U.S. Public Interest Research Group
National Association of State PIRGs

16 August 2005

Federal Communications Commission
Docket Control
(via FCC electronic filing system)

RE: **WT Dockets 05-193 and 05-194, Ex Parte Notice**

To the Commission:

By this letter the U.S. Public Interest Research Group is hereby submitting the attached U.S. PIRG Education Fund report entitled "Locked in A Cell: How Cell Phone Early Termination Fees Hurt Consumers" as U.S. PIRG's **ex parte** filing in **WT Dockets 05-193** and **05-194,** both concerning Early Termination Fees in Wireless Service Contracts.

Please contact me if you have any questions.

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att.

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Locked In A Cell:

How Cell Phone Early Termination Fees Hurt Consumers

a U.S. PIRG Education Fund Report

August 2005

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1. Executive Summary

By almost any measure, the cell phone industry is one of the real market-expansion success stories of the digital age. As of the end of 2004, there were 182 million wireless phones and related devices operating in the United States, up from 24 million in 1994.

Yet, at the same time, the number of giant companies controlling the industry has been shrinking. In mid-2004, six companies – AT&T, Nextel, Sprint, Cingular, Verizon and T-Mobile – controlled approximately 80% of the market. Since then, four of the six – Cingular and AT&T, and Sprint and Nextel– have merged. Now, just four firms will control 80% of the market.

Such a high level of concentration in a major industry can be accompanied by excessive market power, which in turn can reduce competition to the detriment of consumers.

Numerous studies have documented rising complaints about low service quality in the industry. For example, a recent MASSPIRG report, *Can You Hear Us Now*, surveyed 874 Massachusetts cell phone customers and found general dissatisfaction, with 42% of consumers having a billing problem with their provider and 68% reporting dropped calls and other quality problems.[1]

This report, *Locked In A Cell: How Cell Phone Early Termination Fees Hurt Consumers*, is based on a national survey of 1000 consumers and their attitudes on early termination fees (ETFs), which are penalties of $150-$240 per phone designed to lock consumers into a contract with an existing provider – often for periods extending beyond the initial two-year contract – and prevent them from shopping for a new provider with better service or better terms.

In response to consumer lawsuits in several states challenging ETFs as unfair, the cell phone industry has petitioned the Federal Communications Commission (FCC) to treat ETFs not as penalties designed to restrict consumer choice but as a part of the rates that the companies charge their customers for cell phone services.

This report analyzes the industry's efforts to immunize itself from state consumer protection efforts against this unfair practice that effectively makes consumers captive customers.

Key Findings

Between July 12, 2005 and July 14, 2005, the polling firm IPSOS North America called 1000 U.S. households and asked a series of questions about cell phone service and early termination fees. We found:

Cell phone customers are discouraged by the fees from switching to a new cell phone company that would provide lower rates and better service. Thirty-six percent of the respondents replied that the fees had prevented them from switching.

Cell phone customers disagree with the cell phone industry that the termination fees are part of their rate structure – they view the fees as penalties designed to prevent consumer choice. Nearly 9 out of 10 consumers (89%) agreed that the early termination fee is "a penalty to discourage switching cell phone companies."

Early termination fees cost cell phone users more than $4.6 billion from 2002 to 2004. By combining the actual costs incurred by the 10% of consumers who switched in the past three years **($2.5 billion)** with the benefits lost by consumers who couldn't afford to switch (**$1.2 billion)** and benefits lost by consumers who felt the benefits weren't enough to offset the fees **($929 million)**, cell phone early termination fees cost consumers more than $4.6 billion from 2002 to 2004.

Roughly half of consumers would consider switching companies if early termination fees were eliminated. The survey found that nearly half or 47% of cell phone customers would "switch cell phone companies as soon as possible" or "consider switching cell phone companies" if early termination fees were eliminated.

Primary Conclusions

- **Cell phone companies' early termination fees work and, as a result, create captive customers** unable to exercise their right to choose the best-quality service and lowest rates. Customers that are dissatisfied with cell phone service and want to choose a better service provider are saddled with two highly unsatisfactory options: either pay an expensive penalty or continue enduring poor quality service. In most cases, given the high cost of the fees, they are stuck with the latter option.

- **The fees inhibit competition in the cell phone industry.** Because consumer choice is restricted, companies can avoid providing the highest quality service and lowest-possible rates that would otherwise prevail in a highly competitive industry. This represents both an enormous loss for America's cell phone users and a reduction in the efficiency and fairness of the nation's economy.

- **The FCC should not be fooled by the clever but fatally flawed arguments in the industry's recent petition to the Commission.** The industry's arguments distort economic reality, hide the negative impacts of the fees, and represent little more than a desperate attempt to get the federal government to unjustifiably protect the industry from well-deserved legal challenges, on behalf of customers, at the state level. As the economic arguments and empirical research in this report show, the industry's claims that the fees are rates designed to recoup their costs rather than penalties imposed on customers are neither credible nor valid.

- **There is little public support for the FCC to grant the industry's petition.** The public is neither buying the industry's fees nor being fooled by its arguments to the FCC. Cell phone users overwhelmingly want the fees to be eliminated and believe that the fees are penalties rather than rates. Even most of those cell phone users who do not want to switch companies or have not paid the fees support elimination of the fees and reject the industry's claim that the fees are rates.

Major Recommendations

First, **the FCC should reject the cell phone industry's petition** requesting that the Commission define early termination fees as rates rather than penalties and preempt legal challenges to the fees at the state level.

Second, the **FCC, the rest of the Bush administration, and Congress should not take any other steps** requested at a later date by cell phone companies or industry representatives that are **designed to prevent cell phone companies from being held legally accountable for the impacts of early termination fees** at the local, state or federal levels.

Third, **all cell phone service providing companies should quickly eliminate the use of early termination fees** (or other mechanisms with similar adverse impacts on consumer choice).

Fourth, **the Government Accountability Office of the U.S. Congress should conduct an independent review** of the impacts (on consumers, competition and the overall economy) of high concentration and market power in the cell phone service provider industry.

2. Background:
The Cell Phone Industry, Consumer Choice, Competition, and the FCC

While Cell Phone Industry Is Booming, Competition May Be Shrinking

By almost any measure, the cell phone industry is one of the real market-expansion success stories of the digital age. As of the end of 2004, there were 182 million wireless phones and related devices operating in the United States.[2] Annual revenues for services provided by the industry totaled $104 billion in 2004.[3]

The sheer magnitude of cell phone use in the United States is paralleled by the rate of growth in cell phone users and industry revenues. In the five-year period between 2000 and 2004, the number of "subscribers" leaped from 109 million to 182 million, giving the industry a 14% annual growth rate in phones in service. In the ten years since 1995, the number of subscribers increased six fold while there was a similar fivefold increase in industry revenues from wireless services.

