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You Don't Need the FCC: How the FTC Can Successfully Police Broadband-Related Internet Abuses

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Abstract

If a court strikes down the Federal Communications Commission's latest effort to regulate the Internet, the Federal Trade Commission can easily address competition and consumer protection problems in the area of broadband, including questions related to net neutrality. Section 5 of the Federal Trade Commission Act gives the FTC ample authority to challenge any harmful conduct by entities involved in Internet broadband services markets when such conduct undermines competition or harms consumers, and the FTC's highly structured, analytic, fact-based approach to these issues is superior to FCC net neutrality regulation based on vague and unfocused notions of the public interest. If a court does not act, Congress might wish to consider legislation to prohibit FCC Internet regulation and leave oversight of potential competitive and consumer abuses to the FTC.

On February 26, the Federal Communications Commission (FCC) voted to impose 1930s-era "common carrier" regulations on Internet providers by enacting an "Open Internet Order." As a Heritage Foundation analysis points out,[1] this decision threatens to generate hundreds of new rules that will raise the costs of Internet firms, deter innovation, and reduce competition among broadband providers—to the detriment of consumers and the economy.

What if, however, a court strikes down the FCC's order?[2] Such a decision would preclude heavy-handed and inappropriate Internet regulation, but would it leave consumers and competition subject to potential future abuses by Internet firms? The answer is an unequivocal "no."

Key Points

- The Federal Communications Commission's February 26 decision to impose 1930s-era "common carrier" regulations on Internet providers could generate hundreds of new rules that raise the costs of Internet firms, deter innovation, and reduce competition among broadband providers to the detriment of consumers and the economy.
- The Federal Trade Commission closely monitors Internet business activity and has brought various Internet-related enforcement actions. The FTC is perfectly capable of challenging potential "network neutrality" violations that harm consumer welfare.
- FTC evaluations of broadband industry restrictions are likely to be more objective and predictable than "public interest" assessments by the FCC, leading to reduced error and lower planning costs for purveyors of broadband and related services.
- It follows that from a public policy standpoint, it is preferable to rely on FTC competitive and consumer protection analysis to police possible broadband business abuses rather than on subjective FCC public-interest analysis.

This paper, in its entirety, can be found at **http://report.heritage.org/lm154**

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The U.S. Federal Trade Commission (FTC) has ample authority under Section 5 of the Federal Trade Commission Act (FTC Act) to challenge any harmful conduct by entities involved in Internet broadband services markets when such conduct undermines competition or harms consumers. The FTC has substantial experience in this area, having released a detailed report on broadband connectivity issues in 2007[3] and having been heavily involved in investigations of search engines and other firms involved in broadband and Internet issues. Let us examine the nature and possible application of these FTC "antitrust" and "consumer protection" powers.

The FTC and Antitrust

Section 5(a)(1) of the FTC Act[4] prohibits "unfair methods of competition," a term that courts have held encompasses all violations of the Sherman Act,[5] the primary federal antitrust law.[6] In applying Section 5, the FTC assesses most restrictive business agreements under the antitrust "rule of reason," which seeks to determine whether the overall effect of a particular restraint is beneficial rather than harmful to the competitive process. A smaller category of "inherently bad" restrictive agreements will be condemned out of hand (without regard to any possible justifications) as "*per se*" illegal.

Under the general rule-of-reason framework, restrictive agreements that are not illegal *per se* will be challenged only if their anticompetitive effects outweigh their procompetitive benefits.[7] The rule of reason can be boiled down into a multipoint inquiry, which normally proceeds as follows.[8]

First, an enforcer will ask whether the party or parties to an agreement possess "market power," which is the ability to restrict output or raise price without regard to what others in the market are doing. If there is no market power, an agreement

