Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
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Protecting and Promoting the Open Internet	)	GN Docket No. 14-28
	)	
In the Matter of Framework for Broadband Internet Service	)	GN Docket No. 10-127
	)	
	)	

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Introduction

1. These comments are submitted in response to the Commission's Notice of Proposed Rulemaking on Protecting and Promoting the Open Internet (NPRM). The proposed rules would replace the 2010 *Open Internet Order* (2010 Order)[1], which was partially vacated by the United States Court of Appeals for the District of Columbia Circuit in its decision in *Verizon v. FCC*.[2]

2. The proposal contains three major provisions: a no-blocking requirement; an expanded transparency requirement; and a prohibition against "commercially unreasonable practices." In addition, the NPRM asks for comment on whether the Commission should reclassify broadband as a Title II telecommunications service.

3. These comments argue that:

   a. The Commission has not provided the data or analysis needed to show that the proposed rules are necessary, would help consumers, or pass a cost-benefit test.

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[1] *Preserving the Open Internet*, GN Docket No. 09-191, WC Docket No. 07-52, Report and Order, Dec 2010.

[2] *Verizon v. FCC*, 740 F.3d 623 (D.C. Cir. 2014).

b. The no-blocking rule is unnecessary because instances of anti-competitive blocking have been rare. Moreover, broadband providers generally have an incentive to make available as much content as possible to their subscribers in order to maximize the value of their networks. Where incentives may not be aligned, existing antitrust laws provide the appropriate remedies.

c. The transparency requirement, particularly the obligation that broadband providers publish detailed price information, may discourage price competition and facilitate anticompetitive behavior among providers, to the detriment of consumers.

d. The commercially unreasonable standard may distort negotiations between parties and introduce a *de facto* utility-type regulatory regime, even in the absence of Title II reclassification.

e. If the Commission does adopt a commercially reasonable standard, it should be based on traditional antitrust principles. This would protect consumers while giving broadband providers the flexibility to experiment with innovative pricing and business models, which would promote broadband deployment and benefit consumers.

f. Concerns about adverse effects on edge entrepreneurs or degraded service for consumers relegated to the "slow lane" are unwarranted.

g. Subjecting broadband to Title II regulation would represent a sharp departure from the *status quo* that would adversely affect innovation, investment and consumer welfare, and undermine the Commission's goal of extending broadband deployment.

The Commission Has Not Shown the Rule is Necessary

4. In order to determine whether to undertake regulation of the broadband market, and, if so, what form it should take, the Commission should answer the following basic public policy questions:[3]

  a. Is there a market failure?

  b. If so, how does it affect consumers?

  c. Can the failure be remedied by government action?

  d. Would the benefits of such action exceed the costs?

5. As with the 2010 Order, The Commission has not provided the data and analysis to support promulgation of these rules.[4] Specifically, the Commission has not provided evidence showing that the rules would address a significant problem or market failure, has not identified harms to users that the proposed rules would remedy, and has not demonstrated that the benefits of the proposed rules would exceed their costs. The Commission's goal "is to find the best

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[3] This type of analysis is widely accepted as a prerequisite for making good regulatory policy decisions. *See*, *e.g.*, EXECUTIVE ORDER 12866, September 30, 1993, which states: "Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets…. In deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating…. Further, in choosing among alternative regulatory approaches, agencies should select those approaches that maximize net benefits…unless a statute requires another regulatory approach." E.O. 12866 is one of a series of executive orders over the past 30 years requiring this type of regulatory analysis. Although these executive orders did not typically apply to independent agencies such as the FCC, they represent widely accepted principles of sound regulatory decision making.

[4] Comments of Thomas M. Lenard, GN Docket No. 09-191, WC Docket No. 07-52, Jan 26, 2010; available at: http://fjallfoss.fcc.gov/ecfs/document/view?id=7020367680.

approach to protecting and promoting Internet openness,"[5] but the Commission provides no evidence that Internet openness is threatened.