In recent years, the number of giant companies controlling the industry has been shrinking. In 2004, the industry behemoths included AT&T, Nextel, Sprint, Cingular, Verizon and T-Mobile. In October 2004, Cingular gobbled up AT&T, leaving five companies controlling roughly 80% of U.S. cell phone industry revenues.[4] An additional giant merger between Nextel and Sprint, valued at $35 billion, was approved on August 3, 2005 by the U.S. Justice Department and the Federal Communications Commission (FCC). Now, only four companies will likely control more than four-fifths of the market for cell phones in this country by late 2005.

History teaches us that such a high level of concentration in a major industry can be accompanied by excessive market power, which in turn can reduce competition to the detriment of consumers and overall efficiency in the U.S. economy. The cell phone industry is no exception. Cell phone companies are notorious for poor customer service, erratic coverage, and high fees. MASSPIRG 874 Massachusetts cell phone customers and found general dissatisfaction, with 42% of consumers having a billing problem with their provider and 68% reporting dropped calls and other quality problems.[5]

Cell phone companies also have engaged in numerous highly questionable practices designed to reduce the level of competition in the industry and undermine consumers' ability to choose.

Recently, for example, they fought and ultimately lost the battle to prevent cell phone number portability, which allows consumers to keep their old cell phone numbers when they transfer to a new company. They also "lock down" consumers' handsets with special software, which forces customers to buy a new phone, rather than simply change "SIMM" chips, if they want to switch carriers.

Another anti-competitive practice, which is applied to more than nine out of every ten cell phones, is commonly known as ***"early termination fees."*** These fees are the topic of this report. And as the report will show, they should more appropriately be called "consumer choice penalties."

Consumer Choice Penalties:
Switching Companies Can Be Hazardous to Your Pocketbook

Early termination fees are penalties that cell phone customers have to pay if they decide to switch cell phone services, for whatever reason, before their contract with the company has expired. These penalties are in force for approximately nine out of every ten cell phones currently in use.[6] The cost of these penalties currently ranges from $150 to $240 ***per phone*** for the major cell phone service providers. [7] (Each of the major cell phone companies' current early termination fees are reported in Table 1.)

Table 1. Early Termination Fees of Major Cell Phone Service Providers, July 2005

Company	Early Termination Fee
Cingular	$150
Nextel[8]	$200
Sprint[9]	$150
T-Mobile[10]	$200
Verizon[11]	$175
Weighted Average[12]	**$170**

Here's how the penalties work. Suppose a family of two adults and two teenagers, with a total of four phones on a single plan, wants to switch companies to get out from under unnecessarily high monthly rates, poor customer service and unpredictable cell phone reception. They signed up a year-and-a-half ago with a service provider on a two-year agreement. To switch after 18 months, the family could have to pay a cancellation penalty of $800.

These penalties apply regardless of the customer's reason for wanting to terminate the service agreement. The company may be providing low-quality or unreliable reception, poor customer service, and higher rates than competitors are offering. Nonetheless, to add insult to injury, it is the customer, not the company, that pays the price for the company's inadequacies. That's not the way things are supposed to work in a competitive, consumer-driven economy.

Customers are therefore left with two unenviable options. They can pay the penalty for switching companies. Or, if they cannot afford the fee or feel that it's too high a price to pay for the privilege, they will become captive customers of the inferior service provider. Either way, cell phone customers will have been robbed of their power as consumers to make informed choices in the marketplace. The current options, driven strongly by early termination fees, either impose heavy costs on or place serious roadblocks in the way of consumer sovereignty. The dollar value of these costs and barriers is estimated in Section 4 of this report.

The Penalties Undermine Competition

GAO poll finds consumers are stifled by penalties. Previous research indicates that millions of customers who want to switch cell phone service providers are prevented from switching by early termination fees. In 2003, the U.S. General Accounting Office (GAO, now the Government Accountability Office), the investigative arm of Congress, conducted a nationwide poll of cell phone users. The survey found that 20% of cell phone users wanted to change cell phone service providers but did not switch because of contract termination fees.[13] The GAO's finding strongly suggests that the cell phone companies, through early termination fees, are succeeding in holding customers captive.[14]

In other words, early termination fees work. They are effective in stifling consumer choice in the marketplace. Under these circumstances, the best that customers who cannot afford (or are unwilling to pay) the fee can do is to try to get a cheaper plan from their current service providers. The price for doing so, in the event a cheaper plan happens to be available, is continued inferior service and a new long-term agreement saddled with yet another early termination fee. Once again, the consumer is held captive by the fees.

Early termination fees can bind consumers beyond the one to two year initial contract. Cell phone companies bind consumers to these early termination fees through the use of service agreements that typically are one to two years in length. By contract, therefore, a subscriber could be free from paying an early termination fee after the first year or two of service. In practice, however, subscribers can be bound by early termination fees for a much longer period of time.

Many carriers, for example, require customers to extend the term of these contracts whenever they upgrade to a better plan or purchase a new phone. As a result, if, after one year of a two-year agreement, the customer needs to increase the number of minutes of free cell phone usage or switch from a "local" to a "national" plan, then only two options will be available: the customer must either enroll in a new plan, extending the agreement with the current service (along with the early termination fee) for another two years, or pay the early termination fee and switch companies.

Another example of how early termination fees can coerce customers into extending their agreements with their current cell phone service providers is illustrated in the first box below. In this case, the cell phone company, rather than the customer, initiates the process that precipitates an unnecessary and intimidating choice between extending the term of the agreement with the provider, on the one hand, and paying an early termination fee, on the other. As the example shows, the cell phone company, by fiat, can change the terms of the agreement (e.g., raise the price for text messages) and thereby put the customer in an unfair, no-win situation that is ultimately enforced by the presence of the early termination fee.

How Early Termination Fees Coerce Customers

(Communicated through PennPIRG)

From Kerry, Philadelphia, PA 7/11/05
I'm currently in the middle of a two year contract with Verizon Wireless. They just notified me that they are dramatically increasing the charges I pay for receiving each text message from two cents to ten cents. When I called to complain, they left me with a few choices, and I was unhappy with all of them. I could simply accept the increase in charges. Alternatively, I could sign up for an unlimited text messaging plan for another $5/month but only if I renew with Verizon for another two years. Or, I could end my contract and pay an early termination fee of $175. If I don't pay the fee and change my plan to get the best rate for text messaging, then I'm locked in with Verizon for even longer than I originally would have been had they just kept the rates the same. And since the new plan also has an early termination fee, I'll face the same problem if they decide, without my agreement, to change the plan again to suit their needs.