1. *See* James L. Gattuso, *FCC Imposes Net Neutrality, Again*, Heritage Foundation *Commentary*, Mar. 9, 2015, *available at* http://www.heritage.org/research/commentary/2015/3/fcc-imposes-net-neutrality-again. For a more detailed discussion of the economic harm associated with FCC net neutrality regulation, see James L. Gattuso, *Net Neutrality: Internet Regulation Debate Far from Over*, Heritage Foundation *Issue Brief* No. 4339, Jan. 30, 2015, *available at* http://www.heritage.org/research/reports/2015/01/net-neutrality-internet-regulation-debate-far-from-over; James L. Gattuso & Michael Sargent, *Eight Myths About FCC Regulation of the Internet*, Heritage Foundation *Backgrounder* No. 2982, Dec. 17, 2014, *available at* http://www.heritage.org/research/reports/2014/12/eight-myths-about-fcc-regulation-of-the-internet; James L. Gattuso & Michael Sargent, *Beyond Hypothetical: How FCC Internet Regulation Would Harm Consumers*, Heritage Foundation *Backgrounder* No. 2979, Nov. 25, 2014, http://www.heritage.org/research/reports/2014/11/beyond-hypothetical-how-fcc-internet-regulation-would-hurt-consumers.
2. This is a realistic possibility, given that the courts have struck down FCC proposals to regulate the Internet twice before. *See Net Neutrality: Internet Regulation Debate Far From Over*, *supra* note 1.
3. Fed. Trade Comm'n, Broadband Connectivity Competition Policy, FTC Staff Report (2007), http://www.ftc.gov/sites/default/files/documents/reports/broadband-connectivity-competition-policy/v070000report.pdf.
4. 15 U.S.C. § 45(a)(1). The FTC may issue "cease and desist" orders to preclude conduct found to violate Section 5 and may also seek equitable relief in appropriate cases under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b). Because the FTC's jurisdiction does not extend to common carriers, § 15 U.S.C. § 45(a)(2), the FTC could not take enforcement actions with respect to broadband or related services if they were reclassified as common carrier services (which they are not currently)—unless, of course, the FTC Act were amended to eliminate the common carrier exception.
5. 15 U.S.C. §§ 1, 2 (condemning "every contract, combination, or conspiracy…in restraint of trade" as well as acts that "monopolize"). Judicial precedents make it clear that the Sherman Act condemns only "unreasonable" restraints of trade. The FTC also enforces the Clayton Act, 15 U.S.C. §§ 12 *et. seq.*, which prohibits anticompetitive mergers and certain other discrete business practices.
6. There is some precedent supporting the FTC's authority to proscribe conduct that goes beyond the limits established by federal antitrust laws, but the extent of that authority is uncertain and controversial. *See generally* Herbert Hovenkamp, Federal Antitrust Policy 646–647 (4th ed. 2011) ("Hovenkamp"). Hovenkamp is the leading author of treatises on U.S. antitrust law.
7. The rule-of-reason framework described below draws largely upon Hovenkamp, *supra* note 6, at 279–280. The American antitrust rule of reason has developed as a form of federal common law; it is not embodied as a precise statutory or regulatory formulation. Although there are slight variations in the ways in which courts and enforcers have enunciated the rule of reason, they generally comport with the structure described below.
8. *See*, *e.g.*, Hovenkamp, *supra* note 6, at 272–289. Variations on the rule of reason involving a "quick look" may be applied to restraints that appear likely on their face to be anticompetitive but are sufficiently novel not to merit *per se* condemnation without any consideration of their possible merits. There is a presumption of illegality that attaches to a "quick look" restraint that can be overcome by a plausible justification that is sufficient to suggest that the restraint has substantial countervailing efficiencies. If such a plausible justification is put forth, the full rule of reason will be applied; otherwise, the restraint will be condemned.

cannot harm consumer welfare and is allowed to stand.

Second, however, if market power is present, one then asks whether the agreement would threaten to reduce the existing state of competition by, say, a fall in output, rise in price, or degradation of quality. If the answer is "no," the agreement stands.

Third, if the answer is "yes," the enforcer asks whether the agreement generates countervailing substantial efficiencies such as lower costs or improved product or service quality. If the answer is "no," the agreement is illegal.

Fourth, if the answer is "yes," the agreement may nevertheless be condemned if the efficiencies can be achieved by far less anticompetitive alternatives that make reasonable business sense.

Fifth, if, however, the efficiencies cannot reasonably be achieved otherwise, a balancing of benefits and harms is required. In the real world, the last step—an actual balancing of effects—is almost never (if ever) reached.