6. As with the 2009 Notice of Proposed Rule Making (2009 NPRM), the current NPRM refers to the well-publicized cases of Madison River blocking VoIP (2005) and Comcast engaging in network management practices that were criticized for lack of transparency (2007). Both of these problems were remedied relatively quickly and easily before the 2010 Order was adopted. Since then, the Commission found two examples "related to the open Internet rules and norms," both in 2012. The first involved a refusal by Verizon to allow tethering apps on Verizon smartphones; the second, consumer complaints concerning AT&T's refusal to permit Apple's FaceTime iPhone and iPad application to use its mobile network, restricting its use to times the user was connected with Wi-Fi. It is unclear whether either of these cases violated the open Internet rules. The Verizon case, settled for $1.25 million, was related to the openness requirements attached to Verizon's Upper C-Block license. With respect to the AT&T case, "the Commission did not conclude whether such a practice violated our open Internet principles."[6]

7. The 2014 NPRM argues, "Both within the network and at its edges, investment and innovation have flourished while the open Internet rules were in force."[7] But it is disingenuous to suggest that the 2010 Order is responsible for this flourishing innovation. The 2009 NPRM itself contained a lengthy discussion of the success of the Internet under the then-current

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[5] *Protecting and Promoting the Open Internet,* GN Docket No. 14-28, Notice of Proposed Rulemaking, May 2014 at ¶ 4. (*NPRM*)

[6] *NPRM* at ¶ 41.

[7] *NPRM,* ¶ 29.

regulatory regime.[8] In other words, as the Commission itself acknowledges, the Internet was open and a hotbed of innovation before and after the 2010 Order. Empirically disentangling the effects of the 2010 Order from other influences on investment and innovation would be a difficult task, a task the Commission has not undertaken. For example, it is likely that the 2010 Order—in particular, the non-discrimination provision struck down by the Court—prevented the development of innovative, pro-consumer business models.

The No-Blocking Rule is Unnecessary

8. As discussed above, instances of blocking have been rare, minor, and quickly resolved either when the Commission had no open Internet rule in place, or through other means.

9. The 2014 NPRM states that broadband providers have an incentive to limit openness,[9] but this is not generally the case, even when broadband providers are also content providers in competition with other content providers. It is common across many industries for distributors who sell to consumers to sell their own products and services along with those of other vendors. Supermarkets are an obvious example. Safeway does not make it hard for shoppers to buy Oreos in order to promote its own store-brand substitute, Tuxedos. In general, distributors will not find it in their interest to block their customers from accessing goods and services they find valuable.

10. The economics of broadband make it strongly in the provider's interest to offer broad access to content. This is because the incremental cost of subscribers (once an area is wired) is small, so content that will drive incremental subscribership is likely to be profitable. For the

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[8] *Preserving the Open Internet*, GN Docket No. 09-191, WC Docket No. 07-52, Notice of Proposed Rulemaking, Oct 2009. (*2009 NPRM*)

[9] *NPRM,* ¶ 43.

same reasons, blocking content is likely to be unprofitable. Simply put, blocking content that consumers want reduces the value of the broadband platform. In those few cases where anti-competitive blocking takes place, the Commission and the antitrust agencies have the tools to deal with it. Thus, the Commission's anti-blocking proposal is unnecessary.

The Transparency Requirement May Discourage Price Competition

11. The NPRM contains an expanded transparency requirement.[10] The Commission believes disclosure of commercial, including pricing, is pro-competitive,[11] but this is not necessarily the case. In fact, mandated disclosure of prices may deter price competition.

12. As a 2001 OECD report noted, "The competitive risks of increased price transparency, under certain market conditions, have not always been sufficiently appreciated by government policy makers. There have been instances where government mandated increases in price transparency seemed to have produced higher rather than lower prices, probably because they facilitated anti-competitive co-ordination among sellers."[12] The OECD analysis indicates that the competitive risks of increased price transparency are greater in markets characterized by high levels of concentration, a small number of sellers, and high barriers to entry.[13]

13. Price competition often takes the form of secret discounting. Price disclosure requirements make it more difficult for customers on either side of the two-sided broadband

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[10] *NPRM,* ¶ 63-88.

[11] *2010 Order,* ¶ 53 and *NPRM,* ¶ 66.