Restricting consumer choice reduces competition. The upshot of this consumer treadmill is that cell phone service providers do not have to compete as intensely when early termination fees are in place as they would have to compete if the fees did not exist. The major cell phone companies know this all too well. The fact that ***all*** of the major cell phone companies impose the fees on non-prepaid-plan customers indicates that none of them is eager to be swept up in the wave of intensified competition that would ensue if consumers were free to jump ship to take advantage of better service from a competitor.

FCC report on competition ignored early termination fees. Unfortunately, the FCC has not paid attention to the anticompetitive impacts of early termination fees. In its ninth annual report on competition in the cell phone industry, the FCC ignores these penalties and the GAO study in a section of the report entitled "Consumer Ability to Switch Service Providers." Instead, the FCC relied on two pieces of empirical data that, in reality, do not show that consumers have an easy time switching cell phone providers in the middle of their contracts.

The FCC notes that customer "churn rates" (or turnover rates) range about 24% per year and also cites a J.D. Power poll indicating that about one in four customers change service providers each year. [15] The implication is that customers are switching cell phone companies regularly.

In reality, both pieces of evidence have little to do with the impact of early termination fees on customers' abilities to switch companies when they desire to do so. Since cell phone service agreements typically last one-to-two years, the vast majority of those who "churn" or change services in a year are ***those whose contracts have expired*** and who want a better deal. The relatively few customers who can afford the fees and are willing to pay them likely comprise only a small percentage of the churn rate. ***Those who are in the middle of their agreements*** and want to switch but cannot due to the penalties, on the other hand, are not captured at all in the churn rates or the J.D. Power poll results cited by the FCC.

As the new survey results reported in section 3 of this report demonstrate, only about 3% of cell phone customers each year pay the early termination fee to switch service providers before their contracts have expired. The survey also indicated that far more want to switch in mid-contract, but have not as a result of the disincentive created by the fees.

Competition would increase if early termination fees were eliminated. If early termination fees were eliminated and customers were allowed to switch companies without penalties, the companies would have to scramble harder and faster to keep their own customers and build reputations that attract competitors' customers. As a result, rates for cell phone services would be constantly under downward pressure, subsidies and giveaways would remain more necessary competitive weapons, and the service-related performance of the companies would improve more rapidly than under current conditions.

While such a heated competitive environment would increase the risk for less-competitive companies, a less restricted customer base would open the door for new, innovative, service-minded companies to enter the market and compete on a large scale. Consumers would be free to make informed economic choices that would save them money and improve the quality of what is now an essential service. The economy would operate more efficiently as the cost of services declined and performance improved.

Cell Phone Giants Hope the FCC Will Undercut Legal Challenges to the Penalties

The timing of this report coincides with the end of the official FCC public comment period for a petition concerning early termination fees filed with the FCC by the cell phone industry.[16] The petition represents an effort by the major cell phone service providers to maintain the penalties in the face of legal challenges that are being mounted in a number of states with strong consumer protection laws.[17]

Faced with the prospect of losing the fees, the cell phone companies have asked the FCC for help. In an attempt to make their legal problem disappear, the Big Five companies, through their trade association, have essentially requested that FCC use smoke and mirrors to define away the formidable legal challenges to early termination fees. In the petition, the FCC is being urged to undercut the legal challenges at the state level through little more than a clever turn of phrase.

The industry's case hinges on its argument that early termination fees should be defined not as penalties designed to restrict consumer choice but as a part of the normal rates that the companies charge their customers for cell phone services. If the FCC were to grant the industry's petition, then the cell phone industry would try to preempt state laws from applying to early termination penalties.[18]

Without early termination fees, the petition claims, companies could not offer new customers deals, such as subsidized cell phones. According to the petition, if customers had the freedom to switch freely to another company before the end of a two-year agreement, then the original company would not have time to recover its start up costs for new accounts through the monthly charges paid by customers. Since early termination fees ensure that the companies' up-front costs are recovered, the argument goes, they are part of the cell phone rate structure and are thus subject to regulation by only the federal government.[19]

Despite the clever rhetoric in the industry's petition to the FCC, a close look at the industry's claims demonstrates that the fees are indeed penalties and not simply part of the companies' cell phone rate structures. From the point of view of consumer economics, the industry's case contains three flaws that should convince the FCC to reject the petition.

1. The industry's reverse-lemon-law logic. At the heart of the argument that early termination fees are part of the industry's rate structures is the assumption that the fees are necessary to enable cell phone companies to recover the up-front costs of enrolling new customers and extending contracts for existing customers. Indeed, the petition treats the fees as cost recovery mechanisms and company entitlements. In other words, the companies believe that they have the 'right' to recover those costs under any circumstances.

As the examples in the following boxes illustrate, early termination fees are nothing more than the service-industry equivalents of leaving a car buyer unprotected by 'lemon' laws. In a truly competitive market with proper regulatory oversight, a company that provides inferior quality products or services (e.g., poor cell phone reception and inadequate customer care) does not deserve or obtain recovery of its up-front costs since it has failed to live up to its part of the agreement with the customer.

Early Termination Fees Leave No Viable Options

From Jerome of Riverside CA (10/6/03):
I have been with AT&T wireless since 6/29/2002. At the time I entered the 2 year contract with them, it was with the understanding there would be an early termination fee would apply, but I did not understand that included not receiving service at all. I have failed to receive service within 2 miles of my home since I purchased the phone.

I have made several calls to AT&T about the problem but they always try to sell me a new plan or a new phone. I am not interested in a new plan or a new phone, I need service. Most of my life revolves around a 20-mile radius of my home and more than 40% of the time my phone drops call or no service is available. Because of the poor service for such long time I have become familiar with the areas where the calls will drop. I now have to pull off the freeway to complete my phone call. This has become a major inconvenience.

I have 9 months remaining in my 2 year agreement and their best recommendation is to lower my plan to 19.95 to avoid paying $175.00 termination. But anyone clearly sees I would pay $180.00 plus the taxes and any minutes I go over the plan. This is another way for AT&T to get me to pay for service I am not receiving. This recommendation does not address my problem at hand which is no phone service. As a paying customer I feel I should receive service for anything I pay for. But in this situation I will pay for not receiving service no matter what.

Source: http://consumeraffairs.com/cell_phones/att_wireless_coverage.html.

In the upside-down world of the cell phone industry, however, a situation that can only be described as "lemon-laws-in-reverse" prevails. When a cell phone company fails to provide the services that have been agreed upon and paid for by the customer, it is the customer, rather than the company, that is held responsible and has to pay for the company's inadequacies. Either the customer continues paying for poor quality services or pays the company even more money, in the form of the termination fee, to be freed from the under-performing company.

This is the opposite of what occurs in an efficient, competitive, well-regulated, consumer-driven market. In that case, the company providing the inferior quality products or services would be compelled to refund the payments for services made to the company by the unsatisfied customer.

