Net Neutrality: Reining in Innovation

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For an issue that has been debated for more than 10 years, "net neutrality" oddly remains a mystery to most Americans. One reason behind the unfamiliarity is the unusually technical nature of the subject matter, which lies at the intersection of engineering, economics, and law. Another is that the rhetoric of net neutrality has confused more than enlightened. Supporters tout the imposition of net neutrality constraints as strengthening Internet freedom; they claim that shackling providers of Internet *access*—Internet service providers (ISPs)—will increase the freedom of *content* providers to innovate and grow. But the real effect of these newly adopted rules will be quite different. Not only will the economic freedom of ISPs be limited, but so, too, will the freedom of the very providers of content who will find their options limited by a more slowly growing Web. In the end, it is the everyday consumers who will suffer the most, enduring inadequate service and an inability to choose plans that best suit their needs. The biggest winner will be the government, which will find itself with unprecedented discretion over how this network operates.

The term "network neutrality" refers to the principle that Internet service providers (such as Verizon and Comcast) that serve end users should treat all communications that travel over their networks the same way. The concept is based on a network-engineering rule of thumb but had never before been enshrined in a governmental rule or regulation. In fact, in the early 2000s, the FCC specifically declared, in a series of rulings, that broadband Internet service was not a "telecommunications service," and thus not subject to common-carrier rules that bar variations in rates and services. Unlike traditional telephone companies and electric utilities, broadband providers would be free to establish their own business models in the marketplace.[6]

Those findings made sense. Broadband service was, and is, no staid utility. It is a dynamic and growing market with a thin line between a successful investment and failure. Differentiated offerings, such as discounts and priority-service plans, are common in such markets. And the market for broadband is competitive. Despite high capital-investment costs, the ISPs enjoy no monopoly, with two or more major players competing in almost every service area, limiting the prospect for market abuse.

Nevertheless, at the same time that the FCC declared that digital-subscriber-line (DSL) broadband was not a "telecommunications service," it adopted a set of "non-binding" guidelines articulating neutrality principles in 2005. In 2008, the FCC ordered Comcast to stop alleged violations of the principles. Two years later, however, a federal appeals court ruled that the FCC could not enforce the non-binding principles.[7]

In December 2010, the FCC returned to the issue of net neutrality, adopting formal rules limiting how ISPs could handle Internet traffic, and broadening its claim of authority. These "open Internet" rules, as the FCC dubbed them, banned consumer wireline (DSL and cable modem) broadband providers from "unreasonably discriminat[ing] in transmitting lawful network traffic," and "block[ing] lawful content, applications, services, or 'non-harmful' devices."

Verizon, claiming that the FCC lacked jurisdiction over broadband service, soon challenged the new rules in court. As was the case in 2010, the FCC's rules were slapped down in January 2014. Specifically, the court found that the regulations imposed on the ISPs were, in effect, common-carrier regulations. Since the FCC had previously ruled that the broadband service providers were not "telecommunication providers," the FCC was barred by law from imposing common-carrier regulations on them.[8]

In February 2015, the FCC made its third and by far broadest bid to impose network-neutrality rules. By a 3-to-2 vote, the agency reclassified Internet service as a common carrier service, allowing it to regulate ISPs as public utilities.[9] Using this just-declared regulatory power, it then banned ISPs from blocking or slowing down transmissions, and from engaging in "paid prioritization" by offering premium or discount services. This decision also applied to wireless broadband service, which had been exempted from previous attempts to regulate Internet providers.

In addition, the FCC imposed a catchall "general conduct" rule, banning any ISP activities that "unreasonably interfere with or unreasonably disadvantage" the ability of consumers to receive—or content providers to deliver—content, applications, services, or devices of their choice.

What this means in practice is anybody's guess. The FCC says it will enforce this provision on a case-by-case basis, maximizing its flexibility and reducing its transparency. This action will keep regulated enterprises in the dark about what is allowed and what is banned.

The general conduct rules spell an end to what has been called "permissionless innovation" by Internet providers.[10] No longer will ISPs be free to pursue new ways of handling content or new services for Web users. Every innovation will be under a cloud until approved by regulators in Washington.

Advocates of FCC network-neutrality rules argue that such restrictions are essential in order to protect consumers and providers of Internet content from ISPs who otherwise would block content, such as websites and applications, which compete with their own, or discourage innovation by charging undue fees for delivering content to users.

But this sort of behavior is unlikely to occur due to competitive checks on ISP market power. In fact, there has been only one case in which an ISP has blocked Internet content to its own advantage, and that ISP—a rural telephone company in North Carolina—quickly reversed its stance under pressure by the public and the normally slow-moving FCC.

Other claimed instances of anti-consumer activity have, on closer inspection, turned out to be pro-consumer.[11] For instance, in 2008, Comcast was alleged to be "throttling," or slowing down, users of BitTorrent peer-to-peer (P2P) services. But for all the controversy, there was never any indication that Comcast took the action to favor itself. Rather than block competition, the "throttling" was to prevent P2P users from slowing network speeds for other users.

Anti-competitive activity by ISPs is rare for a reason. Economically, the ISPs would be shooting themselves in the foot should they block or discriminate against popular content. Their interest is in getting more content over their networks, not less. Should they try, competitors would be happy to snap up the displeased consumers.

Lastly, even in the event that competition fails to protect consumers, the antitrust laws already on the books provide strong backstop protection against anti-competitive behavior.

