans and discounted handsets for consumers. The ETF permits a carrier to offer attractive initial discounts and competitively priced monthly plans to customers willing to make a minimum service commitment even though the initial cost of adding a new customer to the network is relatively high.\(^60\) Given the competition between carriers for customers, offering a variety of discounts and monthly service plans allows a carrier to compete on price in a number of ways. Similarly, relatively high churn rates in the wireless market, another result of the competition between carriers, make ETFs a rational business method for carriers because they offer a viable remedy should a user decide to end a contract early.\(^61\) An ETF does not lock a customer into a contract. Rather, like most services contracts, it stipulates a charge, which often makes up the difference between a discounted handset and the carrier’s contractual expectation, should a customer decide to opt out before its expiration.

Early termination fees are part of a wireless carrier’s rate structure, which is comprised of multiple components, including fees for activation, monthly access, special features, local and long distance airtime, and roaming charges.\(^62\) Combined, these components are designed to compensate wireless carriers for the services they provide over the length of the contract.

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\(^{60}\) *Can you hear me now?* (noting that “the average acquisition of a customer costs roughly $300, a whopping 12 times more than what it costs to retain an existing customer.”).

\(^{61}\) According to the most recent FCC most data, average churn rates are about 1.5 to 3 percent per month. This means that, on an annualized basis, wireless carriers lose upwards of a third of their customers. Churn rates have been trending downwards of late, which further supports the notion that customers are increasingly satisfied with their wireless service. 13th CMRS Report at para. 181.

\(^{62}\) The exact regulatory classification of ETFs is a matter of much debate and will be discussed in more detail in Part Four.
From the consumer perspective, this structure is beneficial because it provides affordable access to otherwise expensive handsets. For example, the LG Chocolate 3 phone is valued at $269, versus $89.99 if purchased as part of a Verizon Wireless 2-year contract. Similarly, Apple’s iPhone retails for approximately $600, but is available for around $200 as part of a 2-year contract with AT&T. For many customers, financing the cost of an expensive handset via a one- or two-year contract is preferable to paying substantially more upfront for the device and having no contract.

ETFs are also beneficial to consumers as they serve to reduce costs for all customers (regardless of whether they are subject to an ETF) resulting from customers breaking their contracts. ETFs isolate the costs of breaking a contract to the cost-causer, meaning that the costs of one consumer’s actions (e.g., terminating a contract after receiving a discounted handset) are not socialized amongst the general body of customers, the majority of whom honor their contracts. This helps keep rates low for all users, even those who are not subject to ETFs.

3.2 ETFs as a Commercially Accepted Business Practice

Early termination fees are not unique to the wireless market. A useful analog can be found in the way airlines price their tickets. The lowest priced fares are typically nonrefundable and subject to a cancellation or change-of-service fee. Passengers who wish to have the flexibility to cancel their purchase without penalty often pay a higher, unrestricted fare. For example, first-class tickets, which are generally the most expensive fares, typically provide passengers with premium seats, more perks, and the ability to cancel or modify their reservation at any time. Unrestricted or refundable coach tickets likewise provide consumers with a right to change or cancel their purchase. An example is useful. Delta offers a nonrefundable roundtrip coach ticket from New York to Atlanta for $638. Delta charges a $100 fee to cancel the ticket and a $150 fee to modify the reservation. A refundable coach ticket, as well as a first-class ticket, on this same flight costs $836. From the consumer’s perspective, Delta offers a clear choice: a cheaper ticket with less flexibility or a more expensive ticket with a better seat and more flexibility.

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63 See Verizon Wireless, Phones and Devices - LG Chocolate 3, [http://www.verizonwireless.com/b2c/store/controller?item=phoneFirst&action=viewPhoneDetail&selectedPhoneId=3886](http://www.verizonwireless.com/b2c/store/controller?item=phoneFirst&action=viewPhoneDetail&selectedPhoneId=3886).


