AT&T Response to Sen. Kohl's Follow-Up Questions for Hearing on "Cell Phone Text Messaging Rate Increases and the State of Competition in the Wireless Market"

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 AT&T raise its per message price from 10 to 15 cents in January 2007, and from 15 to 20 cents in March 2008? How did AT&T choose 15 cents as your per message price in January 2007, and 20 cents in March 2008?

Answer:[1] We base our pricing decisions on an independent assessment of a number of factors, including how particular prices fit into the full suite of our product offerings, the state of competitor prices, demand trend lines, and the like. No one factor necessarily is determinative and the various factors are weighed, and decisions are made, based on the marketplace circumstances extant at the time of a pricing decision.[2] In connection with changes over the past two years in the price for the pay-per-use, or "PPU," pricing option for text messaging that AT&T offers, we evaluated various factors and determined – in January 2007 and in March 2008 – to continue to meet our competitors' rates for the that option. AT&T's rate for the PPU pricing option has not changed since March 2008.

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 AT&T realizes from text messages.

Answer: As explained during the hearing on this matter, we are not in a position to break down our profit margins at this level of granularity. We make significant investments every year to deploy and support products and services across the full range the communications landscape,[3] and we utilize integrated networks and technologies to take full advantage of available efficiencies and innovations. Likewise, our pricing is designed on a holistic, integrated basis to allow us an opportunity to obtain a return on the entirety of our investments, not just the investments associated with some particular node or component of our network used to offer one pricing option for one product.[4]

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? Is it possible that some customers chose bucket plans only because the rates increased so much?

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[1] For your ease of review, we have attempted, where applicable, to identify where in previous discussions on these topics (whether in correspondence, written testimony, or live testimony), we have addressed a similar question.

[2] *See also* Written Statement of Wayne Watts for June 16, 2009, hearing ("Watts Stmt.") at 3-4.

[3] In 2009, AT&T's U.S. capital outlays are planned to be as much as $18 billion. This is the largest U.S. capital plan of any American company in any industry.

[4] *See also* unedited hearing transcript dated as of June 26, 2009 ("Tr.") at 41.

Answer: As we previously explained, the PPU pricing option is often not the optimal choice for the vast majority of our customers and our package plans have a number of notable benefits:

> In our experience, the PPU pricing option often results in large and unpredictable swings in a customer's total bill, leading to significant customer dissatisfaction and complaints to our customer care lines. Package plans ensure extremely low prices, choice, predictability, and easy-to-understand bills, and thereby greatly improve the overall customer experience. That is, we saw that demand for text messaging was exploding; did not want our customers to suffer unexpectedly large or constantly changing monthly bills; and fixed the potential problem of unhappy customers by avoiding them in the first place. Now, the overwhelming majority of our customers purchase text message packages, and most of them pay pennies or less than a penny per message.[5]

That is, we do not "push" our customers into pricing plans, but our overall pricing structure is designed to emphasize those plans that deliver maximum value to our customers.[6] Thus, it is possible that some customers who were utilizing the PPU pricing option decided to purchase a monthly text messaging plan in response to increases in the PPU price, however, we are confident that, in doing so, those customers are enjoying greater value and predictability in their use of our text messaging service.

4. AT&T 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"?

Answer: As an initial matter, one of the premises of your question – "that each additional text message costs the carrier virtually nothing" – is not correct. As we previously have testified, demand for text messaging service has increased 600% in just two years. The notion that carriers would increase text messaging output at such a rate, while simultaneously meeting the ever-growing voice-traffic needs of their customers, and not face material costs, simply is not supported by facts.[7] When originally developed and deployed, text messaging capabilities were expected to be of limited use; there was no expectation that they literally would transform, as they have, the manner in which Americans communicate. As a result, wireless providers have had to quickly respond to a massive shift in social behavior by augmenting their networks and, in particular, the elements of their networks that exist only to enable text messaging. Indeed, the exponential growth in text messaging affects the most fundamental – and sometimes scarce – component of a wireless network: spectrum. Every text message occupies a control channel, the number of which is finite based on a carrier's spectrum capacity. Thus, regardless of the actual

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[5] Watts Stmt. at 5. *See also* Tr. at 9.

[6] *See also* letter from Tim McKone, Executive Vice President – Federal Relations, to Senator Kohl, dated October 6, 2008, at 2.