A primary concern expressed by advocates of regulation is that ISPs would speed up or slow down traffic on their networks for a fee, a practice known as "paid prioritization." This, they say, would create the equivalent of "fast lanes" on the Internet, unfairly relegating content providers with fewer resources to slower, inferior Internet service.

This claim is nonsense. There is nothing wrong or unusual about differentiated prices. Every well-functioning market has premium pricing and discounts. Such variations are not a barrier to new competition or new services; in fact, they enhance them. One can imagine, for instance, if the same rule were applied to package delivery, banning expedited service and requiring all deliveries to be made in the same time frame. Not only would consumers be worse off, but online retailers—especially new entrants to the marketplace—would have one less dimension in which to distinguish themselves from their rivals.[12]

In any case, no ISP to date has announced plans to adopt a simple "fast lane" pricing system. Instead, the marketplace has been developing a variety of innovative service plans that promise to be a boon to competition and consumers.

MetroPCS, for instance, a smaller, low-cost wireless provider now owned by T-Mobile, attempted to shake up the mobile market in 2011 by offering unlimited wireless access to YouTube on its introductory $40-per-month price-tier service for no additional cost. MetroPCS had no special relationship with YouTube, but it "saw that YouTube is one of the main ways that our customers get multimedia content and we wanted to make sure that content was available to them."[13]

The company drew the ire of pro-regulation groups, such as Free Press, which described the plan as "a preview of the wireless future in a world without protections," and accused the company of "anti-consumer practices."[14]

But MetroPCS was helping consumers. In fact, no one was prevented from enjoying other services. Access to streaming video, voice over IP (VoIP), and other data-intensive services was not only available on the company's higher-priced tiers, but part of plans offered by MetroPCS's many larger rivals. As economist Tom Hazlett of Clemson University notes,

> [MetroPCS] customers were mostly price-sensitive cord-cutters who had little use for the bells and whistles of larger carrier plans, especially at higher price points. MetroPCS's plan was poised to bring wireless data to this market segment.

> But instead it found itself facing the threat of agency action because its plan did not match the Federal Communication Commission's preconceived notion of what the wireless broadband experience should be.[15]

Similarly, T-Mobile in June 2014 launched a program it calls Music Freedom, which provides users with access to various streaming music apps, such as Pandora, Spotify, iTunes Radio, and Rhapsody, without contributing to their monthly data allotment. Under the arrangement, T-Mobile would not charge the music services for the data-cap exemptions.

However, even this would potentially be barred by neutrality rules. Supporters of FCC regulation objected to this freedom and accused T-Mobile of violating net-neutrality principles. Chris Ziegler of Verge, for instance, called the plan "really, really, really bad," asking, "What's to stop [T-Mobile] from using data-cap exemptions as a punitive measure against content providers that aren't on good terms with T-Mobile (or its parent company Deutsche Telekom)?"[16]

By this reasoning just about any discounting of consumer products or services could also be condemned. Once again, the threat of net-neutrality regulation was being used not only to block potential price breaks for consumers, but also to stymie competition from smaller players in the marketplace.

The new FCC rules do not stop here. As noted above, the agency has also established a "general conduct" rule, banning activities that "unreasonably interfere" with Web access by consumers or "edge" providers (a term including firms ranging from Google to Netflix to the smallest app maker). This new offense is only vaguely defined by the FCC, leaving providers uncertain about what is prohibited, and therefore dependent on regulators for clearance for any innovative activities that might hurt their competitors.

As far-reaching as these new rules are, they may be only the beginning. The interconnection of ISPs and "backbone" carriers (which transport content from the edge providers to the ISPs) has successfully operated without government regulation for a long time. But, Netflix now maintains that this, too, is a net-neutrality issue, asking the FCC to ban ISPs from charging to interconnect.[17] The result would be a boon for Netflix—which is responsible for some 34 percent of peak Internet traffic in the United States.[18] Instead of paying for the burdens placed on ISP networks, the cost would be borne by ISPs and their customers—whether they use Netflix and similar services or not.

Other forms of neutrality are sprouting up as well. Google, initially one of the strongest corporate proponents of network-neutrality rules for ISPs, has found itself beset by claims that a similar concept of "search neutrality" should govern search engine results. These would require search engines to display results from user queries in a non-discriminatory way. (Never mind the fact that, by their very nature, search engines differentiate content, providing more prominence to results that users are expected to value more, rather than in random order.)

In 2011, after a lengthy investigation, the Federal Trade Commission declined to pursue an antitrust case against Google based on search neutrality. But European competition-law officials recently launched a case against Google alleging just that.[19] The push for broad search-neutrality rules, however, is not over, and may be intensified with the FCC's adoption of neutrality rules. Some, in fact, have speculated that such rules could even be applied to other Internet firms, such as Amazon, which openly offers higher placement in search results for pay.[20]

App writers, too, could be targeted for regulation under neutrality rules—at least if Blackberry CEO John Chen has his way. In a January 2015 blog post, Chen argued that net-neutrality regulations should be extended to makers of applications for wireless devices.[21] Under such "application neutrality," an app made for Android or Apple phones would also be required to work on a Blackberry. Such a rule would be a natural extension of the neutrality principle, and, coincidentally, would also be a boon to Blackberry's flagging fortunes.

The FCC's adoption of net-neutrality rules was a substantial loss for advocates of Internet freedom. The issue is not yet settled, however, as the rules face challenges in Congress and in the courts. At the same time, policymakers should resist calls to expand the neutrality "principle" to other patches of the Web, which would only compound the loss of freedom.

Endnotes

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