How Early Termination Fees Lock in Poor Reception

(www.masspirg.org)

From Richard, Dorchester, MA (7/20/05)
For approximately the last year, I have been having problems with my cell phone service. I live in the Roxbury/North Dorchester area, and most times when I leave my house I must travel for half a mile before my phone will work. My dropped calls also have gotten even worse. The areas that I have to work in are in a "Dead Zone," and if I have an important call or have to respond to a supervisor it is impossible especially around Hyde Park Avenue, Grove Hall, Downtown Boston, or near my home on Humboldt Avenue. The Mayor drew a map of the dead zone for the *Boston Globe* depicting my point exactly. The City of Boston has 1400 of these phones. I'm just a consumer, but they have lousy service and I'm stuck with this plan until March of 2006 or I will have to pay a shut off fee of about $200.00.

2. The lack of prorated fees. If early termination fees were part of cell phone companies' rate structures and not simply penalties, they would have to be prorated to reflect the amount of time that customers have been paying monthly service charges. Suppose, for example, that a customer wanted to switch companies after paying monthly service charges for 18 months of a 24-month contract that contains a requirement for a $200 per-phone early termination fee. If the fee were simply part of the company's charges for services, as the industry petition claims, the customer should have to pay only $50 per phone, rather than $200, since the company would have recovered three-fourths of its up-front costs by the time the customer wanted to switch.

Unfortunately, in the real world, the customer is responsible for the entire $200 no matter when he/she decides to switch companies.[20]

3. The myth of "no more subsidized cell phones." Third, when the industry claims that it couldn't offer subsidized phones and other incentives to consumers without early termination fees, it ignores the reality of the intensified competition that would result if the fees were eliminated.

In reality, cell phone users would be better off without early termination fees. With the penalties in place, consumers receive subsidized cell phones but lack the ability to switch companies to obtain cheaper rates and/or get out from under poor quality cell phone services. That's hardly a bargain for a frustrated customer. Without the penalties in place, on the other hand, cell phone users would both obtain subsidized phones *and* be able to obtain the highest quality service.

As discussed in a previous subsection, the elimination of early termination fees would generate more intense competition among companies to keep their existing customer base as well as attract new customers. In a more intensely competitive cell phone market created by the elimination of the penalties, all companies will be forced to do whatever it takes to be competitive, including subsidizing phone acquisition by prospective customers and providing the highest quality service.

3. Results of the National Opinion Survey

Introduction to the Opinion Survey

To determine how cell phone customers view early termination fees and what they would like to see done about them, M+R Strategic Services commissioned a national opinion survey. Between July 12, 2005 and July 14, 2005, the polling firm *IPSOS North America* called 1000 U.S. households and asked a series of questions about cell phone service and early termination fees. (For more information about the survey, see section 6 of this report, “Methodology”.)

Overall Findings of the Survey Support Rejection of Industry Petition to FCC

The survey results provide compelling evidence that the nation’s cell phone customers would prefer to have the FCC reject the cell phone industry’s petition to protect early termination fees from legal attacks at the state level. In general, the survey found that tens of millions of cell phone customers:

- are discouraged by the fees from switching to a new cell phone company that would provide lower rates and better service;
- disagree with the key premise of the cell phone industry that the termination fees are part of their rate structure – they view the fees as penalties designed to prevent consumer choice;
- are unhappy with the fees; and
- want the fees eliminated.

Cell Phone Use in the United States Is Widespread

More than three out of four of the 1000 survey respondents (77%) were cell phone service subscribers. This finding reflects an enormous penetration into American households and was not surprising given the 182 million cellular phones and related devices being used in the United States as of December 2004.[21] Combining the survey result, the number of cellular devices, and the number of U.S. households (109 million), yields an estimate that there were, on average, 1.3 cell phones for every one U.S. household by the end of 2004.

This survey result is strikingly uniform with respect to region, race, metropolitan status, gender, and age. The only exception of lower use is for respondents 65 years of age or older. On the other hand, cell phone use varied directly with income and education levels. Households with children, as expected, are more likely to be cell phone service subscribers.

A Small Percentage of Customers Choose to Pay Early Termination Fees

Only one out of ten (10%) cell phone subscribers have paid an early termination fee sometime during the past three years. It is assumed that those customers would have paid the early termination fees only once during that three year period. Therefore, this survey question indicates that an average of only about 3% of customers per year have paid the fees.[22]

Based on this survey result and an estimated weighted average early termination fee of $170 per phone, these customers paid the cell phone companies an estimated $837 million dollars a year to change service providers before their agreements expired.[23]

The Desire for Lower Rates and Better Service Drives Payment of Early Termination Fees

The 10% of respondents who have paid early termination fees to switch service over the last three years were also asked why they did so. Nearly 70% of the reasons offered by the respondents indicated switches were made to obtain lower cell phone rates; higher quality reception; better customer service; and more widespread calling areas.

Early Termination Fees Discourage More Than a Third of Customers from Switching Companies

To provide a definitive estimate of how much early termination fees actually prevent customers from switching, a follow up question was asked of all of the respondents who said that they used cell phones. They were asked if they had ever wanted to switch cell phone providers but decided not to because of the cost of the early termination fees.

Thirty-six percent of the respondents replied that the fees had prevented them from switching. During the past three years, an average of 147 million non-prepaid cell phones were in service each year.[24] If 36% of respondents wanted to switch but didn't because of the fees, then customers using roughly 50 million cell phones could have been locked into their cell phone service providers as a result of the early termination fees.

Early Termination Fees Have a Negative Impact on Nearly Half of Cell Phone Users

Responses to the previous two survey questions indicate that nearly half of all cell phone customers (46%) are negatively affected by early termination fees. As the responses demonstrate, early termination fees have cost consumers in two ways. First, during the past three years, one out of every ten customers paid the fee, which currently averages $170 per cell phone for the major carriers. Second, those who wanted to switch companies but were discouraged by the fees from doing so (36%) paid the price of not being able to take advantage of the benefits of switching.

Early Termination Fee Disincentive Hits Low Income Households and the Unemployed Hardest

The survey found that as household income decreased, the likelihood of being discouraged from switching by the early termination fee increased. Forty-four percent of households with incomes under $25,000, compared to 34% of households with incomes above $50,000, said that they were discouraged from switching cell phone service providers by early termination fees. Therefore, the lower the household income, the higher the likelihood that the fees would discourage switching companies.

It is not surprising that the same relationship holds between unemployed and employed respondents respectively. Whereas 47% of unemployed respondents were discouraged from switching companies by early termination fees, 37% of employed respondents and 23% of retirees were similarly discouraged.

Roughly Half Would Consider Switching Companies if Early Termination Fees Were Eliminated

The survey found that nearly half or 47% of cell phone customers would "switch cell phone companies as soon as possible" or "consider switching cell phone companies" if early termination fees were eliminated. Fifty-one percent of cell phone customers stated that they would "stay with my current cell phone company" even if the fees were eliminated. Based on an annual average of 147 million non-prepaid cell phone subscribers during the past three years, this survey result indicates that users of as many 70 million cell phones could be in search of new service providers should early termination fees be eliminated.

