Sen. Kohl's Follow-Up Questions for Hearing on

"Cell Phone Text Messaging Rate Increases and the State of Competition in the Wireless Market"

For Randy Milch

1. You testified that you did not cooperate or in any way agree with your competitors in setting your per message price for text messaging. So why did Verizon raise its per message price from 10 to 15 cents in March 2007, and from 15 to 20 cents in March 2008? How did Verizon choose 15 cents as your per message price in March 2007, and 20 cents in March 2008?

Answer

Verizon Wireless independently sets the prices all of its products, and has not cooperated or in any way agreed with competitors in setting prices on text messaging. Verizon Wireless sets its prices based on market conditions. Those market conditions have driven the average price per text message down nearly 70% since December 2006, from roughly 3 cents per message to 1 cent per message today. Pricing for postpaid text messaging sold in buckets – nearly 99% of all text messaging on the Verizon Wireless network – varies widely among carriers.

Verizon Wireless did not raise its per-message prices for prepaid text messaging in the way described in the question. As I noted in my testimony, Verizon Wireless prepaid customers pay 1 or 5 or 10 or 20 cents per text message depending on the price plan. As with postpaid bucket pricing, pricing for prepaid "pay-as-you-go" text messages varies widely among carriers.

Post-paid text messages sold individually without a plan account for less than 1% of the total number of text messages over Verizon Wireless' network. Verizon Wireless has changed prices for "pay-as-you-go" text messaging as part of its usual practice of adjusting prices for its wireless voice and data services to meet changing demand and market conditions. In March 2007, Verizon Wireless matched the price Sprint and AT&T then charged for "pay-as-you-go" text messages (Sprint had charged 15 cents a message since October 2006). And in March 2008, Verizon Wireless matched Sprint's 20 cent price (which had been instituted six months earlier, and had not been matched by any other carrier at that point).

Verizon Wireless has changed its prices for postpaid "pay-as-you-go" messaging based on the changing demand characteristics of text message users. Customers who are substantial users of text messaging have moved to bucket plans; the remaining customers are low-volume users with inelastic demand. Almost by definition, low-volume text messaging users do not choose wireless service based on text message pricing, and thus there is no competitive benefit to undercutting competitors by a few pennies on the price for rarely used "pay-as-you-go" text messaging services.

2. Prof. Keshav testified that the cell phone companies' profit margin on text messages is today 80% for those who participate in text message plans, and 98% for with respect to those consumers who purchase text messages on a per message basis. Do you disagree with this calculation? If you disagree, please explain why and state the actual amount of profits Verizon realizes from text messages.

Answer

I have not calculated Verizon Wireless' "profit margin on text messages," nor would it be sensible to do so. Verizon Wireless is a multiproduct firm, with all of those products provided over the same network. Every multiproduct firm has to recover all of its costs across its various products. An analysis that looks only at the cost of sending the next text message over a network ignores the fact that you have a network in the first place. Verizon had to make huge investments in spectrum, in cell sites and in computers and switching equipment in order to be able to carry even the first text message. Text messages have to carry all those shared and common costs along with every other product we have.

I testified during the hearing that there is no reason in a competitive market to believe at any one particular point in time prices will match costs, and that prices in a competitive market are not set based only on cost. Indeed, Prof. Keshav agreed that there need not be any relationship between price for text messaging and the cost of that service.

3. Wasn't a major motive for price increases in text messaging paid for on a per message basis to cause consumers to move to your text messaging plans, which start at $ 5 a month? Didn't raising the price of text messaging from 5 cents to 20 cents per message over four years have the intended effect of pushing consumers into "bucket" plans?

Answer

In Verizon Wireless' experience, consumers generally prefer the low cost, predictability and convenience of bucket plans as compared to per-message usage pricing. Verizon Wireless benefits from customer adoption of bucket plans because it reduces customer complaints and increases customer satisfaction.

All but the most casual text message user likely will choose from among the bucket plans as a result of the low-cost pricing of these bucket plans relative to pay-per-message plans. Customer adoption of bucket plans is a good thing, since it is the widespread adoption of bucket plans and the much lower cost-per-text message of these plans that has driven the six-fold increase in text messaging over the last few years.

