Written Statement of

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Before the Senate Committee on Commerce, Science & Transportation

Hearing on

"The Consumer Wireless Experience"

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I. Introduction

Chairman Rockefeller, Ranking Member Hutchison, and members of the Committee, good afternoon and thank you for inviting me to discuss the issue of handset exclusivity arrangements. My name is Barbara S. Esbin, and I am a Senior Fellow at the Progress & Freedom Foundation, a non-profit think tank that is focused on the digital economy. As Director of PFF's Center for Communications and Competition Policy, I have endeavored to develop and advocate an evidence-based policy framework that relies

to the maximum extent possible on competitive forces to achieve next generation infrastructure deployment and service innovation in the communications industries. Prior to joining PFF, I spent over fourteen years as a regulatory attorney at the Federal Communications Commission, where I held a variety of senior staff positions with the Common Carrier, Wireless Telecommunications, Cable Services, Media, and Enforcement Bureaus.

My testimony will focus on the ongoing debate about exclusive handset arrangements and their role in the consumer wireless experience. On the basis of my research into the issue, it is my conclusion that the wireless service and handset markets are effectively, if not robustly, competitive; that exclusive handset arrangements have brought palpable benefits to both consumers and competition within the wireless sector; and that regulatory intervention to prohibit such arrangements would be ill-advised. Any actual consumer harm arising from demonstrable anticompetitive activity or unfair and deceptive practices would be better handled through our antitrust and consumer protection authorities.

II. The Wireless Service and Handset Markets are Thriving

In January of this year, the FCC's Wireless Telecommunications Bureau released its Thirteenth Annual Report on the state of competition in Commercial Mobile Radio Services. It found that there is effective competition in the CMRS market and that "U.S. consumers continue to reap significant benefits – including low prices, new technologies, improved service quality, and choice among providers – from competition in the CMRS marketplace, both terrestrial and satellite CMRS." American consumers may receive service from a host of national, regional, and small providers, including dozens of mobile virtual network operators (MVNOs). According to the report, "there was an approximate

eight percent increase in the percentage of the U.S. population with access to *five or more* different mobile telephone operators in one year, from nearly 57 percent at the end of 2006 to almost 65 percent at the end of 2007. Moreover, approximately 96 percent of the total U.S. population lives in areas where three or more different operators compete to offer mobile telephone service in some parts of those counties, while nearly 91 percent of the U.S. population continues to live in counties with four or more mobile telephone operators competing to offer service." According to information compiled by CTIA - The Wireless Association, the United States has the lowest HHI (that is, the least concentration) among wireless carriers of the 26 Organisation for Economic Co-operation and Development countries tracked by Merrill Lynch. Further, in the U.S., the top four carriers control only 86 percent of the market, yet in 23 of the 26 OECD countries, the top four carriers control 100 percent of the market. No U.S. carrier has a market share appreciably over 30 percent, which is well below the level of concern for antitrust authorities.

There is also extremely healthy competition in the market for wireless handsets. InformationWeek reported U.S. handset market shares for the larger suppliers as of late 2008: 22.4 percent for Samsung, 21.1 percent for Motorola, 20.5 percent for LG, 10.2 percent for Research in Motion, 8.4 percent for Nokia, and 5.7 percent for Apple. CTIA reports that there are over 630 handsets sold in the United States, manufactured by 33 companies. These devices are sold by both carriers and a vast number of retailers, including "Big Box" and national electronics stores, independent retail outlets, manufacturers' stores and websites, and online auction sites. In nearly every case (Apple has only one handset to sell: the iPhone), handset manufacturers offer a variety of

models, only a few of which are sold under exclusive distribution agreements. New products are hitting the market regularly, and prices for existing models are dropping. Additionally, in the past year, several on-line "applications stores" have launched, making over 40,000 applications suitable for wireless devices available to consumers. There is every reason to expect this cycle of innovation to continue to grow, as carrier networks evolve to support the new handsets and applications, and the latter develop to utilize the former.

This level of competition for both services and equipment has directly benefited wireless consumers as a whole. The price per minute of service in the United States is the lowest of the 26 OECD countries tracked by Merrill Lynch. From December 2006 to December 2007, the average number of minutes each subscriber used per month increased 7.7 percent and the average numbers of text and multimedia messages each subscriber sent each month doubled.

