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Regulating Net Neutrality: Who Will the FCC Really “Protect”?

by

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The Federal Communications Commission’s (FCC’s) [new net neutrality rules](#), released March 12, 2015, are justified by the Commission as necessary to protect an “open Internet” for small, innovative content providers. Without such rules, the FCC claims, large media, content, and applications purveyors will negotiate favorable access and interconnection arrangements with large Internet service providers (ISPs), thereby disadvantaging new digital content start-ups. Unfortunately, the new rules are not based on any empirical evidence that such a threat exists. And the general, vague nature of the rules surely provides the opportunity for intense political lobbying as they are implemented in a rapidly-changing market environment.

When It Comes to Regulation, Past Is Prologue

Almost all new exercises in regulation begin with what is claimed to be a “reasonable” attempt to protect someone from some kind of discrimination. The Interstate Commerce Commission (ICC) was established in 1887 to protect agrarian interests from long-haul/short-haul railroad discrimination. The Civil Aeronautics Board (CAB) was entrusted with regulating airlines in a manner that would provide dependable service to small communities. The Federal Communications Commission (FCC), in concert with state regulators, used its regulatory authority to “protect” local telephone ratepayers and to limit competition in broadcasting so as to

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protect local programming. In each of these cases, the regulators ultimately held back progress and restricted new entry, claiming they were just assuring that consumers would continue to obtain “fair and reasonable” access to some relevant services.

The ICC evolved – with the help of Congress – into an agency that controlled not only railroad rates, but also entry into commodity-specific interstate trucking routes, thereby keeping trucking rates artificially high. This, in turn, kept rail rates high, allowing the ICC to force railroads to continue offering service on unprofitable rural routes. For decades the CAB attempted to maintain service to small communities by blocking all entry into major routes. And for decades the FCC itself attempted to protect its regulated clients from the effects of new entry and new technologies. For example, the Commission attempted to block access to new terminal equipment (1956), switched long distance services (1977), and pay-television services (1977). In each case, in an effort to maintain the *status quo* for existing services, the Commission sought to block entrants using new technologies from delivering new or enhanced services to consumers. This regulatory history is instructive in considering the FCC’s actions in the net neutrality proceeding.

The FCC’s Net Neutrality Rules

The net neutrality rules issued on March 12th appear to have been driven, in part, by an almost religious fervor to impose strict “neutrality” mandates on Internet service providers regardless of the absence of evidence of market failure. But they were also driven, at least in part, by the agency’s response to technology-driven new entry. As high-speed broadband service has spread throughout the country, innovators such as Netflix, Amazon, Apple, and even HBO began to explore “over-the-top” distribution of video programming in competition with broadcast, cable, and satellite delivery of such programming. Given the potential congestion created by these data-intensive video streams, some market participants began to question the network pricing model that had developed in the early years of the Internet. Specifically, should Internet service providers be required to accept all traffic from content suppliers, or the networks delivering their content, at the same, zero price, even though some of this content creates much greater network congestion than other content? Alternatively, should the video streaming services be allowed to negotiate with ISPs for assured, high-quality delivery of their services? When Netflix entered into a deal with Comcast for the termination of its video traffic in February 2014, the political pressure for rules that would, among other things, ban such “paid prioritization” began to build ...surprisingly, even from Netflix.

As Gus Hurwitz, a member of the Free State Foundation’s Board of Academic Advisors, has noted [elsewhere](#), there is no empirical evidence supporting the notion that paid priority granted to Netflix or other large media companies is harmful to smaller content providers. Nor is there any evidence that such arrangements benefit the Internet service companies that must compete for customers with other providers. Collecting fees from content providers for better, more reliable connections is likely to induce the ISPs to compete more aggressively for customers, thereby reducing consumer subscriber fees. As a result, it is difficult to demonstrate that ISPs would profit materially from collecting interconnection fees from content networks or that such a

practice in two-sided markets is economically less efficient than having ISPs rely solely on subscriber fees for their revenues. Nevertheless, the FCC, prodded aggressively by the White House, decided to ban paid prioritization.

The FCC's final regulations require that Internet service providers not engage in: (i) "blocking," (ii) "throttling," (iii) "paid prioritization," and (iv) "unreasonable interference or disadvantaging" of end users or content providers. Conduct must be "reasonable" – surely, a reasonable-sounding mandate. But why should "disadvantaging" of content providers be prohibited? Surely, any improvement in the availability of various types of programming over the Internet, for which viewers pay a direct fee, disadvantages some content providers, such as, for example, those that deliver home shopping networks or infomercials over one of the hundreds of cable or broadcast channels that are available to viewers at no additional charge. The improvements in Internet download speeds and in digital compression technologies have upset the old order in the video programming marketplace. As the foregoing recital of regulatory history shows, regulators very often respond by protecting the old order they have created or in which they are complicit.