[12] *Price Transparency*, Organization for Economic Co-operation and Development, Committee on Competition Law and Policy, Sept 11 2001, pg. 9, available at http://www.oecd.org/daf/competition/abuse/2535975.pdf. (*OECD Report*)

[13] *OECD Report*, pp. 10, 25.

platform to negotiate price discounts, because providers may be reluctant to offer discounts that must be made public to everyone.

14. The economics literature also makes clear that mandated price disclosure may facilitate cartel behavior: “The more prices exceed competitive levels, the more individual sellers stand to gain, at least in the short run, by secretly cutting price. This is the “prisoner’s dilemma” which tends to undermine all attempts at oligopolistic co-ordination, whether formal (i.e., explicit collusion) or otherwise (i.e., tacit collusion, conscious parallelism, price leadership etc.). Stable anti-competitive co-ordination requires that firms find a way to make co-operation the “dominant strategy”, meaning a credible way must be found to detect and punish cheating.”[14] Providing transparency to a concentrated market aids in the detection of cheaters, thereby allowing the stable anti-competitive equilibrium to develop.

15. The OECD report cites empirical studies of the National Industrial Recovery Act (NIRA) and the rail sector where government-mandated price transparency facilitated collusion and higher prices.[15]

16. This is not to suggest that provision of more price information may not also benefit consumers by, for example, reducing search costs. However, these benefits must be balanced against the risks of inhibiting price competition.

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[14] *OECD Report,* p. 24.

[15] *OECD Report,* pp. 32-33.

The Commercially Reasonable Standard May Distort Markets and Introduce a *De Facto* Utility-Type Regulatory Regime

17. The NPRM prohibits "commercially unreasonable practices" without defining them. The prohibition against commercially unreasonable practices replaces the antidiscrimination provision from the 2010 Order, which was struck down in *Verizon v. FCC*. This substitution is potentially a major improvement. Properly defined, the commercially unreasonable standard should allow for the adoption of innovative business models that will promote broadband deployment and benefit consumers.

18. The Commission should be aware, however, that the mere existence of this provision may distort negotiations between private parties who know they can appeal to the Commission if they do not like the best deal they could negotiate on their own. The Commission should develop criteria for commercially unreasonable practices that, insofar as possible, minimize such distortions.

19. The commercially unreasonable standard, particularly in combination with detailed information available from broadband providers due to the expanded transparency requirements, can lead to a steady stream of complaints from interested parties. In addition, it could lead to continual second-guessing of providers' business practices and pricing decisions on the part of the Commission itself. Putting broadband providers in the position of constantly having to justify their business practices as "reasonable" goes a long way toward establishing a *de facto* utility-type regulatory regime, with its attendant problems—reduced incentives to innovate, invest and provide services consumers want—even in the absence of Title II reclassification.

20. Moreover, particularly given the complex cost and network management characteristics of the broadband industry, the providers' data will typically be of limited use in determining

whether a business practice is “reasonable”. The Commission should explain how it intends to use the company data that will be made available and how that will benefit the operation of the Internet ecosystem.

The Commercially Reasonable Standard Should Be Based on Antitrust Principles

21. The Commission seeks comment on “what factors the Commission should adopt to ensure commercially reasonable practices”[16] and “whether there are sources of law or practice the Commission should rely upon in explaining the meaning and application of that standard.”[17] The Commission should base its commercially reasonable standard on competition law principles drawn from economics and antitrust law, as administered by the Department of Justice and Federal Trade Commission. A practice would be deemed commercially unreasonable if there was an abuse of market power that resulted or threatened to result in harm to consumer welfare.

22. Economists have generally been favorable toward using the antitrust laws, which rely on a case-by-case approach, to address net neutrality issues.[18] This is consistent with the Commission’s NPRM.[19] Though antitrust is not without problems, it rests on a fairly well

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[16] *NPRM*, ¶ 123.

[17] *NPRM,* ¶ 119.

[18] William J. Baumol, Martin Cave, Peter Cramton, Robert Hahn, Thomas W. Hazlett, Paul L. Joskow, Alfred E. Kahn, Robert Litan, John Mayo, Patrick A. Messerlin, Bruce M. Owen, Robert S. Pindyck, Scott J. Savage, Vernon L. Smith, Scott Wallsten, Leonard Waverman and Lawrence J. White, “Economists Statement on Network Neutrality Policy,” March 2007.