The evidence above clearly illustrates that the market for both wireless carriers and handsets in the U.S. is competitive and innovative, and is delivering consumer benefits. Yet rural carriers have painted a vastly more pessimistic picture of today's wireless marketplace, one in which the market is dominated by four large nationwide carriers with large enough subscriber bases to exert significant influence on handset manufacturers, such that no manufacturer can afford not to 'play ball' with the largest wireless carriers. The rural carriers do not claim that the handset markets are uncompetitive; rather they stretch to argue that consumers and smaller competitors are harmed by the actions of the "Big 4" carriers (AT&T Mobility, Verizon Wireless, Sprint

Nextel, and T-Mobile) in accepting these exclusive deals because the effect is to deprive some consumers of either their desired handset, their desired carrier, or both.

But this overstates the market power of the carriers when it comes to desirable new handsets. First, as discussed previously, the FCC has found the wireless services market is subject to effective competition. Although the largest national carriers may be large, the level of concentration in these markets is below that which is typically of concern to the antitrust authorities. The RCA Petition alleges that the "Big 4" carriers today exercise "monopolistic" control over device manufacturers and use their market power to force manufactures into exclusive relationships that harm the ability of rural carriers to compete. In the case of high-end handsets, the very opposite seems true: It appears now that it is the manufacturers who "command" the carriers, and the manufacturers are under no generalized "duty to deal" under our antitrust laws. Economists have long recognized the benefits of exclusive deals entered into by companies who lack substantial market power.

Even the RCA Petition acknowledges that "unique services and features" are a key element of competition among carriers. The FCC itself has noted that exclusive handset arrangements—i.e., product differentiation—is a natural competitive response by carriers to the high customer "churn" rates they face. In other words, "churn" is the sign of a competitive marketplace and the exclusive arrangements are a simply feature of an intensely competitive market, rather than an "unfair" or "anticompetitive" tool.

Rural consumers are by no means bereft of attractive options for smartphones and other advanced handsets. There is less a "smartphone divide" than "lag" in the availability of certain models in certain regions of the country. Even if the leader-of-the-

pack, the iPhone, remains available in the U.S. exclusively through AT&T for another year or two, there are already a wide variety of increasingly sophisticated alternatives to the iPhone, each of which also has a limited period of exclusivity with a single carrier. And the other large carriers have all announced plans to support "open" applications and handsets, with not one but *two* emerging open-source mobile platforms—Google's Android and Linux Mobile or "LiMo."

III. Calls for Exclusive Handset Prohibitions Overstate the Harms and Understate the Pro-Competitive Benefits

The typical exclusive handset agreement permits the product distributor, the wireless carrier, an exclusive right to distribute the product for some period of time. Exclusive handset arrangements benefit the manufacturer, the carrier and ultimately, the consumer. The deals typically include a guaranteed minimum order, which gives the carrier an incentive to heavily promote the product and offer subsidies to lower the price of the phone to consumers. Such arrangements can enable the research and development of more innovative—that is, riskier—handsets knowing that the carrier partner has greater incentive to promote and support the result. For manufacturers of smartphones such as the Apple iPhone, RIM Blackberry, and Palm Pre, securing a large base of users is especially important as it ensures that third-party developers will develop applications for the handset. As the number of third-party applications increases, the handsets are even more desirable. As Apple itself expressed it, "Your iPhone gets better with every new app."

Carriers are willing to pay for the right to be the sole retailer of a "hot" new handset in the belief that the handset will draw in new customers. The ability to lure subscribers with a handset that has created a "buzz" is a key element in operator

differentiation, and differentiation is what permits companies to thrive in a competitive environment. AT&T improved its position with the iPhone and now Sprint is hoping to do the same with its exclusive introduction of the Palm Pre. For smartphones, these new customers often also have higher bills because of increased data usage, resulting in even more revenue for the carrier. The net result is a competitive wireless services market that offers consumers a variety of devices, applications, service plans, and content associated with their wireless handsets.