In applying the rule of reason, the FTC scrutinizes economic evidence of the effects of the particular restraints in question on the marketplace and any evidence of the impact similar restraints have had in other settings. It employs highly developed statistical tools as well as established microeconomic analysis. Many cases may be quickly resolved, however, based on readily determinable information—for example, lack of market power or a finding that similarly situated firms have used analogous restraints without any evidence of harm to the marketplace.

Wide-scale adoption of a particular type of restraint by many firms (a particular sort of distribution or licensing or franchise contract, for instance) may be an indication that the restraint is efficient and is not likely to be anticompetitive. On the other hand, parallel adoption of a tight downstream distribution restriction by a few upstream manufacturers with a prior history of collusion might be a sign that the restriction needs to be investigated closely as a possible tool to facilitate manufacturer collusion.[9]

The rule of reason does not apply to a small category of "naked" agreements among rivals whose only plausible effect is to reduce competition and which lack any efficiencies not associated with a harmful restriction of competition.[10] Such agreements, once uncovered, are conclusively presumed to be anticompetitive. They are condemned summarily without an inquiry into their actual effects and thus are deemed "illegal *per se*."

Types of conduct characterized as *per se* illegal include agreements among direct competitors (individuals or businesses) to fix prices of their goods or services; to divide markets (e.g., sell to separate clients or in separate regions); or to rig bids in an auction.[11] If the FTC becomes aware of a *per se* illegal agreement that has been carried out in secret (for example, secret "smoke-filled room" meetings of a price-fixing cartel), it will notify the Justice Department, which is authorized to seek criminal penalties (including substantial fines and jail time) under the Sherman Act.[12]

In short, under the rule of reason, the FTC relies on objective fact-specific analyses of the effects flowing from a particular restraint rather than on highly subjective applications of an inherently vague "public interest" standard. In applying the rule of reason, the FTC also will closely examine economic assessments and lessons drawn from the competitive impact of similar arrangements in the past (referred to by antitrust experts as "natural experiments"). *Per se* illegal restraints, meanwhile, will be condemned.

Thus, FTC evaluations of broadband industry restrictions are likely to be more objective and predictable than "public interest" assessments by the FCC, leading to reduced error and lower planning costs for purveyors of broadband and related services. It follows that from a public policy standpoint,

9. For example, assume that three dominant manufacturers have a history of cartel conduct and now in parallel have adopted identical types of contracts that impose tight geographic limits on sales by their distributors. This may be a sign that the three manufacturers are acting to preclude downstream competition among their three products.

10. Thus, for example, members of a price-fixing cartel cannot argue that they will restrict output and therefore save labor and materials costs. Because such savings come about due only to the anticompetitive output restriction, they are not true efficiencies. Rather, they are merely the inevitable byproduct of harm to competition.

11. *See generally* Fed. Trade Comm'n, "The Antitrust Laws," http://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/antitrust-laws.

12. *See id.*

it is preferable to rely on FTC competitive and consumer protection analysis to police possible broadband business abuses rather than on subjective FCC public-interest analysis.

The FTC and Consumer Protection

The FTC's core consumer protection authority arises from the prohibition of "deception" and "unfairness."[13] The FTC defines deception as involving "a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment."[14] The FTC Act defines unfairness as involving "an act or practice [that] causes or is likely to cause substantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[15] An unfairness determination necessarily implicates cost-benefit analysis.[16]

In other words, the FTC can attack statements made by businesses that mislead and thereby impose harm on consumers (including business purchasers) who are acting reasonably. It can also challenge practices that, though not literally false or deceptive, impose substantial harm on consumers (including business purchasers) that they cannot reasonably avoid, assuming the harm is greater than any countervailing benefits.[17]

These are carefully designed and cabined sources of authority that require the FTC to determine the presence of actual consumer harm before acting. Application of the FTC's unfairness and deception powers therefore lacks the uncertainty associated with an uncabined and vague application of the FCC's "public interest" authority. As in the case of antitrust, the existence of greater clarity and a well-defined analytic focus suggests that reliance on FTC rather than FCC enforcement in this area is preferable from a policy standpoint.