4. Verizon charges customers on a per message basis when they go over their allotted "bucket plan" number of text messages. Should we be concerned about per message price increases here because they will end up pushing more and more customers into your most expensive "unlimited" plans which cost $20 per month? Given the fact

that each additional text message costs the carrier virtually nothing, won't you make the highest profit when customers choose the highest cost "bucket plan"?

Customers are free to choose the plan that best matches their texting usage. Plans enabling unlimited texting at a flat rate have been a key driver of plummeting text message prices and soaring text messaging adoption. Consumers who do not worry about the incremental cost of sending the next text message are likely to send many more text messages. Verizon Wireless' effective price per text message has fallen nearly 70% since December 2006, while the number of text messages sent has gone up six-fold. Thus, Verizon Wireless' text message pricing is not a cause for concern; rather, it reflects fierce rivalry among wireless carriers and the proper functioning of a competitive marketplace. If Verizon Wireless makes a greater return on its investment by cutting prices to consumers and stimulating much greater text message use, that is good both for consumers and Verizon Wireless' investors.

5. (a) What percentage of Verizon's customers do not buy text messaging "bucket" plans?

Answer

Approximately forty-two percent of customers do not buy text messaging plans. Roughly 26% of Verizon customers do not text at all.

(b) Aren't the consumers who don't buy text messaging plans the ones most vulnerable to price increases -- that is, low income customers and elderly customers who only use text messaging occasionally?

Answer

Verizon Wireless does not track the demographics of casual text message users. But for customers who only occasionally text, there's little cost to text messaging. Such text message usage is discretionary.

6. Given what we've seen with respect to text messaging price increases on a per message basis over the last few years, can we expect the per message price to rise to 25 cents, or beyond, in the next year or two? And can we expect the price for your text messaging plans to go up a dollar or two a month? What would prevent AT&T from such price increases?

Answer

The competitive market sets the price for text messaging (and wireless services generally). As noted above, text message prices have been falling rapidly as a result of this competition. Verizon Wireless has no current plan to raise text messaging prices. It has no

information on what would prevent AT&T from raising prices, other than the competitive dynamics of the market.

7. Until recently, the cell phone industry was a real competition success story. The industry had many national and regional providers, giving consumers numerous choices, driving down prices, and competing to introduce new services. But in the last few years, the wireless industry has sharply consolidated through mergers and acquisitions. Today four companies combine to control 90% of the market. Your two companies have a 60% market share. Now we see these sharp increases in text messaging prices on a per message basis. Are these price hikes just a harbinger of things to come in the cell phone market, and will it begin to more closely resemble the cable and local phone markets, where consumers have few choices and rarely see the benefits of vigorous price competition?

As I noted in my testimony, the cell phone industry has been – and very much continues to be – a competition success story. Wireless innovation is breathtaking, investment has been massive, and prices have relentlessly decreased. The rapid decline in text message pricing reflects a competitive market, not a consolidated one.

As the Federal Communications Commission noted in its most recent report on competition in the wireless industry, "[m]any operators continue to seek to fill gaps in their coverage areas, as well as to increase the capacity of their existing networks. As the Commission has previously concluded, operators with large footprints can achieve economies of scale and increased efficiencies compared to operators with smaller footprints." These economies and efficiencies lead directly to lower prices and more seamless provision of services.

The wireless industry continues to see robust new entry. Leap Wireless and MetroPCS are growing rapidly. Leap headlined its most recent earnings release by noting "Leap Reports Record Net Customer Additions of 500,000 for First Quarter 2009 – Strong Performance Results in 114 Percent Year-Over-Year Growth in Net Customer Additions." Leap recently entered the Philadelphia, Chicago and Washington-Baltimore markets, while MetroPCS announced expansion into New York and Boston. Cable companies such as Cox Communications and Comcast now are entering the wireless market. And mobile virtual network operators such as Virgin Mobile (five million customers) and Tracfone (ten million customers) compete with traditional carriers using prepaid wireless offerings.

8. What is Verizon's policy for prorating the contract so the fee is reduced to reflect the amount of time remaining on the contract? If it is not proportional to the time remaining on the contract, please explain why not?