Exclusivity is far from a rarity in the world of cell phones, and it is not a practice limited only to the largest carriers. Many carriers work closely with manufacturers to offer the specific package of features that they think will be most desirable to potential customers. For example, Cellular South's "Pic Sender" feature automatically delivers every picture taken with the built-in camera in a subscriber's cell phone to a specific e-mail account, a folder on the user's computer, or photo sharing websites. T-Mobile's Hotspot Calling feature allows certain of its WiFi-enabled phones to make unlimited calls from any WiFi hotspot and can seamlessly transition from WiFi to cellular networks. And as a startup with no customers, Jitterbug was able to work with Samsung to design and manufacture an exclusive handset designed specifically for the elderly, thus differentiating itself from other providers. Jitterbug is now a successful MVNO with 5 million subscribers. Helio (which was recently sold to Virgin Mobile), another small MVNO that never had more than 170,000 subscribers, worked with Pantech to develop one of 2007's most talked about phones, the Ocean.

There are many potential developers of innovative handsets, including both traditional manufacturers and new entrants such as Apple and Google. No single firm

appears to have market power in the handset market, and certainly no single firm may be viewed as a sole source of innovation. The fact that small MVNOs can procure innovative "exclusive" handsets strongly suggests that there is no market failure to be addressed by regulatory intervention.

A. The iPhone is an Example of a Successful Exclusive Distribution Arrangement

Back in 2005, what we now know as the "iPhone" was just a concept, with no name, design plan or operating system, offered by a computer company with neither market share nor experience in wireless service or devices. This was a risky venture for both the equipment designer and the wireless carrier, one that has paid off handsomely. But the success of the iPhone follows the failure of Apple's first attempt to bring its iTunes music service to the mobile phone: the Motorola ROKR, launched in September 2005. The ROKR failed, in part, because Motorola insisted on loading the phone with its standard software. ROKR's failure to meet Apple's expectations caused the company to launch development of its own mobile phone product.

Part of the iPhone's success is because of features, such as Visual Voicemail, that were only possible through changes to the carrier's wireless network. Apple originally began negotiations with Verizon to be the exclusive carrier of its product, but Verizon was unwilling to meet Apple's demands, which also included limitations on the set of retailers for its handsets. Apple then turned to Cingular (now AT&T). AT&T was willing to cede control and take the risk of modifying its network and entering into an exclusive arrangement when the iPhone's market success was unknown. AT&T recognized that only by letting Apple take the lead on technological development could a truly revolutionary device be created. The resulting partnership allowed the two

companies to make significant investments to develop a radically innovative device while ensuring that the phone and its new features would function properly on AT&T's network, thus guaranteeing the high-level user experience that Apple seeks for its devices.

In agreeing to be the exclusive provider of wireless service for this product, AT&T gave up the substantial sway that carriers normally had over how phones were developed and marketed for use on their wireless networks. Both carrier and equipment manufacturer took considerable risks, and contributed substantial assets toward product development. Nearly eighteen months and $150 million in development costs later, the iPhone was born.

The iPhone was not only a revolutionary product in terms of design and features. The original business model struck between Apple and AT&T was revolutionary as well: It appears to be the first time a handset manufacturer was able to obtain a share of the monthly subscriber revenues generated by its product. When the follow-up "iPhone 3G" was launched in 2008, it was sold for $199, less than half the price of the original. This dramatic price reduction reflected a change in the business model: AT&T agreed to pay Apple a subsidy of about $300 per device, according to industry analysts, to help hold down the retail cost of the handset to consumers. Although this represented a reversion to the traditional business model of carrier subsidization of handsets, at $199, the iPhone became far more affordable for the average wireless user and available to a vastly expanded customer demographic.

This continual cycle of technological innovation, aided by flexible business arrangements, has led to iPhone capacity increasing and prices dropping approximately

$500 in a two year period. Overall, this is an extremely consumer-friendly outcome, as it brings the iPhone, first released as a very high-end wireless phone and data product, within the reach of average wireless users. Regulation, with its inherent delays and disputes, simply cannot produce comparable consumer benefits.

B. The Harms of Exclusive Arrangements are Overstated

One might think that everyone would celebrate the iPhone as a breakthrough stimulus to innovation in the handset market as well as to the business relationships between carriers and equipment manufacturers. Yet, on May 20, 2008, the Rural Cellular Association (RCA) petitioned the FCC to investigate whether the agency should prohibit as anticompetitive the business model that helped bring the iPhone to fruition: an exclusive arrangement between the wireless carrier and the handset manufacturer. This is a profoundly backward-looking request, and I respectfully suggest that both the FCC and Congress decline the invitation.