[19] *NPRM,* ¶ 136.

defined set of pro-consumer, economic efficiency principles and goals, which gives antitrust enforcement some predictability.

23. The Commission is also requesting comment on whether pay-for-priority practices should be treated as *per se* violations of the commercially reasonable standard.[20] Clearly, charging higher prices for more or better service is ubiquitous in the economy and should generally be considered commercially reasonable, consistent with the antitrust standard described above, unless there is an abuse of market power that harms consumers. Pay-for-priority for edge providers who require large amounts of capacity—such as video providers with a large customer base—will permit lower broadband prices for consumers. It will also avoid cross-subsidization of consumers who consume a lot of those services by consumers who don't.

24. In addition to charging higher prices for more or better services, it is likely to be economically efficient and pro-consumer—and, therefore, consistent with the antitrust standard—to charge different customers different prices for the same service, depending on their demand characteristics. Such innovative business models are particularly beneficial for industries, such as broadband, that are capital-intensive and require large up-front investments. Demand-based pricing is common for this type of industry. It is the most efficient, and possibly the only, way of covering costs. The Commission acknowledged in its 2009 NPRM "economic theory that holds that benefits can arise from price and quality discrimination, at least in certain cases. For example…the ability of a provider to price discriminate not only will benefit the provider, but may also benefit the public as a whole (although not necessarily in all cases)."[21]

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[20] *NPRM,* ¶ 138.

[21] *2009 NPRM*, ¶ 66.

Barring demand-based pricing could (a) diminish the resources available for infrastructure investment, and (b) raise prices for users with a less intense demand for broadband. These effects would hinder efforts to extend broadband access to new subscribers and lower-income subscribers, which is inconsistent with the Commission's objectives.

25. As the Commission noted in its 2009 NPRM, "Theoretical economic analyses suggest that price discrimination may be more beneficial in a two-sided market than in the standard one-sided market."[22] Broadband platforms are intermediaries in two-sided markets, with users on one side and applications and content providers on the other side.

26. Consistent with antitrust principles, the commercially reasonable standard should permit non-zero pricing on both sides of the two-sided market. There is nothing in the economics literature that suggests that, as a general rule, a zero price on one side of a two-sided market is economically efficient or good for consumers. Under different circumstances the efficient price broadband providers charge to edge providers could be zero, positive, or negative (i.e., broadband providers pay edge providers). Particularly since the Internet is still rapidly evolving, the Commission should not second-guess experimentation with different business models.[23] The Commission appears to recognize this when it states that the no-blocking rule "does not preclude broadband providers from negotiating individualized, differentiated arrangements with similarly

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[22] *2009 NPRM*, ¶ 66.

[23] *See* Robert Hahn and Scott Wallsten, "The Economics of Net Neutrality," *The Economists' Voice*, June 2006. ("The point is that there is not one 'right' way to charge different customers in these markets, and firms should be allowed to experiment to find out what works best. Because these markets are so dynamic, pricing can be expected to change over time in response to new demands and opportunities.")

situated edge providers (subject to the separate commercial reasonableness rule or its equivalent).”[24]

27. If broadband providers are precluded from charging edge providers, broadband consumers likely will pay higher prices than otherwise. Payments by edge providers can help defray the infrastructure costs and therefore lower prices to users, increasing subscribership, particularly among more price-sensitive users.

Concerns About Adverse Consequences Unwarranted

28. The Commission and others are concerned that if broadband providers are permitted to charge edge providers, it will be more difficult for edge entrepreneurs to enter the market. This seems unlikely because entry by edge entrepreneurs is in the broadband provider’s interest. As discussed above, broadband providers want to maximize the value of their networks, which means they want to make as much content available to consumers as possible. Therefore, it would not be in the interest of a broadband provider to price edge entrepreneurs out of the market. To do so would reduce the profits the broadband network could generate and thus, reduce the value of the network. Moreover, new entrants would not require the capacity that some existing edge providers require—particularly those in the video space. One would expect that if broadband providers were to charge edge providers, they would establish a very low (likely zero) price for new entrants.

