THE FREE STATE FOUNDATION
A Free Market Think Tank for Maryland......Because Ideas Matter

Perspectives from FSF Scholars
August 3, 2016
Vol. 11, No. 28

FCC Privacy Rules Would Harm Consumers by Creating Barriers for ISP Advertising

by

Michael J. Horney *

In March 2016 the FCC adopted a Notice of Proposed Rulemaking (NPRM) purporting to protect "the privacy of customers of broadband and other telecommunications services." While the FCC's NPRM proposes a number of requirements regarding the amount and manner in which ISPs can collect admittedly non-sensitive consumer information, the most problematic proposal in the FCC's NPRM would require consumers affirmatively to "opt-in" before Internet service providers (ISPs) can engage in "sharing [non-sensitive] customer information with non-communications-related affiliates or third parties or before using customer information themselves." In this way, the FCC's proposal differs significantly from the Federal Trade Commission's (FTC) approach, which does not require "opt-in" for non-sensitive information. The act of sharing non-sensitive information with third parties enables ISPs to deliver innovative services that consumers enjoy without those consumers having to pay for such access to information.

Digital advertising is a business model that allows consumers to access online content and information without paying monetary fees. Instead of buying a subscription to an application or website, consumers often "pay" for online content by exchanging their personal non-sensitive information. ISPs and edge providers collect consumer information and make that data available to advertising agencies which target prospective consumers with ads. Without advertising revenue, websites and applications would be forced to charge subscription fees in order to maintain a profitable operation. And thus many low-income consumers would be priced out of the market. Although ISPs charge subscription fees, one could make the case that the price of broadband access subscriptions would be higher if ISPs did not also employ, at least to some extent, the advertising business model. Digital advertising in the United States was a $58 billion market in 2015 and is projected to be worth $67 billion by the end of 2016 and $93 billion by the end of 2019.

There are a number of ways ISPs offer "free" services to consumers through the collection of their non-sensitive information and use of the advertising business model. Public WiFi services provided by retailers and other third parties on an ad-supported basis often use data collected from network usage for targeted advertising. Also, ISPs can design their homepages with tailored news, information, and advertisements for each individual consumer.

Free data programs, or so-called zero-rated programs, which enable consumers to have access to curated content with an exemption from monthly data caps, primarily do not use advertisements to offer content access, but the business models are similar. Free data programs allow ISPs and edge providers to create agreements that give consumers access to a curated list of applications that will not cost the consumer any mobile data, hence the name "free data." In some free data plans, edge providers cover the costs of the data to ensure that mobile consumers use their applications. Like third-party advertising agencies which purchase consumers' non-sensitive information to deliver targeted ads, edge providers are third parties in the relationship between the consumer and the ISP. In this business model, edge providers purchase mobile data in order to encourage traffic on their application, enabling them to sell ads or subscriptions to free data users.

But free data programs are still an emerging innovation. ISPs likely will use consumer trends to determine which applications and websites would create the most value when developing such pro-consumer offerings. ISPs may even begin to tailor offerings to individuals who frequently use specific applications, but the requirements proposed by the FCC would create barriers to ISPs' ability to collect and share the non-sensitive consumer information that is needed to innovate and deliver such targeted offerings. Considering that 94% of Millennials say they would sign-up for free data services when offered by their current provider, regulations which could stifle the growth of these beneficial offerings should be avoided.

The NPRM acknowledges the innovative services that ISPs can offer through targeted advertising, but it claims that its proposed regulations merely would give consumers choices. The reality is that consumers already have choices regarding their privacy, and ISPs and edge providers often update their privacy settings to account for rapid changes in consumer preferences. ISPs should have the option to differentiate their privacy policies in order to compete in the broadband marketplace. But because the FCC's rules would impose an explicit opt-in requirement for consumers, the default "choice" would be that ISPs cannot use or share consumers' even *non-sensitive* information. This mandated default does not reflect what we know about consumer choice.

No one disputes that that Americans value privacy. A May 2015 Pew Research Center study found that 93% of American adults say it is important to be in control of *who* can get information about them. Ninety percent of American adults say it is important to be in control of *what* information is collected about them.

But, significantly, surveys also show that consumers would rather "pay" for content with their personal information than with subscription fees. A 2012 survey cited in the FTC's May 2012 consumer privacy recommendations found that 84% of consumers prefer targeted advertising in exchange for free online content. A 2015 Microsoft survey entitled "The Consumer Data Value Exchange" discovered that American consumers are willing to share personal data when there are clearly defined benefits in return. The survey results show that 100% of consumers are willing to share personal data in return for cash rewards, 77% of consumers are willing to share personal data in return for discounts, and 68% of consumers are willing to share personal data in return for convenience.

Not only are consumers willing to share personal data in exchange for content and information, but consumers do not like to read the terms and agreements of permission requests that opt-in policies necessarily would employ. A 2011 University of California, Berkeley survey found that only 17% of participants paid attention to permission requests and only 3% of the survey respondents could answer three permission comprehension questions correctly.

In a 2000 paper entitled "Protecting Privacy in the New Millennium: The Fallacy of 'Opt-In'," authors Fred Cate and Michael Staten argued that "opt-in is more costly [than opt-out] precisely because it fails to harness the efficiency of having customers reveal their own preferences as opposed to having to explicitly ask them." The authors also say that opt-in requirements confuse consumers because they expect to have their data collected and shared so long as they have the choice to opt-out at any time. These findings are consistent with recent statements made by FTC staff.