RCA's Petition to the FCC casts the nations' "Big 4" carriers variously as "monopolistic," "dominant," and "oligopsonistic" villains who use their market power to "command" exclusive arrangement's like that between AT&T and Apple. The RCA Petition claims that its members are challenged in their ability to compete with the "Big 4" not only by their inability to access wireless handsets comparable in function and style to the high-end exclusive handsets, but by virtue of their inability to command the same volume discounts from vendors as the largest carriers, creating what RCA states is a "wireless marketplace bordering on oligopsony." The alleged "oligopsony" is a small group of carriers who, as handset *buyers*, supposedly exercise market power over handset *suppliers*. But the RCA Petition overlooks the fact that rival handset manufacturers offer many advanced handsets with features that are competitive with the most popular models

sold under exclusive distribution arrangements, and that several of these models are available to and offered by RCA member companies, including the HTC "Touch" series of phones (offering touchscreen, Internet access, e-mail and music capability).

In addition to their alleged harms to smaller competitors, the RCA Petition claims that the exclusives create two distinct forms of consumer harm: (i) Consumers in "Big 4" service areas are forced to purchase service from a carrier they may not wish to use in order to utilize their handset of choice (which will cost more due to the lack of competition for distribution), and (ii) consumers in the foreclosed areas (those served by RCA members) are denied the opportunity to obtain service for the premium handsets they desire.

There is not yet—nor should there be—a governmentally-sanctioned right to obtain a particular handset (no matter how desirable that handset might be). Where both the handset manufacturer and the carrier service markets are effectively—if not robustly—competitive, the lack of availability of some equipment in certain parts of the country today should not give rise to an FCC rulemaking tomorrow.

RCA offers not a shred of evidence that the iPhone, for example, would cost less *but for* the exclusive distribution deal with AT&T. Nor would it seem likely that such a case could be made. There has been a steady decline in iPhone prices and the introduction of larger-capacity phones since its introduction two years ago. Nor do these arguments take into account that despite its initial premium (although falling) price, the iPhone has set record sales globally since its introduction. Again, this is the sign of a highly desirable product for which consumers are willing to pay a high price—in other words, the sign of a healthy marketplace, not one hobbled by anticompetitive activity.

Additionally, it is argued that exclusive arrangements are disproportionably harmful to rural consumers. An unstated premise of the rural carrier's request that exclusives be prohibited is that consumers in every area of the country have a legal or perhaps even constitutional right to the smartphone of their choice, and that any business arrangement that restricts the exercise of this right is, in essence, "contrary to the public interest." This is an extraordinary proposition, unsupported by fact, law, or reason.

Consumers today have an incredible array of wireless devices before them, and are by no means foreclosed from obtaining competitive wireless services by reason of the exclusive handset agreements. Moreover, the exclusive handset arrangements in the market today are for limited periods of time, and appear to be undergoing significant renegotiation by the principals as the market for these products evolves. Resolution of the thorny problem of the correct duration of an exclusive distribution arrangement is best left to freely negotiated contractual arrangements between the carrier and the equipment manufacturer.

RCA has argued that such arrangements harm rural consumers (and, of course, RCA's members) because only the largest wireless carriers are able to command these exclusive arrangements, leaving small rural wireless carriers and their customers without access to the most innovative handsets and services. According to RCA, the combination of Apple's exclusive U.S. deal with AT&T and the carrier's policy of barring its users from spending more than 40 percent of their time roaming off-network effectively renders the iPhone unavailable to subscribers in RCA member service territories.

The argument that these deals are driven by the market power of the four largest national wireless carriers, who use exclusive arrangements as a weapon against their

competitors, including rural carriers, overlooks the fact that, if the iPhone is unavailable in certain rural areas, it is because AT&T *does not compete* as an originating carrier in that area. The sought-after prohibition on a wireless carrier's ability to enter into an exclusive handset distribution agreement with an equipment manufacturer would effectively regulate the equipment manufacturer's ability to conduct business in a profitable manner. It would interfere with the manufacturer's ability to freely contract the terms and conditions under which it sells its products, by imposing a back-door "duty to deal" with each and every wireless carrier. This would be both unprecedented and bad public policy.