[7] Tr. at 61-62.

size of a text message, each of the billions of messages that traverse the AT&T network in a given month separately occupies channel capacity on the network – capacity that is shared by the millions of other voice and text users and the billions of other messages. Put simply, making this transformative service available to millions of consumers and growing its output at exponential rates is not a cost-free exercise.

Beyond cost issues, there should be no concern about greater adoption of text messaging package plans. First, while AT&T does offer unlimited messages for $20/month, it also offers smaller packages, including 200 messages for $5/month and 1500 messages for $15/month. Thus, there is a package suitable for any customer interested in one. Second, the effective rates under these plans are very low; indeed, as we testified, AT&T's overall effective rate per message as of March 2009 was just $0.014 – 70% less than it was just two years ago.[8] Put simply, AT&T's package plans are not "expensive;" they are a boon to our customers.

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

Answer: Approximately 25% of AT&T's text-messaging users utilize the PPU pricing option in those months when they send text messages, and less than 1% of AT&T's postpaid text messaging volume is handled on a PPU basis.

(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: We are not aware of any facts or analyses indicating that low-income or elderly customers make up a disproportionate percentage of users of the PPU pricing option. Moreover, because the vast majority of PPU users are low volume users, the actual economic impact to such customers of the PPU rate increases is quite small.

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: First, as noted in Mr. Watts's testimony, AT&T has not changed the price for PPU text messages in over a year, and the price for all other text messages has declined dramatically over the same period of time. Second, given the dynamic and intensely competitive nature of the wireless industry, it is impossible to predict the price of any product or option in a year or two. Indeed, if the last two years are any guide, we reasonably can expect that customers will continue to enjoy low prices and greater capabilities when utilizing AT&T's text messaging services. And, we can conclusively confirm, as we have explained above and in previously in our testimony, that AT&T will continue to unilaterally evaluate its entire pricing portfolio based on a variety of factors to deliver maximum value to our customers. The competitive marketplace and our own ingenuity in satisfying the demands of our customers will be the driving forces.

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[8] Watts Stmt. at 4; Tr. at 8.

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?

Answer: The U.S. wireless industry was and is a highly competitive industry. Indeed, it is the most competitive wireless industry in the world, American consumers reap the rewards of this competitive success story, and there is no reason to think that this will change. Moreover, the facts belie any suggestion that there is a lack of effective competition in the wireless industry.[9] Nine independent companies each serve more than four million retail customers. More than 95 percent of the U.S. population – those living in urban, suburban and rural America – are served by at least three competing carriers, and more than half live in areas served by at least five. Eight years ago there were 100 million U.S. wireless customers. Today, there are more than 270 million, and in 2008 they used more than 2.2 *trillion* minutes – a tenfold increase since 2000. At the same time, prices have declined precipitously. Revenue per minute has fallen 89 percent since 1994, and U.S. wireless prices are much lower than in any other major industrialized country. And, while AT&T and Verizon are currently the two largest wireless providers, the next two largest, Sprint and T-Mobile, have a combined 82 million customers, and the carriers that round out the top 10 have another nearly 20 million customers among them.[10] And, while it is true that the top four U.S. carriers represent 86% of the market, in 23 of the 26 OECD countries, the top four carriers represent 100% of the market.

8. In a letter dated June 23, 2009, you corrected your testimony at the hearing regarding early termination fees. You stated that, after the first month, AT&T reduced its $ 175 early termination fee on a two year contract by $ 5 per month, so that after 23 months a customer will still owe $ 60 if he or she terminated the contract. Why is that AT&T's policy, rather than simply reducing the early termination fee in a manner proportional to the amount of time remaining on a customer's contract (i.e., reducing the early termination fee by 1/24 for each month on a customer's two year contract)?

Answer: Early termination fees ("ETFs") are an essential component of a long-standing practice in the wireless industry that has put the best devices into American consumers' hands at discounted prices. Our customers typically purchase a handset for a discounted price, and sign a one or two year agreement promising to pay a monthly fee for service.[11] The ETF provides a

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[9] See also Watts Stmt. at 1-3.

[10] Just by way of example, Metro PCS, which now has over 6 million customers, and Leap Wireless, which now has over 4 million customers, added 700,000 and 500,000 net new customers, respectively, just in the first quarter of this year. These are huge growth rates, and these carriers are now a major competitive force in this industry.