Three-fourths of Cell Phone Customers Support Elimination of Early Termination Fees

According to the survey, the cell-phone-using public clearly supports the elimination of early termination fees. When asked directly about how they would feel about eliminating the fees, 57% of cell phone customers said that they would "strongly support" it while another 20% said that they would "somewhat support" elimination. Only 22% of customers said that they would were either "somewhat opposed" (11%) or "strongly opposed" (11%).

At a minimum, these results indicate that the ***FCC lacks a public mandate*** for any action that would prevent the elimination of early termination fees, including ***granting the cell phone industry petition***. Instead, the results suggest that consumers, by a margin of more than three to one, would oppose action that would prolong early termination fees and would support action to eliminate the fees.

Even Apparently Satisfied Customers Believe Early Termination Fees Are a Bad Idea

Not only unsatisfied customers favor elimination of the early termination fees. Seventy-seven percent of customers support elimination of the fees. That's far more than the 47% of customers who would switch immediately or would consider switching companies. It appears, therefore, that more than half of the customers who want to stick with their current companies believe that early termination fees are a bad idea.

Customers View Early Termination Fees as Penalties That Prevent Them from Switching Companies

The cell phone industry has based its petition to the FCC largely on its claim that early termination fees are simply charges for cell phone services for customers wanting to switch companies rather than penalties for switching.

To understand the true nature of the fees, we decided to test the industry's claim by going directly to the source. That is, we asked the people who are directly affected by the early termination fees -- the cell phone industry's own customers -- how they viewed the fees.

For this question in the opinion survey, customers were informed only that cell phone companies claimed that the early termination fee "is just another rate charged for your use of cell phones similar to the monthly rates that you pay for your calling plan." This information was crafted to reflect what the industry claims in its petition to the FCC. Customers were then asked if they agreed with that claim or instead viewed the fees "as penalties designed to discourage customers from switching and bring in extra money from those customers who decide to switch."

The results could not have been clearer. Only 9% of the customers surveyed agreed with the companies. In stark contrast, an overwhelming 89% percent stated that they thought the fees were penalties designed to discourage switching companies. These findings should send a strong message to the FCC that the arguments underpinning the cell phone industry's petition are on shaky ground.

4. An Economic Analysis of the Impacts of Consumer Choice Penalties: *How Much Cell Phone Customers Pay and Lose*

Early Termination Fees Are Double Trouble for Consumers

The results of the national opinion survey reveal that early termination fees are really nothing other than consumer choice penalties that impose substantial costs on cell phone users. The poll demonstrated that those penalties are double trouble for consumers, who are placed in a no-win situation.

The costs of early termination fees to cell phone customers who would like to switch from one service provider to another can take one of two forms. First, the customer can pay the fee to the company if it is affordable and the customer believes that the benefits of switching companies exceed the level of the fee. Or, the cost takes the form of the value of the benefits of switching companies that the customer will never see because the fee prevents them from switching cell phone services. In the latter case, either the fee was not affordable or the customer believed that the benefits of switching companies were not worth the cost of paying the fee. In either case, as the survey demonstrated, 46% of cell phone customers are worse off than they would be had early termination fees not existed.

The Economic Logic Governing Estimation of the Costs of Early Termination Fees

The total nationwide dollar value of these two types of costs can be estimated from publicly available cell phone industry data and by new data generated by the national opinion survey. These two costs, when summed, will provide the total cost of the early termination fees to cell phone users.

The cost of the consumer choice penalties *to those who paid them* can be estimated by multiplying the following three variables:

- The number of U.S. households, with occupants using cell phones, that paid the fee;
- The average number of non-prepaid cell phones per household; and
- The average early termination fee per cell phone paid to cell phone companies.[25]

The value of the foregone benefits of switching companies *for those who couldn't or wouldn't pay the fees* can be estimated by multiplying the following variables:

- The number of U.S. households with occupants using cell phones that did not switch companies due to early termination fees;
- The average number of non-prepaid cell phones per household; and
- The average value per cell phone of the foregone benefits of switching companies.

Calculating the Costs of Early Termination Fees

1. The cost to customers who paid the consumer choice penalties

The number of U.S. cell phone-using households that paid the penalties was obtained by multiplying 10% of households (from the opinion survey) by 83.9 million U.S. households with occupants using cell phones.[26]

The average number of non-prepaid cell phones per household was obtained by dividing the annual average number of subscribers for the 2002-2004 period (161 million) by the number of U.S. households using cell phones (83.9 million) and then multiplying that product by the percentage of cell phones that were on non-prepaid plans (92%).

The weighted average penalty per cell phone paid by U.S. cell phone subscribers was estimated to be $170. It was derived by finding the weighted average of major companies' current early termination fees. (See Table 1 in section 2 of this report for major companies' current fees.)[27]

2. The cost to customers who wanted to switch but couldn't/wouldn't pay the penalties

The number of U.S. cell phone-using households that did not switch companies due to early termination fees was obtained by multiplying 36% of households (from the opinion survey) by 83.9 million U.S. households using cell phones.[28]

The average number of non-prepaid cell phones per household was obtained by dividing the annual average number of subscribers for the 2002-2004 period (161 million) by the number of U.S. households using cell phones (83.9 million) and then multiplying that product by the percentage of cell phones that were on non-prepaid plans (92%).

The average value per cell phone of the foregone benefits of switching companies contains two components:

- those who wanted to switch and believed that switching companies would have been worth the cost of the fee but did not switch because they could not afford the fee; and
- those who believed that the benefits of switching were worth less than the cost of the early termination fee.

Those unable to afford the cost of the fees. For those who could not afford to switch, the minimum value of the foregone benefits from switching companies can be estimated to be the value of the average early termination fee. These customers indicated in the survey that they would have paid at least that much if they had the money.

To determine the number of households that comprise this category of would-be switchers, opinion survey respondents who said that they decided against switching because of the fees were asked to describe why they didn't pay the fee. The survey found that 36% of cell phone-using households were discouraged from switching companies by the early termination fees. Of those households, 26% responded that "switching companies would have been worth the cost but I felt I didn't have enough money to pay the fee of $150 or more."

The value of the foregone benefits, then, *for those who could not afford to pay* the early termination fees can be calculated by multiplying together:

- the number of households with occupants using cell phones;
- the percent of cell phone-using households that were prevented from switching by early termination fees;
- the percent of those households that could not afford the fees;
- the average number of non-prepaid cell phones per household; and
- the average value of early termination fees per cell phone.