C. The Benefits of Exclusive Handset Arrangements Are Increased Innovation and Competition

Now that the iPhone's success is established, why should other carriers that were initially unwilling to take the risk be able to share in the success? More importantly, if every wireless carrier had been able to sell the iPhone when it was initially released, it is unlikely that there would have been as much carrier support for developing competing products such as Google's G1, Research In Motion's touch screen Blackberry Storm, Samsung's Instinct, or Palm's Pre. And without those smartphones to compete with, Apple might have had little incentive to release the second-generation and now third-generation iPhones so quickly after the initial iPhone's release. For its part, Congress and the FCC should let the competitive forces of the wireless services and handset markets continue to produce devices like the iPhone unhindered by unnecessary government intervention.

Arguments that exclusive agreements doom rural customers to dwell forever on the wrong side of the so-called "Digital Divide" between urban/suburban residents with

access to the hottest new smartphones and rural customers without ignores an even more important divide: that between the technologies of today and the disruptive innovations of tomorrow. If Congress or the FCC prohibits the exclusive partnerships between manufactures and carriers that make it possible to master the technical challenge of device innovation *and* to finance such risky ventures, *all* Americans will miss out on the dramatic benefits of innovation and increased mobility of Internet access.

One must ask whether the iPhone or its competitor devices would have been developed as well and as quickly without such exclusive deals—and ask the same question about *future* devices. In other words, would banning such arrangements effectively spite *all* consumers by ensuring that, if some customers can't have the fruits of device innovation immediately, then none should?

While some carriers had reached exclusive arrangements prior to the 2005 Apple/Cingular iPhone deal, most of those deals concerned MVNOs, whose business model as resellers required that distinguish themselves from the underlying carriers whose services they resold by offering unique devices and service features. These early exclusive equipment arrangements largely failed in the marketplace. But today other smartphone manufacturers are following Apple's lead and demanding exclusive deals with sharing of revenue from resulting customer wireless data service plans rather than the traditional model of simply try to sell as many units as possible. This practice makes sense—the attractive new devices can attract huge numbers of new customers to a carrier—with each new customer paying for data as well as voice service. In an industry with high fixed costs and low marginal costs, this translates into large potential profits for a carrier with an attractive new device.

This dynamic can incentivize a new entrant like Apple to fund expensive, risky efforts to develop revolutionary wireless handset products like the iPhone. Handset innovation, in turn, can spur carriers to upgrade their infrastructure to accommodate the increased bandwidth demands sophisticated handsets place on their wireless networks. Each side of the business transaction gains, but more importantly, so do consumers in terms of gaining innovative handset features, data applications, and wireless service offerings.

The phenomenal success of the iPhone has galvanized other equipment manufacturers and carriers to enter into similar exclusive arrangements to develop their own innovative, competing products. The introduction of the iPhone was followed by a flood of other innovative handsets under exclusive distribution agreements. These include, in addition to the handset options discussed above, LG's Voyager (offered exclusively by Verizon Wireless), Samsung's Ace and Instinct (offered exclusively by Sprint Nextel), Samsung's Katalyst (offered exclusively by T-Mobile), and the RIM Blackberry Storm (offered exclusively by Verizon Wireless). Several of these handsets have features the iPhone lacks, such as the Bold's higher resolution and the Instinct's tactile feedback. Similarly, Google has teamed up with HTC to offer a "G1" smartphone exclusively through T-Mobile. The G1 makes use of Android, Google's new operating system, and also offers features not available with the iPhone. Many, if not most, of these products are direct competitive responses to the challenge posed by AT&T and the iPhone; their development has brought additional feature-rich options to consumers.

The most recent entrant to this burgeoning field is the "Palm Pre," touted as a "respectable competitor" to Apple's increasingly popular device, which for a limited time,

will be exclusively sold by Sprint Nextel, a carrier that has been struggling with customer losses over the past few years and is looking for a way to stop subscriber losses and win back market share. The device is being marketed at $299 before a $100 rebate for new or renewing Sprint data plan customers.

It is likely not coincidental that Apple announced its new lower $100 pricing for last year's iPhone 3G at about the same time the Pre hit the market. Just days later, AT&T itself took out advertisements promoting its exclusive Blackberry Bold smartphone for $199 after mail-in rebate of $100. In addition, there are recent signs that some carriers are dropping, and others considering dropping, the cost of their monthly data service plans supporting these smartphones to further drive penetration. These are signs of a well-functioning marketplace: one competitor breaks ahead of the pack with a unique offering, others race to catch up, new products and services are introduced, prices drop, and consumers benefit.