29. Similarly, there is no basis for the concern that service quality will suffer for content providers who do not “pay for priority”—that they (and consumers of their services) will be

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[24] *NPRM,* ¶ 89.

relegated to the "slow lane." Again, broadband providers want to maximize the value of their platform. This means making the whole gamut of content available in a way that is satisfactory to their customers.

Title II Regulation Would Adversely Affect Investment

30. The Commission is requesting comment on whether it should reclassify broadband as a Title II telecommunications service, which would provide authority for public utility regulation of broadband markets. Broadband has thus far been subject to light-handed regulation, consistent with its classification as a Title I information service. Title II public utility regulation would change that and would signify a sharp departure from the status quo, under which the broadband market has generally thrived.

31. Title II regulation would subject broadband to non-discriminatory open access requirements and to price regulation. Such public utility regulation has not been notably conducive to innovation.[25] Broadband is a capital intensive industry, requiring billions of dollars of investment in technologies that are sometimes quite risky. Title II regulation would inhibit the development of new business models, increase risk, reduce expected returns, and therefore adversely affect incentives for investment and innovation in the broadband infrastructure and possibly at the edge as well.

32. In addition, counter to the Commission's goals, Title II regulation would hinder efforts to extend broadband penetration. There are at least two reasons for this. First, the rules would

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[25] See, for example, Jerry A. Hausman, Valuing the Effect of Regulation on New Services in Telecommunications, *Brookings Papers: Microeconomics*, 1997.

preclude the introduction of innovative pricing plans that might reduce prices to some or all consumers—particularly more price-sensitive consumers—thereby inducing them to increase their adoption of broadband. Second, the rules would reduce the return on investment (partly because of the limitations on pricing) and therefore the buildout of the broadband infrastructure.

33. This has been confirmed by empirical studies comparing the U.S. with the European experience under public-utility-style regulation, such as implied by Title II. Both Wallsten and Hausladen and Yoo find that such regimes have a significant negative effect on investment and deployment of advanced networks.[26]

34. Title II regulation may also reduce incentives to invest and innovate at the edge of the network. For example, if such regulation precludes pricing plans that would increase broadband subscribership, it would also reduce the market for providers of content, adversely affecting innovation at the edge.

Conclusion

35. Imposing Title II public utility regulation would represent the sharpest departure from the status quo, and would have serious adverse effects on investment and innovation in the Internet infrastructure over time. The history of public utility regulation suggests it generally has been counterproductive and harmed the consumers it was designed to protect.

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[26] *See* Scott Wallsten and Stephanie Hausladen, "Net Neutrality, Unbundling, and their Effects on International Investment in Next-Generation Networks," *Review of Network Economics* 8(1), pp. 90-112, March 2009, available at http://www.techpolicyinstitute.org/files/wallsten_unbundling_march_2009.pdf, and Christopher S. Yoo, "U.S. vs. European Broadband Deployment: What Do the Data Say?" University of Pennsylvania Law School, Center for Technology, Innovation and Competition, June 2014.

36. Even in the absence of Title II regulation, the Commission's proposal may have negative consequences associated with utility-type regulation. It may discourage price competition, discourage experimentation with innovative business models and reduce investment in the broadband infrastructure.

37. Given the potential adverse consequences from the disclosure of company data—particularly, the potential to discourage price competition—the Commission should carefully evaluate the benefits and costs of its proposed transparency requirement and explain how it intends to use the data that will be made available and how that will benefit the Internet ecosystem.

38. If the Commission does adopt a "commercially reasonable" standard, it should be based on competition law principles drawn from economics and antitrust law. These principles are the best available way to further pro-consumer and economic efficiency goals and incentivize investment and innovation in the Internet.

39. Despite the Commission's repeated declarations of the need to protect openness, the Internet has flourished under a light-handed regulatory regime, without any formal open Internet rule and with broadband classified as a Title I information service. Thus, the Commission's proposal remains "a solution in search of a problem."

Respectfully submitted, July 14, 2014

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