Application to Broadband-Related Activities

How would the FTC's antitrust and consumer protection powers apply to particular types of restrictions related to broadband provision—and, in particular, to alleged violations of "net neutrality?"

For one thing, most commercial arrangements that are likely to raise questions of net neutrality involve "vertical" contracts entered into between firms at different levels of the distribution chain: broadband service providers (typically cable, telecommunications, or satellite service firms) on the one hand and "upstream" content providers or "downstream" broadband service consumers (including business consumers) on the other hand. Economists view such vertical contracts as usually procompetitive and beneficial to consumers because, for example, they tend to align the incentives of providers and consumers of content and services, facilitate investments, and reduce cumulative monopoly markups at different stages of distribution.[18]

Although vertical contracts can lead occasionally to anticompetitive "foreclosure" (reduction in competition caused by higher costs and harm imposed on competitors at a particular level of distribution not outweighed by efficiencies), that is typically not the case. Moreover, non-neutral "walled garden" vertical arrangements, such as AOL's purchase of major media companies in the 1990s and Google's offering of financial guarantees to become the default search engine

13. 15 U.S.C. § 45(a)(1) (declaring to be unlawful "unfair or deceptive acts or practices in or affecting commerce").
14. FTC Policy Statement on Deception, Oct. 14, 1983, appended to Clifford Associates, Inc., 103 F.T.C. 110, 174 (1984), http://www.ftc.gov/ftc-policy-statement-on-deception.
15. 15 U.S.C. §45(n).
16. *See*, *e.g.*, J. Howard Beales III, Director, Bureau of Consumer Protection, Fed. Trade Comm'n, "The FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection" at II.A (May 2003), http://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection. Current FTC Commissioner Joshua Wright also has stressed the importance of cost-benefit analysis. *See* Joshua G. Wright, "The Economics of Access to Civil Justice: Consumer Law, Mass Torts, and Class Actions," at 20–22 (Mar. 16, 2014), http://www.ftc.gov/system/files/documents/public_statements/293621/140316civiljustice-wright.pdf.
17. The FTC's ability to act against perceived unfair and/or deceptive net neutrality violations was underscored by its recent suit in federal court against AT&T for allegedly "throttling back" data service speeds to disfavored customers. *See* text accompanying note 22, *infra*.
18. *See generally* Remarks of Joshua D. Wright, Commissioner, Fed. Trade Comm'n, at the Information Economy Project's Conference on U.S. Broadband Markets in 2013 (Apr. 19, 2013) (Wright Speech), http://www.ftc.gov/sites/default/files/documents/public_statements/broadband-policy-consumer-welfare-case-antitrust-approach-net-neutrality-issues/130423wright_nn_posting_final.pdf.

on AOL (and thereby achieve economies of scale), proved beneficial to competition and to consumers.[19]

In short, according to FTC Commissioner Josh Wright, who is both a PhD economist and a lawyer, "fundamental observation and market experience [demonstrate] that the business practices at the heart of the net neutrality debate are generally pro-competitive."[20] This suggests a rule of reason that will fully weigh efficiencies but not shy away from challenging broadband-related contractual arrangements that undermine the competitive process.

Internet-Related FTC Enforcement Actions

The FTC closely monitors Internet business activity and has brought various Internet-related enforcement actions.[21] Most recently, the commission sued AT&T in federal court for allegedly slowing wireless customers' Internet speeds, although the customers had subscribed to "unlimited" data usage plans.[22]

The FTC asserted that in offering renewals to unlimited-plan customers, AT&T did not adequately inform them of a new policy to "throttle" (drastically reduce the speed of) customer data service once a certain monthly data usage cap was met. The direct harm of throttling was in addition to the high early termination fees that dissatisfied customers would face for early termination of their services. The FTC characterized this behavior as both "unfair" and "deceptive." Moreover, the commission claimed that throttling-related speed reductions and data restrictions were not determined by real-time network congestion and thus did not even qualify as reasonable network management activity.

This case illustrates that the FTC is perfectly capable of challenging potential "network neutrality" violations that harm consumer welfare (since "throttled" customers are provided service that is inferior to the service afforded customers on "tiered" service plans) and thus that FCC involvement is not warranted.