Product development, like business arrangements, in the fast-moving technology sector can be a hit or miss endeavor. For every successful product like the iPhone, there are tens if not hundreds of commercial failures. It would be unfair to require carriers and manufacturers to share the rewards of only their successes, while bearing sole responsibility for their product failures.

IV. Competition Should be Protected, not Competitors

It is the competitive process, rather than individual competitors, that competition policy seeks to protect in light of the benefits competition brings to consumers in the form of lower prices, greater innovation and better service quality. It is well recognized that the wireless market is reaching saturation: that is, most all of the people who want mobile phones likely have them already. Subscriber growth for the carriers must come

from attracting new customers away from the competition. Handset differentiation is a key means of drawing such customers, and handset exclusivity is a key marketing tool. Prohibiting such arrangements and effectively mandating that all offerings look the same would interrupt a well-functioning competitive process and leave the carriers with fewer options to attract customers. Although this undeniably leaves some carriers out of the competition for customers desiring a particular smartphone, it does not completely foreclose their ability to compete on other service features and functions.

One of the enduring lessons of childhood is that you should share your toys. But in the realm of electronic communications networks, this rule of thumb does not always have beneficial consequences. In a 1999 U.S. Supreme Court decision overturning portions of the FCC's unbundled network element sharing rules, AT&T v. Iowa Utilities Board, concurring Justice Stephen Breyer observed :

> Nor can one guarantee that firms will undertake the investment necessary to produce complex technological innovations knowing that any competitive advantage derived from those innovations will be dissipated by the sharing requirement . . . Increased sharing by itself does not automatically mean increased competition. It is in the unshared, not in the shared, portions of the enterprise that meaningful competition would likely emerge.
>
> A totally unbundled world -- a world in which competitors share every part of an incumbent's existing system, including say, billing, advertising, sales staff, and work force (and in which regulators set all unbundling charges)-- is a world in which competitors would have little, if anything, to compete about.

Substitute mandatory "sharing" of handsets developed through equipment manufacturer-carrier collaboration and shared risk taking for "advertising" and one can see the net effect of a prohibition on exclusive handset arrangements: there will be little

left for the carriers to compete about. In networked industries like wireless, with high fixed costs, if all other areas of competition are removed, forcing the firms to compete on price alone will make recovery of network investment more difficult and eventually could lead to one or more of the current providers exiting the market. In other words, it would likely lessen, rather than enhance, competition and consumer welfare.

V. Existing FCC Policy and Rules Correctly Permit Exclusive Handset Arrangements

Well established FCC precedent supports exclusive handset arrangements, based on the highly competitive nature of the telephone consumer equipment market and the effectively competitive services market. In the 1968 *Carterfone* decision, the Commission first required that any piece of "customer premise equipment" be allowed to access the telephone network (then truly a monopoly) so long as it did not cause harm to the network. In the FCC's landmark 1980 *Computer II* decision, the agency "de-tariffed" —removed from common carrier regulatory controls—customer premises equipment (CPE) as well as data transmission services, but required that both be sold unbundled from the underlying common carrier wireline service and by separate corporate entities. The FCC did so in recognition of the fact that the CPE market was highly competitive such that the imposition of common carrier regulation had serious and deleterious consequences. In 1992, the Commission created an exception to the bundling prohibition in its *Cellular CPE Bundling Order*, allowing wireless providers to bundle devices and transmission services with wireless voice service. The Commission justified this exception on the grounds that "most wireless carriers were smaller and operated in local markets, making it unlikely that they could 'possess market power that could impact the numerous CPE manufacturers operating on a national… basis.'"

In the same 1992 order, and at a time when there were only *two* cellular carriers per market, the FCC rejected claims by both cellular resellers and equipment manufacturers that permitting carriers to enter into exclusive agreements with CPE providers created the potential for anticompetitive abuse. Two markets were analyzed: the CPE market and the cellular services market. The FCC had little trouble concluding that the "cellular CPE market is extremely competitive." After noting that the record was not conclusive as to whether the service market was "fully competitive," the FCC reiterated that in establishing the duopoly cellular market, it had concluded that "even a marginal amount of facilities-based competition will foster public benefits of diversity of technology, service and price." Accordingly, the FCC refrained from intervening in these markets where the record before it was devoid of evidence that cellular carriers were violating their obligations to provide service to customers purchasing other brands of CPE or that the exclusives were having an anticompetitive impact on competition in the CPE market.