[11] This is not a required arrangement. If the customer is not interested in a term commitment, she can simply pay the full, non-discounted amount for the device at the outset, make no term commitment, and there would be no

necessary and appropriate assurance that we will have a fair opportunity to recover the discount that underlies that low handset price. In the absence of an ETF, this system would be severely undermined, and U.S. consumers, like their counterparts in Europe and other parts of the world, would pay significantly more for a smaller selection of handsets. Aside from its impact on innovation, this approach would be regressive, effectively pricing the most capable devices beyond the reach of many low-income Americans. Moreover, a simple pro rata ETF would not likely be viable. Under AT&T's ETF policy, a customer who signed a two-year contract would face an ETF balance of $60.00 at the end of 23 months. This amount, which is only 35% of the original ETF, nonetheless incentivizes the customer to fulfill the remaining term of the agreement, which, as explained, is the foundation for the substantial up-front cost that AT&T incurred. An inflexible pro rata system would not engender these same incentives and the discount system would be undermined.

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?

Answer: AT&T supports the FCC's existing roaming regulations, which effectively serve their twin purposes of ensuring that a customer has service when roaming outside his/her provider's service areas and promoting investment in the nation's wireless infrastructure. The FCC has explained that, "if a carrier is allowed to 'piggy back' on the network coverage of a competing carrier in the same [home] market [where it has its own spectrum], then both carriers lose the incentive to build-out into high cost areas in order to achieve superior network coverage."[12] Thus, the so-called home market exception encourages carriers to compete and invest by building out service in areas where they have spectrum. Likewise, the FCC has correctly declined to extend roaming obligations to non-switched services such as wireless broadband Internet services. The wide array of developing "data" services, devices, applications and standards make it impossible to craft an automatic roaming rule without severe detrimental network effects that would be harmful to consumers. This is especially true today, as wireless networks face the daunting challenge of handling streaming video, an application for which they were not originally designed. Any government mandate, in short, would discourage the very infrastructure investment in broadband wireless services that our nation sorely needs.

(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: *See* response to Questions 9(a), above.

ETF regardless of when she might discontinue service. In fact, the customer can bring her own device to our network and obtain service without signing up for a term commitment.

[12] *See Reexamination of Roaming Obligations of Commercial Mobile Radio Service Providers*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd. 15817, ¶ 49 (2007) ("*Automatic Roaming Order*").

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 AT&T's position on handset exclusivity? Doesn't allowing the practice constitute a barrier to competition?

Answer: Exclusive arrangements of all kinds permeate the U.S. marketplace today and are essential to robust competition. In the wireless industry, exclusive handset arrangements have provided U.S. consumers the most advanced devices in the world at distinctly affordable rates. Indeed, the successful collaborations of U.S. wireless carriers and handset manufacturers over the past few years have shifted the center of handset innovation from Europe and Asia – where it rested for years – to the United States. By allowing a carrier and a manufacturer to share the enormous risks and costs of bringing an inventive but unproven new device to market, exclusive arrangements both quicken the pace of technological advancement and incentivize the carrier to offer even greater handset subsidies to its customers. Now, the U.S. leads the world, with the best devices being designed and manufactured by American companies and American consumers often enjoying the earliest – and cheapest – access to them. Thus, the true victims of any prohibition on exclusive arrangements would be consumers; they would face less innovation, fewer choices, and significantly higher prices for handsets.

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?

Answer: As we explained in a letter subsequent to the hearing on these issues, AT&T has deployed technology that offers customers an advanced level of control over their wireless services.[13] Smart Limits for Wireless™, a product primarily designed as a sophisticated parental control, allows for detailed limits and controls on the use of many capabilities of a wireless device. With specific reference to text messaging, limits can be set for the number of text messages that a device can send or receive, and text messages from specific mobile phone numbers can be blocked. The charge for this service is $4.99 per month per line. And, any customer can block all incoming text messages, free of charge. Thus, while some companies might consider an offering that does not include charges for incoming text messages, AT&T has selected a path that couples extremely high-value text messaging pricing with next-generation control options.

[13] See letter from Wayne Watts, Senior Executive Vice President and General Counsel, to Senator Kohl, dated June 23, 2009.