Those who felt that the cost of the fees exceeded the benefits of switching. The other category of customers who wanted to switch had the money to pay the fee but thought that the benefits of switching were lower than the cost of the fee. The survey found that 69% of the cell phone customers who were discouraged from switching by early termination fees "had the money but didn't think that the benefits of switching were worth paying $150 or more per phone" for the fee.

To determine precisely how much money these respondents would be willing to pay for the benefits of switching, the survey asked them "how low the fee would have to have been to have made it worth it to you to switch cell phone companies?" Responses ranged from $125 to zero dollars. The weighted average value of the benefits of switching was found to be $49.66 per phone.[29]

The value of the foregone benefits, then, for those who could afford to pay the early termination fees but did not believe the benefits of switching were great enough, can be calculated by multiplying together:

- the number of households with occupants using cell phones;
- the percent of cell phone-using households that were prevented from switching by early termination fees;
- the percent of those households that could afford the fees but felt that the cost of the fees exceeded the benefits of switching;
- the average number of non-prepaid cell phones per household; and
- the average value, per phone, of the benefits of switching companies.

Early Termination Fees Cost Cell Phone Users More Than $4.6 Billion from 2002 to 2004

Combining the elements of the costs of early termination fees described in the previous section results in three cost equations.

1. The cost to customers who paid the consumer choice penalties from 2002 to 2004

The following values were multiplied to determine the cost of early termination fees actually paid by cell phone customers:

- 10% of households with occupants using cell phones paid early termination fees over three years;
- on average, 1.76 non-prepaid cell phones per household with cell phones;
- 83.9 million households with occupants using cell phones; and
- $170 early termination fee per cell phone.

This yields the following solution:

Equation 1: (.10)(1.76)(83.9 million)($170) = **$2.511 billion**

2. The cost to customers who wanted to switch but couldn't/wouldn't pay the penalties

Those unable to afford the cost of the fees. The cost to customers who could not afford the $150 or more consumer choice penalty is obtained by multiplying the following values:

- 36% of households with cell phones, who were prevented from switching by the penalties;
- 51% of the 'prevented' households who wanted to switch companies during the 2002-2004 period;[30]
- 26% of the 'prevented' households who said they could not afford the penalties but said the benefits of switching were worth the cost of the penalties;
- on average, 1.76 non-prepaid cell phones per household using cell phones
- 83.9 million households with occupants using cell phones; and
- $170 early termination fee per cell phone.

This process yields the following solution for the 2002-2004 period:

Equation 2: (.36)(.51)(.26)(1.76)(83.9 million)($170) = **$1.199 billion in lost benefits**

Those who felt that the cost of the fees exceeded the benefits of switching. The cost to those customers who could afford the consumer choice penalty but who did not believe that the benefits of switching companies were worth paying the fees is obtained by multiplying the following values:

- 36% of households with cell phones who were prevented from switching by the penalties;
- 51% of the ‘prevented’ households who wanted to switch companies during the 2002-2004 period;
- 69% of the “prevented” households who said they could afford the penalties but said the benefits of switching were **not** worth the cost of the penalties;
- 1.76 non-prepaid cell phones per household using cell phones;
- 83.9 million households with cell phones; and
- $49.66 average valuation of the benefits, per phone, of switching companies.

This process yields the following solution:

Equation 3: (.36)(.51)(.69)(1.76)(83.9 million)($49.66) = **$929 million in lost benefits**

Combining the solutions for the three preceding equations generates the total cost of early termination fees to U.S. cell phone users:

Equation 4 – ($2.511 billion + $1.199 billion + $.929 billion) = $4.639 billion

In summary, between 2002 and 2004, cell phone service providers’ early termination fees cost cell phone users in the United States more than $4.6 billion in unwanted penalties and lost benefits of better cell phone service and lower rates.

5. Conclusions and Recommendations

Conclusions about Cell Phone Early Termination Fees

The preceding sections of this report demonstrated that cell phone early termination fees are a serious problem for tens of millions of the nation's consumers and are a threat to an efficient, just and competitive economy. The report used basic economic logic, a national opinion survey and an empirical economic analysis to show that U.S. consumers pay a multi-billion-dollar price for the penalties and that the industry's recent petition to the FCC is flawed. Based on the detailed empirical findings and the economic arguments of the previous sections of the report, the following overall conclusions can be drawn.

- **Cell phone companies' early termination fees work and, as a result, create captive customers** unable to exercise their right to choose the best-quality service and lowest rates. Customers who are dissatisfied with cell phone service and want to choose a better service provider are saddled with two highly unsatisfactory options: either pay an expensive penalty or continue enduring unnecessarily poor quality service. In most cases, given the high cost of the fees, they are stuck with the latter option.

- **The fees inhibit competition in the cell phone industry.** Because consumer choice is restricted, companies can avoid providing the highest quality service and lowest-possible rates that would otherwise prevail in a highly competitive industry. This represents both an enormous loss for America's cell phone users and a reduction in the efficiency and fairness of the nation's economy.

- **The FCC should not be fooled by the clever but fatally flawed arguments in the industry's recent petition to the Commission.** The industry's arguments distort economic reality, hide the negative impacts of the fees, and represent little more than a desperate attempt to get the federal government to unjustifiably protect the industry from well-deserved legal challenges, on behalf of customers, at the state level. As the economic arguments and empirical research in this report shows, the industry's claims that the fees are rates designed to recoup their costs rather than penalties imposed on customers are neither credible nor valid.

- **There is little public support for the FCC to grant the industry's petition.** The public is neither buying the industry's fees nor being fooled by its arguments to the FCC. Cell phone users overwhelmingly want the fees to be eliminated and believe that the fees are penalties rather than rates. Even most of those cell phone users who do not want to switch companies or have not paid the fees support elimination of the fees and reject the industry's claim that the fees are rates.

Recommendations:
New Public Policies Are Needed to Foster Changes in Cell Phone Industry Practices

The findings and conclusions of this report demonstrate that the current cell phone industry practice of imposing early termination fees should not be allowed to continue and that the industry's attempt to prevent legal challenges at the state level is unpopular and not in the interest of consumers or the nation's economy. The following specific recommendations represent steps that need to be taken to properly address the issues raised by those consumer-choice penalties.

First, the FCC should reject the cell phone industry's petition requesting that the Commission define early termination fees as rates rather than penalties and preempt legal challenges to the fees at the state level.

Second, the FCC, the rest of the Bush administration, and Congress should not take any other steps requested at a later date by cell phone companies or industry representatives that are designed to prevent cell phone companies from being held legally accountable, at the local, state or federal levels, for the negative impacts of early termination fees.

Third, all cell phone service companies should quickly eliminate the use of early termination fees (or other mechanisms with similar adverse impacts on consumer choice).

Fourth, the Government Accountability Office of the U.S. Congress should conduct an independent review of the impacts (on consumers, competition and the overall economy) of high concentration and market power in the cell phone service provider industry.