Not only did the FCC find that no evidence of anticompetitive effects from the exclusive CPE deals had been presented on the record before it, but the agency went on to note that the record did not demonstrate a reason to be concerned about future exclusive dealing arrangements, because nondiscrimination requirements (still in effect today) precluded cellular carriers from refusing to provide services to a customer on the basis of the CPE he or she owns and it was unlikely that cellular carriers could effectively eliminate competition in the CPE market by entering into such agreements. In other words, the two markets potentially affected by exclusives—the upstream CPE market and the downstream carrier services market—were both sufficiently competitive even in 1992

to withstand any potential adverse effects from exclusive deals. Certainly today's exclusive deals pose no greater threat in wireless markets served by many more carriers offering a far greater variety of handset options.

VI. Any Prohibition on Handset Exclusivity Would Be Difficult to Implement

If Congress wished to impose a prohibition on exclusivity, it would have to address the question of what should be considered an "exclusive?" As explained above, many carriers offer nearly identical handsets with the only differences being the software. In some cases, carriers offer handsets in exclusive colors, or with the camera removed.

Similarly, because there are multiple wireless standards in the United States, a phone designed for GSM networks simply will not work on CDMA networks without significant product redesign. For voice, there is also Sprint's iDEN network, and for data there are multiple technologies for both of the two major network types. In the case of the iPhone, AT&T currently has a technological basis for its exclusive distribution arrangement. It is the only major U.S. carrier with a 3G network utilizing the HSPA standard on the 850 MHz band, and the iPhone as currently configured only supports AT&T's service for full data functionality. Even if carriers were prohibited from entering into exclusive arrangements, manufacturers can easily obtain de facto exclusives by designing phones for only one carrier's network. Adapting the phone to the spectrum interface technologies utilized by other carriers would most likely require adding other spectrum bands and/or overhauling the device to utilize CDMA calling and 3G access utilizing standards other than HSPA. Forcing manufacturers to design phones for multiple carriers is more likely to destroy innovation than to increase consumer welfare.

Eventually, as carriers transition their networks to a common 4G standard, some of these differentiating factors will disappear. But even if exclusive handset

arrangements were prohibited tomorrow, it would not be possible for all carriers to immediately offer the iPhone or similar handsets on their network. Thus, little good would be accomplished but tomorrow's innovations would be put at risk.

Even setting limits on the terms for exclusive arrangements, while less disruptive than an outright prohibition, would entail difficult decisions over exactly what the permissible period of exclusivity should be. Last December, France's Competition Council struck down Apple's five-year exclusive iPhone distribution agreement with Orange (formerly known as France Telecom). The decision was partly reflective of the authority's concern that the French mobile phone market was less competitive than others, such that a five-year exclusive sales agreement was far too long. The ruling specified that all existing and future sales agreements between Apple and Orange must expire after a maximum of three months, which the carrier argues will not allow it to justify the investments needed to upgrade its network to support mobile Internet services. If five years is too long, and three months too short, would Congress or the FCC be able to set a single time limit on exclusivity that will fairly balance the equities for all wireless providers and all equipment manufacturers?

Finally, an economic assessment prepared for one of the larger rural carriers seeking an FCC rulemaking to limit use of exclusive handset arrangements suggests that any exclusive sales arrangement made by a "Big 4" carrier and an equipment manufacturer be limited to apply the handset exclusivity only to the other Big 4 carriers, leaving smaller carriers free to obtain those handsets. Even assuming there were a competitive basis for such a restriction (which is doubtful), while it may be clear enough which carriers should be so restricted in their ability to contract for equipment today, it is

by no means clear what the appropriate test should be in the future, or even how such a rule could be written into the Code of Federal Regulations.

VII. Alternatives Exist for Rural Carriers Seeking Access to Innovative Handsets

Rather than trying to prohibit or limit the use of exclusive handset arrangements, the rural carriers may wish to pick up where the ACG members left off, pool their resources, and negotiate such arrangements for themselves. Like AT&T, the rural carriers may have to be willing to share some subscriber revenue or increase their handset subsidies to bring prices on advanced units down sufficiently to increase the addressable market for such products, but that's simply the market at work.