65 All prices and terms are as of May 29. Details can be found at [www.delta.com](http://www.delta.com).
ETFs are widely used in a number of other industries and are routinely found in many service contracts. For instance, hotels often charge cancellation fees if customers cancel their reservation after a certain point in time. Most car leases include a substantial fee for breaking a lease before the expiration of the term. Similarly, many rental car companies charge nonrefundable deposits. Magazine subscriptions oftentimes levy a fee (or retain prior payments made) should a reader cancel a subscription. Many gym memberships require the payment of an ETF for ending a contract ahead of the scheduled term. Satellite TV services also include ETFs. For example, DirecTV charges a cancellation fee of up to $480 depending on the agreement signed by the user, as well as a deactivation fee or an unreturned equipment fee.\footnote{See DirectTV, Agreements, http://www.directv.com/DTVAPP/global/contentPage.jsp?assetId=1100106.}

As with any contract, customers are presumed to be aware of all the terms and conditions contained in the document they are signing. As previously discussed (Section 2.1.3), recent data from the FCC indicate a leveling off of ETF-related complaints per million wireless subscribers, suggesting that most consumers are aware of their ETF obligation. Further, as discussed in Section 4.1, most carriers adhere to the CTIA Consumer Code, which requires that all aspects of wireless contracts and service, including the ETF requirement, be disclosed to buyers at the point of sale and in advertisements.

The continued use of ETFs by wireless carriers reflects the basic market reality that consumers appreciate good deals and low prices. The regulatory framework for wireless—which is national in scope and minimalist in nature—encourages wireless carriers to compete head-on. In order to compete on price, carriers have had to lower monthly rates, subsidize equipment and increase the quality of their customer service. ETFs allow carriers to do this, while enabling them to continue to provide innovative products and services.

3.3 The Wireless Industry’s Response to Consumers Regarding ETFs

Carriers have responded to consumer demand by altering the way they use ETFs. For example, in 2006 Verizon Wireless began pro-rating ETFs, which means that the longer a customer stays in a contract, the lower the ETF would be for canceling a contract prior to its end date.\footnote{13th CMRS Report at para. 114.} All of the other major carriers, and many smaller carriers, have followed suit. Similarly, a growing number of carriers have instituted no-strings return policies that do not invoke the ETF.
AT&T implemented a 30-day return policy in August 2004, which was matched by Sprint Nextel in 2006. Verizon Wireless and T-Mobile offer similar return policies. In addition, carriers offer a wide array of non-ETF service plans (see Table 1).

3.4 Conclusions

The market-based evolution of pricing plans has been recognized by the FCC as indicative of competition in the market. Pricing plan diversity puts the ultimate control of wireless service in the hands of customers. Consumers who contract with a carrier for a year or two will typically benefit from a reduced monthly charge and a discounted handset in return. The carrier, in turn, receives the certainty, backed by an ETF, that the consumer will be their customer for that fixed period of time. If a consumer does not wish to be contractually bound to a carrier, they can avail themselves of any number of hybrid plans that provide them with greater flexibility.

4. Policy Considerations: Protecting the Future of Wireless

As discussed in Parts Two and Three, the wireless marketplace is competitive, responsive to consumer demand, and producing a number of consumer welfare gains. These benefits have flowed from a regulatory framework that is national in scope and minimalist in nature. Indeed, Congress and the FCC have been deliberate in their approach to the wireless market because of its unique structure and ability to quickly innovate and deploy new services. As a result, careful policymaking in and around the wireless market is essential in order to ensure continued consumer welfare gains, to spur investment in new networks, to encourage the development of innovative new products and service, and to enhance the overall user experience.

This section discusses a number of considerations for policymakers as they seek to craft and implement meaningful regulations for the wireless market.

4.1 Regulatory Certainty and Innovation in the Wireless Market

The wireless sector has thrived under the national regulatory framework that was implemented by Congress, on a bipartisan basis, in the early 1990s. Such

68 Id. at para. 111.

an approach has provided the sector with regulatory certainty and has allowed carriers to compete head-on without overly intrusive or inconsistent state-by-state regulations. The result is a marketplace for wireless services that is characterized by product innovation, price and service competition, and network investment. However, recent actions by the courts and some policymakers at the state and federal levels threaten to inject regulatory uncertainty into the wireless market. Unnecessary intervention would likely chill innovation and competition, leading ultimately to consumer welfare losses.