Appendix One:
The National Opinion Survey

The national opinion survey conducted for this report was undertaken by the polling firm, IPSOS North America, which is located at 1101 Connecticut Ave. NW, Suite 200, Washington, DC. For the poll, 1000 adults were interviewed between July 12 and July 14, 2005. The margin of error for poll was plus or minus 3.1% for all adults and plus or minus 3.5% for cell phone subscribers. The questions, as they were asked, and their results appear below.

1. Have you or anyone in your household paid for cell phone service anytime during the past three years? N = 1000; margin of error = +/- 3.1%

Yes	77
No	23
Not sure	-

(Unless otherwise specified, all remaining questions asked only of 775 respondents reporting that they or anyone in their household had paid for cell phone service in the past three years. N= +/- 3.5%)

2. In general, how do you feel about the cost of your cell phone service? Is it…?

Much too high	22
Somewhat high	41
Just about right	31
A real bargain	6
Not sure	1

Now, I'm going to ask you some questions about fees that customers of cell phone companies have to pay if they decide to switch from one cell phone service to another.

All of the major cell phone companies require users to sign contracts for one or two years, and if you change service to another company before the contract expires they charge you what are known as "early termination fees." These early termination fees typically range from $150 to $240 for each of the household's cell phones.

3. Have you ever paid an early termination fee to a cell phone company during the past three years?

Yes	10
No	90
Not sure	-

(Asked only of those who have paid a termination fee in the past three years. N= 77; margin of error = +/- 11.9%)

4. Why did you pay the early termination fee? Was it…

To get lower rates from a new company	31
To get better customer service from a new company	16
To obtain higher quality reception while talking on the phone	19
To be able to make and receive calls in more places throughout the U.S.	14
(NOT READ) Bad customer service	11
(NOT READ) Didn't use/want service	7
(NOT READ) Rates/costs too high	5
(NOT READ) Change in personal life	4
(NOT READ) Cancelled one of multiple cell phone lines	4
(NOT READ) Phone was stolen	4
Other	11
Not sure	-

5. Did you ever think about switching or want to switch from one cell phone company to another, but decided against it because of the early termination fee?

Yes	36
No	63
Not sure	1

(Asked only of those who decided against switching because of early termination fees. N = 279; margin of error = +/- 5.9%)

6. Which one of the following best describes what prevented you from switching cell phone companies?

Switching companies would have been worth the cost but I felt that I didn't have enough money to pay a fee of $150 or more per phone	26
I had the money but didn't think the benefits of switching were worth paying $150 or more per phone	69
(NOT READ) Other	3
(NOT READ) Nothing	1
Not sure	1

(Asked only of those who didn't think the benefits of switching were worth paying the termination fees. N = 194; margin of error = +/- 7.0%)

7. Please tell me how low the fee would have to have been to have made it worth it to you to switch cell phone companies.

$125 per phone	2
$100 per phone	1
$75 per phone	6
$50 per phone	41
More than $25 but less than $50	1
(NOT READ) $40 per phone	2
(NOT READ) $25 per phone	18
(NOT READ) $20 per phone	1
(NOT READ) $5 per phone	2
(NOT READ) Nothing/free	16
(NOT READ) Other	6
Not sure	4

8. How do you feel about eliminating the early termination fees for cell phone companies? Do you…

Strongly support	57
Somewhat support	20
Somewhat oppose	11
Strongly oppose	11
Not sure	2
Total Support	77
Total Oppose	21

9. If early termination fees were eliminated altogether, would you…

Switch cell phone companies as soon as possible	13
Consider switching cell phone companies	34
Definitely stay with my current cell phone company	51
Not sure	2

10. Cell phone companies claim that an early termination fee is just another rate charged for your use of cell phones, similar to the monthly rates you pay for your calling plan. Do you agree with this claim or do you think that early termination fees are penalties designed to discourage customers from switching and bring in extra money from those customers who decide to switch anyway?

I agree with cell phone companies that it is just another charge for services provided	9
It's a penalty to discourage switching cell phone companies	89
Not sure	2

Appendix Two:
Selected Derivations Used in the Economic Analysis

Equations 2 and 3 in section 4 of this report used an estimated value of 51% to represent the percent of 'prevented' households who wanted to switch companies (but did not) *during the 2002-2004 period*. In the survey, respondents were asked "did you *ever* think about switching or want to switch…" To convert "ever" to the "past three years", it was necessary to estimate the percentage of the 36% of cell phone users wanting to switch who likely felt that way during the 2002-2004 period.

Derivation of the 51% estimate had two components: 1) cell phone customers who have cell phone accounts that were brought into service for the first time during the 2002-2004 period and who therefore could have wanted to switch only during those three years; and 2) customers who have cell phone accounts that were first brought into service prior to the 2002-2004 period but wanted to switch during the 2002-2004 period.

1. Cell phone accounts added during 2002-2004

Between 2002 and 2004, according to industry data, 30% of the 182 million cell phones being used at the end of 2004 were added to industry accounts.[31] Thus, at least 30% of the 36% who wanted to switch but didn't could have wanted to switch only during the 2002-2004 period.[32]

2. Cell phone accounts added prior to 2002-2004

If 30% of the 36% are 2002-2004 new accounts, then what about the remaining 70% of the 36%? About 90% of the growth in U.S. cell phone use can be accounted for during the ten-year period between 1995 and 2004. If it is assumed that the remaining 70% of cell phone users would have been equally likely to have wanted to switch companies in any one of those ten years, then each year would account for 7% of those cell phone users. The three-year, 2002-2004 period would, therefore, have accounted for a total of 21%.[33]

3. Combining accounts from 2002-04 and accounts prior to 2002-04

Summing up (30% + 21%) leads to a conservative estimate that 51% of the 36% of cell phone users who ever wanted to (but were unable to) switch cell phone providers wanted to switch during the 2002-2004 period.