The meaning of these four stated prohibitions will only be fleshed out as antagonists and protagonists flood the Commission with complaints and pleadings. Indeed, the final regulations allocate more space to the pleading and complaint process than to the detail of the four prohibitions. Given the vagueness of the rules, the prospects for adjudication of these complaints that establish any meaningful and proper boundaries are not good. For the present, Netflix relies heavily on programming produced by the large traditional media companies. But what happens when and if attractive new content emerges from elsewhere, even from abroad? For example, soccer from the UK's Premier League or interactive video games from Asian countries could begin to succeed through direct digital feeds over the Internet. When this begins to occur, our media and "cultural" interests will begin to petition the FCC for protection from unfair or unreasonable competition from abroad, much as the Canadian content owners have done for decades. And they could easily succeed if they can persuade the FCC, or a sitting President, that the carriage of the new content "disadvantages" existing Hollywood producers.

Mark Cuban, an early developer of digital video, has even offered a prediction that the net neutrality rules eventually could invalidate the traditional cable/broadcast model of video distribution. [His interview over CNBC](#) on the day the rules were released was summarized as follows:

The rules would mean that television as we know it is over, Cuban said. He asserted that the transmission of content over television is essentially the same as the transmission of content over the Internet. By that logic, he speculated that the FCC could determine television delivered by cable should be part of the open Internet.

That would mean the same standards would apply to television content providers, including the ban on pay for prioritizing service, he said, so shopping channels such as QVC would run around those rules because they pay cable providers to carry their content.

‘Bits are bits and if all bits are to be treated equally you can't give priority to delivery of a television stream in a managed service,’ he said.

Surely, Mark Cuban’s predictions cannot be dismissed out of hand. Already, [some of the video-streaming services are apparently seeking “specialized” services](#) – *i.e.*, high-speed lanes over separate cable channel bandwidth – from cable companies. If the FCC were to ban such arrangements, concluding that they are evasions of the paid prioritization prohibition, the video streamers likely would sue the Commission for allowing “paid prioritization” on traditional cable channels but not on “specialized service” channels.

Given the vagueness of the new regulations and the rapidly-changing technological environment that drives the Internet’s evolution – and ultimate consumer choices – one cannot predict how the politics of Washington ultimately will drive implementation. This is even more true now given that the FCC seemingly has allowed itself to be in the position of following the President’s dictates. But no one should necessarily expect that the small innovator, perhaps working diligently in his own garage, will prevail against the major media and communications interests that inhabit Washington.

Consumer Protection Is Advanced by Deregulation

We are fortunate that the 1970s deregulatory movement succeeded in abolishing the ICC and the CAB. Transportation markets are now essentially open to new entry, new technologies, and new business models. For instance, the U.S. airlines are currently trying to prevent the new Gulf-state carriers – Emirates, Etihad, and Qatar Airways – from competing with them on North Atlantic routes. Prior to 1978, they might have convinced the CAB that this competition should be banned because it would bring an end to scheduled airline services to such outposts as Ely (NV), Kalispell (MT), or Rockland (ME), but there is no longer a regulatory forum available for such anti-competitive lobbying. In Canada, by contrast, Air Canada has succeeded in protecting its extremely inefficient operations by persuading regulators to severely limit this “unfair” Gulf-state competition on Canadian routes.

Alternatively, imagine what oil prices would be today if the Federal Energy Regulatory Commission (FERC) had jurisdiction over production of oil and natural gas that is found on private property in the various states. The recent Keystone XL pipeline fiasco provides a clue. Given strong lobbying pressures from environmentalists (in this hypothetical, perhaps joined by established major oil companies with large reserves of these commodities), U.S. oil and gas production would surely have remained near its mid-2000s lows. Luckily, Congress has not given FERC the authority to assure “just and reasonable” exploitation of private oil and gas reserves, and its failure to do so thus has allowed the “fracking” revolution to begin. In addition, the lack of an ICC with regulatory authority over railroads has been instrumental in allowing the increased oil supplies to move across state lines by rail as the federal government succumbs to environmentalists and blocks incremental pipeline construction.

Conclusion

Deregulation has also served consumers well in the communications sector to the extent that it has been implemented. Driven by technological change, unregulated prices of ordinary voice and text messages have declined dramatically. The classification of broadband as an information service meant that the FCC, unlike its European counterparts, refrained from regulating Internet service providers. This unleashed a major wave of investment in broadband networks. Unfortunately, Congress has left the Communications Act of 1934 largely intact, so the Commission has now been able reverse course with likely disastrous effects on network investment – unless the Commission’s action is reversed.

Given the massive economic stakes involved, future arguments over the meaning of the new Title II regulations as they are implemented inevitably will stimulate a major increase in litigation and Washington lobbying. Were I a hedge fund manager, I would not try to predict how technology will evolve and whether Google, Comcast, Verizon, Apple, Disney, or DISH will emerge as the winner in future battles over the meaning of the new Title II rules. Rather, I would hedge my bets by simply buying downtown Washington, DC, real estate.

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The Free State Foundation is an independent, nonpartisan free market-oriented think tank located in Rockville, Maryland.