Once the FCC tacitly endorsed ETFs as part of a larger order that allowed the bundling of wireline and wireless services for the first time, and ever since Congress implemented the national regulatory framework, there has been increasing debate over whether ETFs are “terms & conditions” of wireless service and thus within the regulatory purview of states or whether they are “rates” and therefore beyond the reach of state regulatory authority. In the absence of a ruling by the FCC or guidance by a federal statute on the matter, some states have begun to invoke their “terms & conditions” authority in response to consumer complaints regarding ETFs. Similarly, a number of class action lawsuits have been filed against carriers, arguing that certain ETF clauses are unreasonable and thus illegal. While none of these cases has definitively settled the issue of the proper regulatory classification of an ETF, this type of piecemeal approach is disruptive to the marketplace.

For example, even though all major carriers currently pro-rate ETFs, some consumers continue to file class action lawsuits in the hope of following the precedent set in a recent case against Sprint. In that case, the court found that Sprint’s previous ETF structure was illegal, even though the use of ETFs was found to be legal. Similarly, a number of advocates cite a ruling issued by the 11th Circuit Court of Appeals in 2006 as support for the notion that ETFs are “terms & conditions” of wireless service, even though the case dealt with the issue of state authority to regulate the use of line-items in wireless billing. The Court did chastise the FCC for its failure to provide proper guidance regarding the difference between a “rate” and a “term & condition” of wireless service,

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71 CTIA ETF Petition.
72 Sprint ETF Case.
which has further added to the uncertainty regarding the classification of an ETF.\textsuperscript{74}

Recent actions by the FCC and Congress have sought to provide clarity on these issues. For example, the FCC considered ETFs at a public hearing in June 2008, which focused on two main issues: how to define an ETF and whether the states or the federal government is the better regulator of the industry. As previously noted, a number of consumer protection bills have been introduced in both houses of Congress over the last few years. ETF provisions included in these bills tend to focus on ensuring that consumers are aware of their responsibility for paying these fees should they break their contract. More clarity, however, is still needed.

Over the last several years, however, the wireless industry has responded to concerns regarding ETFs by adopting a more flexible ETF structure (see Section 3.3) and a more open approach with its customers. To this end, most wireless carriers adhere to a Consumer Code issued and administered by CTIA—The Wireless Association.\textsuperscript{75} The Code requires adherents, among many other things, to provide ample disclosure regarding ETFs and other service terms. In addition, a number of wireless carriers in 2004 entered into an Agreement of Voluntary Compliance (“AVC”) with over 30 state Attorneys General regarding consumer practices.\textsuperscript{76} Under the AVC, carriers agreed to, among other things, “provide coverage maps,” “give consumers at least two weeks to determine if service is available where they need and want it,” “permit consumers to terminate service contracts within three days for any reason without paying the early termination fee or any activation fees”\textsuperscript{77} and to provide “clear and conspicuous” disclosures regarding ETFs.\textsuperscript{78}

These developments, coupled with the decreasing amount of overall complaints and ETF-related complaints received by the FCC, underscore the importance of a regulatory approach that provides carriers with ample flexibility to

\textsuperscript{74} Id.
\textsuperscript{76} Text of the AVC settlement can be found at http://www.nasuca.org/VERIZON%20WIRELESS%20AVC%20FINAL%20VERSION.pdf (“AVC Text”).
\textsuperscript{78} AVC Text at para. 18.
implement solutions on their own. Moreover, the actions taken by courts and state regulators to try and assert regulatory authority over some aspects of wireless service (e.g., ETFs) have produced regulatory uncertainty. Given a choice between the competition-based measures implemented by the wireless carriers on the one hand, and the fractured approach taken by courts and state regulators on the other, the most efficient and consumer-friendly choice is clear.