The FTC is the expert agency with jurisdiction over privacy violations within the *entire* Internet ecosystem and addresses consumer complaints on a case-by-case basis. The FTC already requires an opt-in policy regarding the collection and use of what is widely acknowledged to be *sensitive* consumer information. The FTC's Bureau of Consumer Protection submitted comments to the FCC in May 2016 in which it stated that consumer choice should be "focused on whether the collection and use of information is consistent with the context of a consumer's interaction with a company and the consumer's reasonable expectations." FTC Commissioner Maureen Ohlhausen supplemented those comments at the 2016 Advertising and Privacy Law Summit in June 2016:

> Beneficial uses of consumer data go far beyond targeted advertising, of course. In the ISP context, such benefits could include lower prices and improved security and services. Regulatory restrictions on use of consumer data may foreclose these benefits, imposing significant costs on consumers – a fact often overlooked by advocates who may have different privacy preferences than average consumers.

Commissioner Ohlhausen stated that default opt-in policies for non-sensitive information, like the requirement proposed by the FCC, harm consumers:

> Let me be clear on this point: FTC experience demonstrates that more onerous privacy regulation does not always benefit consumers. Some, however, believe that more stringent regulation adds costs to business but only provides benefits to consumers. Yet

> because privacy preferences vary widely, regulation can impose significant costs on consumers. Consumers who wish to receive targeted advertising or to benefit from services funded by advertising are harmed by regulation that increases the difficulty of using information. As a result, if a regulation imposes defaults that do not match consumer preferences, it forces unnecessary costs on consumers without improving consumer outcomes. The burdens imposed by overly restrictive privacy regulation, such as broad opt-in requirements for non-sensitive data, may also slow innovation and growth, harming all consumers.

In the Free State Foundation's comments to the FCC regarding the agency's privacy proceeding, FSF scholars similarly declared:

> Banning arrangements in which consumers opt to pay for equivalent services rather than provide personal information amounts to an onerous form of price control that reduces consumer welfare. A ban would enshrine in regulation the mistaken assumption that consumers are not competent to decide what form of payment – whether in personal information or money – that they are willing to make for services. Consumers who choose not to "opt in" – a requirement not generally imposed by the FTC – may lose out on beneficial offerings. The critical point is that the choice should be left up to consumers. A ban, however, would eliminate consumer choice and result in regulation-imposed opportunity costs on consumers through loss of service offerings.

The FCC's proposal would create unnecessary barriers to broadband providers' ability to collect and share non-sensitive consumer information that could be helpful to ISPs for analyzing individual and aggregate trends. The proposed "opt-in" requirement will create uncertainty among broadband providers regarding the number of consumers who will choose to opt-in and likely discourage ISPs from offering targeted marketing deals, delivering advertisements and tailoring information to personally design the experience of their service, and/or creating free data programs for selective consumers. If adopted, these regulations would harm all Internet subscribers, not just those who avoid opting-in. If ISPs cannot cover the costs of offering innovative services that consumers prefer because only a small percentage of consumers choose to opt-in, then they will refrain from offering such products. And because the FCC's proposal requires ISPs to obtain explicit permission before they can use consumer information, they would need consumers to opt-in before they can even inform those consumers about tailored service offerings. This loss in advertising revenue almost certainly will increase the price of broadband Internet access for *all* consumers.

The tradeoff between privacy and free content/information should be determined by the relationship between the ISP and the consumer, not by the FCC with a default opt-in mandate that can harm and confuse consumers.

There are many reasons why the FCC should not adopt its proposal to regulate privacy practices of ISPs that go beyond the focus of this paper. FSF scholars discussed them in our May 2016 comments. But sticking to the focus of this paper, advertising is a business model that enables consumers to access content without paying subscription fees. Understanding that Americans value privacy of their personal non-sensitive information and that they value free online content, there is nothing under the current FTC approach that is inconsistent with recognizing these two consumer preferences. The FCC's proposed privacy regulations would make it more difficult for ISPs to offer tailored services and for consumers to receive information they value without having to pay for it. This does not enhance overall consumer welfare.

* Michael J. Horney is a Research Associate of the Free State Foundation, an independent free market-oriented think tank located in Rockville, Maryland.

Further Readings

Michael J. Horney, "The FCC's Privacy Proposal Would Harm and Confuse Consumers," *FSF Blog* (June 9, 2016).

Comments of the Free State Foundation, Regarding Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, (May 31, 2016).

Michael J. Horney, "Former FTC Chairman Leibowitz Opposes FCC Privacy Rules," *FSF Blog* (May 26, 2016).

Michael J. Horney, "More FCC Rules with Flawed Analyses Likely on the Way," *FSF Blog* (February 4, 2016).

Seth L. Cooper, "FCC's Internet Privacy Power Grab Unsupported by Law," *FSF Blog* (October 23, 2015).

Michael J. Honey, "FCC's 'Gatekeeper' Theory Is a Flawed Market Failure Analysis," *FSF Blog* (August 19, 2015).

Seth L. Cooper, "Old School Regulations Could Sidetrack Multi-Stakeholder Privacy Initiative," *FSF Blog* (June 26, 2013).

Seth L. Cooper, "Vindicating A Voluntary Process For Protecting Digital Privacy," *Perspectives from FSF Scholars*, Vol. 7, No. 31 (October 26, 2012).

Seth L. Cooper, "The FCC's Mobile Data Inquiry: No New Privacy Regulation Needed," *Perspectives from FSF Scholars*, Vol. 7, No. 19 (July 30, 2012).

Randolph J. May and Seth L. Cooper, "Any New Privacy Regime Should Mean An End to FCC Privacy Powers," *Perspectives from FSF Scholars*, Vol. 7, No. 9 (April 5, 2012).