Over a decade ago, the FTC challenged the merger between AOL and Time Warner on antitrust grounds and entered into a consent order that required the merged company to open its cable system for all content on a nondiscriminatory basis to competitor Internet service providers, including those offering broadband. With regard to consumer protection, the FTC separately sued America Online, CompuServe, and Prodigy, alleging that each company had offered "free" trial periods that resulted in unexpected charges to consumers.

The FTC also filed a complaint charging Cyberspace.com with mailing supposed "rebate" or "refund" checks for $3.50 without disclosing that by cashing the checks, consumers were agreeing to monthly charges on their phone bills for Internet access services. Following a trial, the court ordered the defendants to pay more than $17 million to remedy the injury caused by their fraudulent conduct, and a court of appeals affirmed.

Competition and Consumer Protection in Broadband Space

Let us now take a few simple hypothetical examples of competition and consumer protection issues in broadband space that might come to the FTC's attention. These are not based on real cases and do not purport to assess how the FTC would undertake

19. *See id*. at 11–12. Other examples of "non-neutral" behavior that proved beneficial to competition and consumers have been cited by FTC Commissioner Maureen Ohlhausen. *See* Remarks of Maureen K. Ohlhausen, Commissioner, Fed. Trade Comm'n, before the MaCCI Law and Economics Conference on the Future of the Internet (Oct. 26, 2012), at 14–15, http://www.ftc.gov/sites/default/files/documents/public_statements/open-internet-regulating-save-unregulated-internet/121026mannheim_0.pdf.

20. Prepared Statement of Commissioner Joshua D. Wright, Fed. Trade Comm'n, Before the United States House of Representatives, Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law, Washington, D.C. (June 20, 2014), at 4, http://www.ftc.gov/system/files/documents/public_statements/409571/140620antitrusttestimony.pdf. This point is further developed in Wright Speech, note 18, *supra*.

21. The following examples are drawn from Fed. Trade Comm'n, FTC Testifies on Broadband Internet Access Service (June 14, 2006), http://www.ftc.gov/news-events/press-releases/2006/06/ftc-testifies-broadband-internet-access-services.

22. Fed. Trade Comm'n, FTC Says AT&T Has Misled Millions of Consumers with "Unlimited" Data Promises (Oct. 28, 2014), http://www.ftc.gov/news-events/press-releases/2014/10/ftc-says-att-has-misled-millions-consumers-unlimited-data. For an analysis of the FTC's complaint, see Michael Sargent *Lawsuit Against AT&T Over Slowing Customers' Internet Shows We Have Enough Internet Regulations*, The Daily Signal (Oct. 28, 2014), http://dailysignal.com/2014/10/31/lawsuit-att-slowing-customers-internet-shows-enough-internet-regulations/.

fact-specific analyses. They are designed merely to provide a general idea of how the analytic frameworks described above might be applied.

First, assume that a major cable broadband service company offers differential pricing to content providers calibrated to the expected volume of monthly content streaming, with price rising in tandem with expected usage. If the company has no market power (say there are a variety of other broadband companies that vigorously compete with it), the inquiry ends.

If the broadband company has market power, one would ask whether competition in the upstream content provision market would be harmed. Charging differential pricing that merely reflects streaming burdens on the network would be unlikely to harm the upstream competitive process (in fact, it would be expected to create incentives for better use of bandwith by content providers).[23] Thus, the inquiry would end.

Even assuming some harm to individual competitors, efficiencies associated with this scheme (including incentivizing further improvements to the broadband network and efficient use of existing resources) would appear to predominate and probably would preclude an enforcement challenge.[24]

Second, assume that a major broadband company appears to offer "better" contract terms to upstream content providers in which it has a partial ownership interest. If the broadband company has market power, the FTC might ask whether the difference in terms had a material effect on upstream competition among content providers, causing certain upstream providers to exit the market. It might also ask whether those market exits would weaken competition in broadband provision, because other broadband providers would find it costlier to obtain content and compete successfully with the broadband firm imposing those terms.

If competition was indeed harmed, the FTC would then consider whether countervailing economic efficiencies existed (for example, was the differential pricing more efficient, and did it actually incentivize improved investment in upstream content) and, if so, whether they more than outweighed the competitive harm. The net result in this hypothetical case would turn on detailed facts.