Consumer welfare gains are numerous and tangible in the wireless marketplace. Prices continue to decrease as the number and type of service options continue to increase. The FCC could provide certainty to the marketplace in the form of a clear determination that ETFs are a “rate” and thus outside the jurisdiction of states. Similarly, Congress could provide certainty by developing a national framework for consumer standards (see Section 4.3). In the meantime, consumers have proven to be an effective regulator of carrier behavior and carriers should be given enough latitude to continue to craft and implement solutions that satisfy the demands of their subscribers.

4.2 Government Regulation of the Structure of Wireless Service Plans is Inefficient and Unnecessary

While many approaches to the ETF issue focus on enhancing customer awareness and understanding of these provisions, some advocates have called for an outright suspension of ETFs. This proposal probably appeals to a certain segment of consumers but, upon close examination, does not make sense for wireless customers or wireless carriers for a number of reasons.

First, as previously discussed, ETFs are ultimately pro-consumer because they provide customers with access to affordable handsets and subsidized monthly service plans in exchange for a promise to remain in a contract for a year or two. Without the ETF option, consumers would have to pay full price for handsets, many of which retail for several hundreds of dollars more than the subsidized price. In essence, agreeing to pay an ETF defers the upfront cost of the handset while providing the consumer with an affordable monthly service plan. Eliminating ETFs would thus deprive consumers of an affordable and popular service plan option.

Second, the industry has responded to consumer demand by implementing a more flexible ETF structure. All major carriers now pro-rate their ETFs and provide at least 14 days to cancel a contract without invoking the ETF clause. In

79 See, e.g., Testimony of Nebraska PSC Commissioner Anne Boyle Before the FCC En Banc Hearing on Early Termination Fees, June 12, 2008.
addition, carriers are required by a number of regulations and agreements to ensure that customers are aware of and understand the terms of their contracts, including the presence and scope of an ETF requirement, in their advertisements and at the point of sale. Such efforts provide consumers with ample notice of ETFs and an opportunity to cancel an ETF contract without penalty.

Third, ETFs are legal contract provisions that are used in a variety of contexts. The *quid pro quo* embodied in the wireless ETF has been in use for many years and has proven to be an essential business doctrine. Suspending or otherwise declaring wireless ETFs to be illegal or bad policy would create a slippery slope and could have the unintended consequence of limiting the contract practices of millions of businesses across a spectrum of industries.

Fourth, for those consumers who wish to break their contracts and thus trigger the ETF clause, a number of innovative approaches have been developed by third-parties that provide subscribers with options for not paying the fee. For example, websites like Cellswapper.com and Celltradeusa.com offer consumers a conduit for trading cell phone contracts rather than canceling them.\(^{80}\) Most wireless carriers allow subscribers to swap contracts, thus creating a secondary market for wireless plans and devices.

Fifth, as outlined above, the market provides consumers with a growing universe of options for obtaining wireless service. Consumers are not forced to enter into yearly contracts that contain ETFs. Indeed, recent subscriber growth has been spurred by the availability of non-ETF plans like pre-paid service, which accounted for the vast majority of growth in the first quarter of 2009.

Finally, government micromanagement of wireless contract terms will not enhance consumer welfare and would likely hurt consumers. The success of the wireless market is directly attributable to the current regulatory framework, which is decidedly hands-off. As such, government intrusion into the market in the absence of a clear market failure would unnecessarily and negatively disrupt its many gains.

4.3 A National Regulatory Framework and the Role for National Consumer Standards

The policy vacuum vis-à-vis ETFs and the resulting regulatory uncertainty described in Section 4.1 supports the need for a more comprehensive approach to consumer standards in the wireless market. Although an unambiguous classification of ETFs by the FCC would be a promising first step, many agree that a new framework for wireless consumer standards is required, one that is national in nature, establishes standards that are both a “floor” and a “ceiling,” and allows states to enforce these rules.81 Such a framework would provide regulatory certainty to the marketplace and would provide consistent protections to consumers across the country.

