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California Net Neutrality Bill Would Stifle Network Investment

by

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Last month, the California State Legislature passed the "California Internet Consumer Protection and Net Neutrality Act of 2018" (SB 822). If signed by Governor Jerry Brown, SB 822 would impose state-wide net neutrality regulations on California broadband providers.

This legislation would harm consumers by prohibiting innovative services, such as paid prioritization and zero-rated offerings. The bill also would further contribute to the creation of a "patchwork" of differing state net neutrality regulations, hindering the delivery of interstate communications services for broadband providers. Moreover, SB 822 would be inconsistent with federal policy and presumably would be preempted, but perhaps not before imposing substantial costs on broadband providers which likely will crowd out network investment throughout California.

The net neutrality regulations in SB 822 are very similar to the regulations imposed in the FCC's February 2015 *Title II Order*. Notably, the California bill copies the now-repealed *Title II Order* in that it would ban blocking and degrading lawful Internet traffic as well as paid prioritization. But SB 822 also would go further, prohibiting zero-rated services, which are popular among consumers. Therefore, the California legislation actually would be even more burdensome on broadband providers and consumers than the *Title II Order*. Paid prioritization and zero-rated services provide innovative offerings to consumers and create additional revenue opportunities for providers. The additional revenue enables them to invest in capital infrastructure and new consumer-friendly services.

Because California's SB 822 regulates interstate communications services by imposing state-wide net neutrality regulations on broadband providers, it violates federal law. The FCC's *Restoring Internet Freedom Order*, adopted in December 2017, expressly preempts any state measure that, in effect, would levy prohibitions and restrictions on Internet service providers (ISPs) that are inconsistent with the prohibitions and restrictions the federal agency has repealed. SB 822's provisions regarding blocking, impairing or degrading, and paid prioritization essentially mirror the rules that were repealed by the FCC. And the outright prohibition on zero-rated "free data" services contradicts the FCC's deregulatory policy. Thus, SB 822, if signed into law, would be contrary to what the FCC's order called the "preemptive federal policy of nonregulation for information services."

The FCC's *Restoring Internet Freedom Order* also states:

> It is impossible or impracticable for ISPs to distinguish between intrastate and interstate communications over the Internet or to apply different rules in each circumstance. Accordingly, an ISP generally could not comply with state or local rules for intrastate communications without applying the same rules to interstate communications.

Assuming it is even possible for broadband providers to distinguish between intrastate and interstate communications, as a practical matter ISPs likely would need to install considerable additional data processing capabilities to monitor data flows across the country. Any online activity can result in Internet traffic being transmitted all across the country. This means broadband providers would need to implement different practices in efforts to accommodate California's and other states' net neutrality laws. So, if the law is not preempted by the FCC, the additional costs imposed on ISPs having to comply with a patchwork of differing state net neutrality regulatory regimes may well deter investment in broadband facilities in California and other states which adopt laws that contradict federal policy.

Furthermore, SB 822's outright bans on paid prioritization and zero-rated services are misguided and will harm consumers by preventing them from receiving innovative offerings.

In the Free State Foundation's initial comments submitted to the FCC in the *Restoring Internet Freedom* proceeding, FSF scholars stated that evidence from other markets shows that paid prioritization arrangements generally lead to more capital investment. Broadband providers' ability to charge different prices for different qualities of service creates additional resources that can be used to upgrade networks or deploy in underserved areas. Moreover, consumers would benefit from paid priority of Internet traffic in the same way they have benefited from paid prioritization in other markets, like highway toll lanes, priority mail services, and first-class seating.

Free State Foundation's Ted Bolema explained this in a May 2017 *Perspectives from FSF Scholars*:

> Various forms of paid prioritization arrangements can be found in many different industries, including grocery stores, book store chains, air travel, sports stadiums, and package delivery services. Governments seeking to attract private investment for road construction are expanding their optional toll lanes for commuters willing to pay to avoid congestion. Having prioritization as a revenue source increases the incentive for providers in other industries to make capital investments needed to compete for customers willing to pay for priority service. These capital investments provide benefits to all customers, even the ones who are not paying for prioritization. In general, these pricing arrangements have not worked to exclude those who do not pay for prioritization, and more typically lead to lower prices and better service for the most cost-conscious customers.
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> Autonomous vehicles, interactive e-learning, and telemedicine are examples of applications in their early stages of development that require a high level of end-to-end reliability. Investors may be unwilling to take the risk of investing in these applications if they cannot be assured of reliable prioritized broadband connections. Some edge providers that are sensitive to delays may be better off paying extra, in the same way that some people shipping packages are willing to pay extra for priority mail services, while others will not see enough benefit from avoiding delays to justify paying more.

Zero-rated services, or "free data plans," are popular, consumer-friendly offerings that allow consumers to have unlimited access to specific websites or applications without such access counting towards monthly data caps or thresholds. Consumers, and particularly low-income consumers, benefit from accessing "free data" without paying a monetary fee.

As FSF scholars stated in their reply comments for the *Restoring Internet Freedom* proceeding, zero-rated services enhance consumer choice and enable providers to invest more than they otherwise would without these service offerings:

> Consumers widely perceive free data plans as complements to plans with data thresholds or caps, since free data plans enable consumers to access certain websites or content without the traffic counting against the data allotments of their service plans. Unlimited data plans are viewed as substitutes to free data plans and data caps, particularly for consumers who use a lot of traffic. Of course, each type of plan serves a different purpose and each individual consumer can subscribe to the plan that best fits his or her preferences. These complimentary and substitutable options spur consumer demand and usage and allow for an efficient allocation of data usage based on consumer preferences.
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> [Governor Jerry Brown and the California State Legislature] should recognize that these innovative mobile broadband offerings benefit consumers in the short-term by providing free data usage and by enticing value-conscious consumers to increase their

usage, while also promoting long-term investment by mobile broadband ISPs. That is, freedom for consumers to choose the type of mobile plan that best fits their preferences increases demand for mobile services. Increased demand spurs additional content offerings from edge providers, and increases incentive for network investment by broadband ISPs. And to the extent that edge providers benefit from covering a portion of the costs of data traffic associated with consumer usage of their content or applications, consumers enjoy a valuable discount while broadband ISPs can obtain increased returns on investment and draw from those increased returns to upgrade networks or deploy in underserved areas.

California Governor Jerry Brown should not sign SB 822. If it becomes law, it would prohibit innovative pro-consumer services and likely discourage broadband investment throughout California. And it would further create a patchwork of state regulation inconsistent with the FCC's explicit national policy of not regulating Internet service providers in a public utility-like fashion. If Governor Brown does sign this bill, it will likely be subjected to FCC preemption.

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Further Readings

Michael Horney, "California Privacy Law Will Increase the Cost of Accessing Online Content," *Perspectives from FSF Scholars* Vol. 13, No. 30, (July 23, 2018).

Seth Cooper, "State Executive Orders Reimposing Net Neutrality Regulations Are Preempted by the Restoring Internet Freedom Order," *Perspectives from FSF Scholars* Vol. 13, No. 5, (February 2, 2018).

Theodore Bolema, "Allow Paid Prioritization on the Internet for More, Not Less, Capital Investment," *Perspectives from FSF Scholars* Vol. 12, No. 16, (May 1, 2017).

Reply Comments of the Free State Foundation – Restoring Internet Freedom, WC Docket 17-108 (August 30, 2017).

Comments of the Free State Foundation – Restoring Internet Freedom, WC Docket 17-108 (July 17, 2017).