Third, assume that two major competing cable broadband companies have differential pricing and service programs that are offered to consumers or to upstream content providers. The competing companies have met and agreed that they should offer similar terms, citing economic efficiencies.

This arrangement likely would be attacked and struck down as an illegal *per se* price-fixing scheme without regard to the purported efficiency justifications. Similarly, simple agreements between the two broadband companies to deal with different sets of content providers (upstream) or business users (downstream) likely would be deemed illegal *per se*.

Fourth, assume that a broadband company states publicly that it will never change the content of its "basic" cable television package but subsequently does just that, requiring consumers to pay double for "premium" packages in order to receive the same content. Also assume that the broadband company imposes a major termination and equipment return fee on users that wish to discontinue their basic service.

This arrangement could well be deemed "unfair" in that it imposed after-the-fact harm that could not reasonably have been avoided by consumers and did not appear to have countervailing efficiencies. It could also be deemed "deceptive" to the extent that it involved a material representation that consumers reasonably relied upon and that caused them harm. Efforts by the broadband provider to avoid liability by restyling the premium package as the "new" basic package likely would be rejected as pretextual.

These are, of course, mere stylized examples. Real-world situations could involve a wide variety of complications not addressed above, and any analysis

23. The Obama Administration appears to argue that differential pricing that reflects relative burdens imposed by different network users is a "net neutrality" violation that the FCC should be empowered to prevent. *See* White House Press Release, "Statement by the President on Net Neutrality" (Nov. 10, 2014), *available at* https://www.whitehouse.gov/the-press-office/2014/11/10/statement-president-net-neutrality ("asking for an explicit ban on paid prioritization and any other restriction that has a similar effect"). Yet such differential pricing enables efficient behavior by broadband service providers that enhances efficiency and network quality to the ultimate benefit of consumers. Defining net neutrality to encompass a ban on efficient differential pricing—a ban that would harm consumer welfare—is ill-advised and bad public policy.

24. U.S. antitrust enforcement is concerned with harm to the overall process of competition, not with harm to individual competitors (unless the competitors have been harmed by "bad acts" or inefficient forms of conduct that are not competition on the merits).

would turn on specific market conditions that might differ significantly from case to case.

Diversity, Free Speech, and Other Social Goals

Finally, it might be argued that despite its beneficial features, FTC antitrust and consumer protection enforcement would not suffice to advance diversity, free speech, and other unenumerated social goals that might be dealt with through net neutrality regulation. Such claims, however, are by nature vague and opaque.

Moreover, a close examination belies the notion that net neutrality plainly would benefit free speech and diversity interests. By impinging on paid prioritization[25] and other techniques used to manage Internet traffic flow, net neutrality mandates may lead to reductions in broadband investments and diminished quality of Internet services. Quality degradations may interfere with Internet users' understanding of diverse points of view, and the inability to pay for better service may restrict certain individuals' First Amendment interest in projecting their views as effectively as possible.

Even if, however, particular net neutrality rules effectively advanced *some* goals other than antitrust and consumer protection, what *neutral* principle could be applied to decide what goals should be preferred? How would regulators weigh the harm to particular third-party interests that would be a byproduct of the pursuit of such other goals (for example, the harm to those whose messages would be conveyed less effectively because of a paid prioritization ban)? And most significantly, why should a handful of government officials (Federal Communications Commissioners) be empowered to pick "winners" and "losers" through their pursuit of ill-defined goals?

These considerations strongly militate against the notion that net neutrality regulation would clearly benefit society by effectively addressing problems that are beyond the reach of antitrust and consumer protection law.

Conclusion

If a court strikes down the latest FCC effort to regulate the Internet, the FTC has ample authority to address competition and consumer protection problems in the area of broadband, including questions related to net neutrality. The FTC's highly structured, analytic, fact-based approach to these issues is superior to FCC net neutrality regulation based on vague and unfocused notions of the public interest. If a court does not act, Congress might wish to consider legislation to prohibit FCC Internet regulation and leave oversight of potential competitive and consumer abuses to the FTC.

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25. *See* note 23, *supra*.