This approach has been supported by an increasing number of policymakers at the state and federal levels. Indeed, leading state policy groups like the National Association of State Regulatory Commissioners (“NARUC”) and the National Conference of State Legislatures (“NCSL”) have endorsed such a framework.82 Congress is also currently considering legislation that would codify a similar approach to developing and implementing national consumer standards.83

A new national framework would be beneficial and effective for a variety of reasons. Such a framework would provide additional regulatory certainty to wireless carriers, which would encourage further investment and network deployment. Even though states lack jurisdiction over most aspects of wireless


82 NARUC recently adopted a resolution that calls for the formulation of “mutually agreed upon, uniform national wireless consumer protection standards coupled with an effective partnership of State and federal enforcement.” See NARUC Committees on Telecommunications and Consumer Affairs, Resolution Concerning the Communications Policy Statement (July 23, 2008), available at http://www.naruc.org/Resolutions/TC%20Communications%20Policy.pdf. NCSL recently adopted a “Twenty-first Century Communications Policy Statement” that “urges state and federal policy makers to work together to ensure that industry targeted consumer protections can be applied within a national framework that ensures the continued ability of the state attorneys general to enforce such consumer protections.” See Committee on Communications, Financial Services & Interstate Commerce, Twenty-first Century Communication Policy, available at http://www.ncsl.org/standcomm/scsvcs/CommFinSvcs_Policies.htm#21Century.

83 Another Attempt at Wireless Consumer Protection Bill.
service, hundreds of bills are introduced each year in legislatures across the country that seek to regulate some aspect of it. Individual states tend to rationalize these bills as a way to bolster consumer protections for their residents, but the “aggregate effect of these differing consumer protection bills would be a net negative impact on consumers – prices would increase as service providers increase expenditures to comply with a multitude of varying rules.”

Implementing national consumer standards that, as appropriate, are enforced locally would provide consumers with robust protections regardless of geographic location. Moreover, the downward trend in wireless pricing would continue under such an approach since carriers would be able to decrease compliance costs incurred under the current patchwork of state regulation.

5. **Conclusion**

Consumers have proven to be an effective driver of change in the wireless marketplace. Similarly, carriers have been receptive to the demands of their customers and are responsive to the fact that customer retention is critical as the market becomes increasingly saturated. This dynamic has produced a vibrant, competitive, and innovative wireless space that provides consumers with an array of options for obtaining service and for using robust networks for making a call, sending a text, checking email, or using one of the thousands of interactive applications available on increasingly sophisticated handsets.

Claims that the marketplace is anti-consumer or anti-competitive are not supported by the facts. Moreover, focusing specifically on the efficacy of ETFs overlooks both the many gains that consumers have reaped over the last few years and the specific roles played by ETFs. When viewed as part of a much larger and innovative space, ETFs quickly become one small thread in the strong, vibrant fabric that is the U.S. wireless market. Efforts to derail this progress by shifting the focus towards the tenability of ETFs are fundamentally

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84 *Wireless Federalism* at p. 11.

85 See, e.g., George S. Ford, Thomas M. Koutsky & Lawrence J. Spiwack, *An Economic Approach for Evaluating a National Wireless Regulatory Framework*, at p.2, Phoenix Center Policy Bulletin No. 19 (Oct. 2007), available at [http://www.phoenix-center.org/PolicyBulletin/PCPB19Final.pdf](http://www.phoenix-center.org/PolicyBulletin/PCPB19Final.pdf) (arguing that “permitting unfettered state regulation of an industry characterized by extra-jurisdictional effects and spillovers may harm social welfare—even if states enact policies that maximize the welfare of their own constituents.”); *Wireless Federalism* at p. 13 (observing that “When states are allowed to implement a patchwork of disparate regulations for a good or service that is national in nature, individual policy choices have a large aggregate impact on providers, the consequences of which inevitably trickle down to consumers, usually in the form of higher prices.”).
misguided and dangerous to consumer welfare. Going forward, policymakers should consider ETFs only in the context of the larger wireless market generally and of the many other types of service options available to consumers specifically. Otherwise, policymakers risk disrupting the remarkable amount of innovation and abundant consumer welfare gains that characterize the current market.

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The ACLP is an interdisciplinary public policy program that promotes solution-focused dialogues among state and federal policymakers, industry, academe, consumers, and the financial community regarding changes to the state and federal regulatory regimes governing the advanced communications sector. For more information, please contact:

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