Notes

[1] See Deirdre Cummings and Kerry Smith, MASSPIRG, March 2005, "Can You Hear Us Now? A Report on How the Cell Phone Industry has Failed Consumers: A MASSPIRG Report on the Cell Phone Industry Including a Shoppers' Guide for Consumers." The report also finds that in 2003, the Federal Communications Commission (FCC) received 21,000 wireless service complaints. Available at http://masspirg.org/reports/cellphonereport.pdf (Last visited 2 August 2005)
[2] Cellular Telecommunications & Internet Association (CTIA), "Semi-Annual Wireless Industry Survey." 2005. http://files.ctia.org/pdf/CTIAYearend2004Survey.pdf
[3] CTIA, 2005.
[4] Computation on market share derived from data in required "10-K" filings by major cell phone companies with the federal Securities and Exchange Commission.
[5] See Deirdre Cummings and Kerry Smith, MASSPIRG, March 2005, "Can You Hear Us Now? A Report on How the Cell Phone Industry has Failed Consumers: A MASSPIRG Report on the Cell Phone Industry Including a Shoppers' Guide for Consumers." The report also finds that in 2003, the Federal Communications Commission (FCC) received 21,000 wireless service complaints. Available at http://masspirg.org/reports/cellphonereport.pdf (Last visited 2 August 2005)
[6] Just under 10% of cell phones come with prepaid plans that do not impose the penalties.
[7] In most states, Cingular charges a fixed early termination fee of $150. In FL, GA, SC, NC, KY, TN, MS, LA, AL, NY, and applicable parts of IN and NJ, early termination fees are prorated but start from a $240 base, the highest of all of the Big Five companies. Exact data on revenues generated by early termination fees paid by customers is unavailable. To avoid over-estimating the impact of the penalties on customers, $150 was used for Cingular's fee to calculate the weighted average for the Big Five. *See,* http://www.cingular.com/cingular_advantage (accessed July 28, 2005).
[8] *See*, http://nextelonline.nextel.com/en/legal/os_general_terms_conditions_popup.shtml (accessed July 28, 2005).
[9] *See*, www.sprintpcs.com/common/popups/popLegalTermsPrivacy.html (accessed July 28, 2005).
[10] *See*, www.t-mobile.com/info/legal/terms_cond.asp (accessed July 28, 2005).
[11] *See*, http://www.verizonwireless.com/b2c/store/controller?item=planFirst&action=viewPlanDetail&sortOption=priceSort&catId=323&cm_re=Home%20Page-_-Personal%20Box-_-Individual%20Plans (accessed July 28, 2005).
[12] The weighted average for the major corporations providing cell phone services was obtained by weighting each company's early termination fee by its share of the total number of cell phone subscribers held by the Big Five companies.
[13] "Results of Consumer Survey on Mobile Phone Service," Mobile Phone Call Quality: GAO-03-501. U.S. General Accounting Office, 2003. The poll surveyed 1000 U.S. residents. The 20% result was obtained by combining the results of questions 23 and 24 of the survey. For #23, 28% of respondents said that they wanted to switch companies but did not for some reason. For #24, 70% of those 28% said that contract termination fees were important in the decision not to switch. The equation is: (.28)(.70) = .20
[14] Results of a new survey conducted for this report, which are reported in section 3, make an even stronger case for this phenomenon.
[15] Federal Communications Commission. "Ninth Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Market Services." September 28, 2004. Pp. 67-68.
[16] "Petition of the Cellular Telecommunications & Internet Association for an Expedited Declaratory Ruling," March 15, 2005.
[17] Lawsuits by customers adversely affected by early termination fees have been filed in courts in California, Florida and Illinois.
[18] This is not the first time that telecommunications companies have sought refuge in FCC rulings that "preempt" states' rights to protect their consumers from harm. Cell phone companies currently also are seeking to preempt state regulations regarding carriers' billing practices. *See*, Cingular Comments, CTIA Comments, Nextel Comments, Sprint Comments, T-Mobile Comments, Verizon Wireless Comments in *Second Report and Order, Declaratory Ruling, and Second Further Notice of Proposed Rulemaking*, CC Docket No. 98-170, FCC 05-55, 2005 WL 645905 (rel. March 18, 2005). Also see Comments and Reply Comments by the AARP, Asian Law Caucus, Consumers Union, Disability Rights Advocates, National Association of State PIRGs, and the National Consumer Law Center for that docket. Telecommunication companies also are seeking to preempt state telemarketing laws. Joint Petition for Declaratory Ruling that the FCC has Exclusive Regulatory

Jurisdiction over Interstate Telemarketing, *In the Matter of Alliance Contact Servs., et al.* 3, CG Docket No. 02-278 (filed Apr. 29, 2005).

[19] "Petition of the Cellular Telecommunications & Internet Association for an Expedited Declaratory Ruling," March 15, 2005.

[20] Only one of the major cell phone service companies prorates any of its early termination fees. Cingular prorates fees in ten states and in portions of two additional states. Throughout the rest of the country, customers face a $150 fixed, non-prorated fee. In at least ten states, however, Cingular's base early termination fee is $240. As a result of the $240 baseline for the prorated fee, the revenues from prorated fee may well approximate revenues from the non-prorated fee.

[21] Cellular Telecommunication Industry Association, 2005. http://files.ctia.org/pdf/CTIAYearend2004Survey.pdf Accessed August 3, 2005.

[22] Annual data on early termination fee payments is not published by cell phone service providers.

[23] See the next section of this report, "An Economic Analysis of the Impacts of Consumer Choice Penalties," for details about the derivation of this estimate. Since the survey had a margin of error of plus or minus 3.5%, the potential range of cell phone company revenue from early termination fees is likely to be between $490 million and $1.13 billion per year.

[24] Early termination fees are not part of prepaid cell phone plans. Based on company filings with the federal Securities and Exchange Commission, as of December 2004, an estimated 8% of cell phones were on prepaid plans.

[25] Prepaid agreements with cell phone service providers do not require the payment of early termination fees. Cell phone service providers' 10-K filings with the federal Securities and Exchange Commission indicate that about 8% of U.S. cell phones are covered by prepaid agreements.

[26] In 2004, based on data from the U.S. Census Bureau, there were about 109 million households in the United States. According to the national opinion survey, 77% of the total (84 million) had cell phone service.

[27] The early termination fees that major cell phone companies charged customers were weighted by each company's share of the sum of those companies' revenues from cell phone services.

[28] The survey question was asked of all cell phone users, including those who paid the fees and those who were covered by prepaid plans, who should have been among the 63% of respondents who answered, "no", when asked if the early termination fees prevented them from switching service providers.

[29] Each response (e.g., $100) was weighted by the number of times that response was given by survey respondents.

[30] See Appendix Two of this report for discussion of how 51% was derived.

[31] CTIA, Annualized Wireless Industry Survey Results, 2005.

[32] This is a conservative estimate, since the 2002 GAO survey showed that 37% of cell phone using respondents had used their cell phones two years or less. In that two-year period, only 22% of all cell phones had been added to the industry's accounts, indicating that the rate of growth in cell phone use was smaller than the rate of growth in cell phone-using households. If that result is applied to the 2002-2004 data on the number of cell phones, then new cell phone users during that period would be upwards of 40% rather than 30%.

[33] This is also a conservative assumption since complaints about early termination fees increased over time according to FCC data. Between 2002 (the first year the FCC reported complaint data) and 2004, the number of complaints jumped by 71%. That increase suggests that more customers would have wanted to switch in recent years than in earlier years. See the 2002-2004 issues of the FCC's. "Quarterly Inquiries and Complaints Report." http://ftp.fcc.gov/cgb/quarter/