There is nothing stopping smaller carriers from banding together to achieve economies of scale. Indeed, many have already done so. The Associated Carrier Group (ACG), a consortium of 25 small or rural Tier II and II CDMA carriers "was formed to benefit both its members and the consumer by facilitating efficient production and marketing of devices as well as increased competition. The consortium enables its members to work with manufacturers, suppliers and other vendors to develop and procure products in a more timely fashion through economies of scale and standardization of coding and other features." Proceeding in this manner, the ACG members actually beat Apple and Cingular's Motorola ROKR to market in 2005 with a digital music player smartphone, the Kyocera Slider Remix KX5 music phone. At the time, ACG's president proudly declared: "Although other phones have been launched with MP3 capability, we think this was the first phone to be centered around music. Shortly thereafter, other carriers launched music-centric devices," adding, "This phone is exclusive to us for a limited time."

More recently, ACG has partnered with Brightpoint, Inc. which supplied approximately 84 million wireless devices globally in 2008. Similarly, twenty eight small carriers that won licenses in the FCC's recent 700 MHz auction formed NextGen Mobile, LLC. An official of the new company explained that, "By aggregating our orders, NextGen Mobile hopes to entice device manufacturers to develop and deliver the next 'it' handset or data card to those customers shut out in the past."

The fact that these small carriers and MVNOs can procure innovative "exclusive" handsets indicates that other smaller carriers can as well and strongly suggests that there is no market failure to be addressed by regulatory intervention. As no single carrier and no single manufacturer has a position of market power, exclusive arrangements should pose no antitrust concern.

Yet another avenue is negotiating with the carriers who currently have exclusive distribution arrangements for desired handsets. There are indications that at least one rural cellular carrier, Cellular South, through the ACG, is in discussions with Verizon Wireless to secure access to handsets currently exclusive to Verizon Wireless from two manufacturers, six months after their introduction by Verizon Wireless. Such negotiated contractual resolutions to the problems alleged by rural cellular interests are surely far superior to resolution through government intervention.

VIII. Conclusion

RCA has asked the FCC to initiate a rulemaking proceeding to investigate alleged anticompetitive effects of exclusivity arrangements between commercial wireless carriers and handset manufacturers, and to adopt such rules, as necessary, to prohibit such arrangements as contrary to the public interest. But the allegations supporting this request amount to little more than complaints that lack of access to the most popular new

smartphones such as the iPhone and Blackberry Storm make it more difficult for rural carriers to compete with the largest national carriers. But the FCC and Congress should refrain from interfering with these beneficial contractual arrangements freely negotiated by equipment manufacturers and wireless carriers in a competitive marketplace.

These exclusive handset arrangements do not preclude competition on other wireless service attributes any more than they preclude the smaller carriers from joining together to strike their own deals for exclusive handsets with equipment manufacturers. The situation is not analogous, for example, to that of an exclusive contract to serve multiple-dwelling unit for multichannel video programming services where the existence of the contract completely precludes marketing a competing service to the residents. Rather, it is more closely analogous to network sharing requirements for unbundled elements, where the accepted standard is whether access to the desired element is *necessary* in that lack of access would *impair* the ability of a competitor to enter the market. Mere difficulty is not impairment, and sharing of competitive assets should not be ordered lightly. A prohibition on exclusive handset arrangements would have the net effect on equipment manufacturers and carriers of a sharing obligation. Such an action is neither necessary nor advisable in today's wireless marketplace. But if I am incorrect in my views on the competitive situation or harms to consumers posed by these arrangements, there would be nothing to prevent our antitrust authorities from intervening under either the antitrust laws or consumer protection statutes.

I respectfully submit that neither Congress nor the Commission should take such action on the matter of exclusive handsets. The FCC today has before it a record on this question. If further study of the matter is deemed advisable, the FCC is well within its

powers to conduct a Notice of Inquiry and gather a more fulsome record from additional parties. I am confident that at the end of such an inquiry, the Commission would determine that there is no need for additional regulatory intervention.

Mr. Chairman, thank you again for the invitation to testify today. I would welcome any questions the Committee may have.