Answer

Verizon Wireless reduces its early termination fee of $175 by $5 dollars for each full month toward the minimum term that the customer completes. Verizon Wireless provides

significant subsidies on most handsets it sells to post-pay customers. Without an early termination fee, Verizon Wireless might not be able to provide those subsidies.

9. (a) I understand that, under current FCC rules, a competitive cell phone carrier has no right to interconnect to another carrier's network with respect to "data" – that is, for internet connections necessary for e-mail and many other applications found on "smart phones" today. Would you support a regulatory change which would require cell phone carriers to grant data roaming on reasonable and non-discriminatory terms? Why or why not?

(b) Would you support ending the "in-market" exemption to voice roaming requirement, the exemption that relieves a cell phone provider from providing voice roaming with respect to any carrier that has a wireless license to provide service in a specific geographic area, even if that carrier has not actually built out that area? Why or why not?

Answer to (a) and (b)

Congress and the FCC should not expand regulation of roaming agreements among wireless companies to mandate home roaming or to include all data services. The Commission's existing regulation, supplemented by the right of any company to file a complaint seeking relief from unreasonable or discriminatory roaming practices, has served consumers well. By intruding into the terms of commercial agreements, additional roaming rules would discourage providers from investing in their own networks by allowing companies to improperly piggyback off the investments of competitors.

Please see attached Verizon Wireless' recent submission to the House Energy and Commerce Committee, which addresses this issue in greater detail.

10. Consumer advocates argue that allowing cell phone to gain exclusive agreements to sell the most in-demand cell phones harms competition by denying to competitors the ability to sell those cell phones, and advocate that the FCC take action to ban "handset exclusivity." What is Verizon's position on handset exclusivity? Doesn't allowing the practice constitute a barrier to competition?

Neither Congress nor the FCC should regulate the terms of device supply arrangements between manufacturers and providers. Exclusivity arrangements are common throughout the American economy, and drive innovation. Restricting them would clearly undermine innovation and disserve consumers. Moreover, Verizon Wireless has offered to limit exclusivity for devices manufactured by two of its largest suppliers – LG and Samsung – for a period not to exceed six months so that smaller carriers can gain access to those devices sooner.

Please see attached Verizon Wireless' recent submission to the House Energy and Commerce Committee, which addresses this issue in greater detail.

11. At the hearing, you stated that you do not know of any technology that permits customers to block incoming text messages on a per message basis. Wouldn't a solution to the concerns that customers have to pay for incoming messages they don't want be to not charge customers for incoming messages?

Verizon Wireless works hard to makes sure customers do not receive unwanted text messages, because a non-trivial volume of unwanted text messages would lead to customer dissatisfaction and complaints.

Verizon Wireless employs sophisticated tools in its network to detect incidences of unsolicited electronic messages, or "spam," sent to our customers' wireless devices. Verizon Wireless also provides customers with self-help tools to manage and even restrict receipt of spam messages that do manage to get through the network-based spam countermeasures. As noted on Verizon Wireless' website:

> **How do I block unwanted text messages?** You can use either Internet Spam Controls or Call & Message Blocking available through Spam Controls (My Verizon>My Services>Verizon Safeguards>Spam Controls).
>
> If the message is originating from an email address or web domain, visit Internet Spam Controls and enter the email or domain to be blocked. Internet Spam Controls allow you to designate and block up to 15 email addresses, vtext IDs and/or Internet Domains from sending text, picture or video messages to you.
>
> If the message is originating from a phone number, visit Call & Message Blocking and enter the phone number of the individual who you wish to block. Call & Message Blocking allows you to designate and block up to 5 phone numbers from sending text, picture or video messages to you.

Many of Verizon Wireless' customers are on unlimited text message plans, or enjoy unlimited text messaging with other Verizon Wireless customers, and thus many customers do not pay for unwanted text messages that manage to evade these company and individual protective measures.

Verizon Wireless continues to spearhead legal efforts to block spam. Verizon Wireless supported the passage of federal legislation aimed at providing consumers with control over receipt of spam. Verizon Wireless has also been aggressive battling spam in court. Over the past two years, Verizon Wireless has filed lawsuits against several companies it has accused of sending text message spam to its customers.