The Free State Foundation

A Free Market Think Tank For Maryland...Because Ideas Matter

Testimony of

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before the
New York City
Committee on Technology in Government
On
Resolution No. 712

Net Neutrality Principles Resolution

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Madame Chairwoman and distinguished Members of the Committee:

Good afternoon. My name is Randolph May, and I am President of The Free State Foundation, an independent, non-profit research and educational institution located in Potomac, Maryland. The Free State Foundation is a think tank that promotes free market principles. I appreciate the opportunity to present this testimony on Resolution No. 712.

I have over thirty years of experience working in communications law and policy and, more generally, regulatory affairs. I am a past Chair of the American Bar Association's Section of Administrative Law and Regulatory Affairs. I am the co-editor of two academic books on communications policy and the author of over a hundred scholarly law review articles, essays, and commentaries on communications law and policy topics, including dozens specifically on the subject of net neutrality. A brief biographical sketch may be found at:

http://www.freestatefoundation.org/images/Randolph_May.Web_Version.doc

And a partial list of my publications may be found at:

http://www.freestatefoundation.org/images/PublishedWorksofRandyMay.doc

Especially pertinent to today's hearing, I am the co-editor of a book published in 2006 by Springer entitled, *Net Neutrality or Net Neutering: Should Broadband Internet Services Be Regulated*.

First, let me say that I can understand the sentiment behind Resolution 712 to the extent that it is motivated by a concern that Internet access services should be widely available to the citizens of New York and, indeed, to all the citizens of the United States. I also can understand the sentiment behind the resolution to the extent that it is motivated by a concern that broadband providers should not unreasonably restrict their subscribers from accessing any lawful Internet content. But neither of those sentiments justifies adoption of the resolution.

Most fundamentally, I disagree with the resolution's suggestion that net neutrality mandates will ensure that the Internet "will continue to foster innovation, increase competition, and spur economic growth as well as making the Internet faster and more affordable for all." In my opinion, net neutrality mandates would have precisely the opposite effect. In other words, they would deter innovation and new investment, dampen competition, and decrease overall consumer welfare.

Like the proverbial pleas of competitors in all regulatory arenas for "fairness" and a "level playing field," the phrase "net neutrality" has a pleasing ring. But because much more is at stake in the debate over net neutrality than pleasing sound bites, we should make very clear at the outset what "net neutrality" really means in the communications policy context. It means that broadband Internet access offered by Internet service providers like Verizon, Time Warner, Cablevision, AT&T, T-Mobile, Sprint, and others

would be regulated on a public utility-like common carrier basis. This is because the core of net neutrality is a strict non-discrimination obligation. And at the core of public utility common carrier regulation is the same non-discrimination requirement, one that history demonstrates inevitably is accompanied by rate regulation because there is no way to assess whether discrimination is occurring with reference to the price charged for a "like" service.[1]

While such public utility regulation may have been appropriate during much of the twentieth century's generally more monopolistic communications environment, it is not appropriate in today's dynamic, and much more competitive, digital marketplace environment. Indeed, the costs of now imposing common carrier regulation on broadband providers would far exceed any consumer benefits.

Let me explain briefly why.

I. Net Neutrality-Like Abuses Do Not Presently Exist

There is really little dispute that, except for a few isolated instances which have been quickly remedied,[2] there are not presently practices occurring in the marketplace that even are claimed to be net neutrality-like abuses. In other words, the marketplace presently is working to protect consumers and the process of competition without Congress passing new laws.[3]

Net neutrality is inherently a vague concept. The bills that thus far have been proposed in Congress to mandate neutrality contain terminology, such as that prohibiting "discrimination" or prohibiting the "degrading" or "impairing" of websites, which almost certainly would be subject to ongoing costly legal disputes. On its face, Resolution No. 712 seems principally motivated by a concern about a specific form of possible claimed "discrimination," that is, that some content providers, perhaps such as Google or eBay, "will be charged for more for faster data/content delivery, in part, to offset the cost of new high-speed lines."[4] The resolution says some network executives suggest that this might occur in the future.

I will explain below that price differentiation and other forms of product differentiation are common in competitive markets, and, indeed, the existence of such pricing flexibility is intrinsic to improving overall consumer welfare. But for present purposes, the point is that no one claims such price differentiation is occurring now. So

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[1] This is why so much of traditional common carrier jurisprudence concerns determining whether services are "like" in response to allegations of discriminatory treatment.

[2] The most notable of the rare claimed abuses involved a wireline telephone company, Madison River Communications, which blocked access to the Internet telephony service of an independent VoIP provider. When a complaint was filed with the FCC against Madison River, the blocking dispute was resolved in a matter of days without further litigation. Madison River Communications LLC, File No. EB-05-IH-0110, DA 05-543.

[3] It is important to emphasize that the goal of sound public policy is not to protect particular competitors or market participants, but rather to protect the competitive *process*. This is often overlooked as *competitors* seek to use the legal or regulatory process to advantage themselves vis-à-vis other market participants by imposing costly restraints on others that do not apply to themselves.

[4] Resolution No. 712.

there is no present problem to remedy that requires the adoption of new laws. By definition, laws that attempt to address not-yet-existent problems almost always turn out to be overly broad in their reach because they are based on imagined problems rather than real ones. And, of course, this overbreadth in drafting may well prohibit conduct which, as circumstances develop over time, would be beneficial to consumers.

II. The Broadband Internet Marketplace Is Flourishing and Sufficiently Competitive To Protect Consumers

Whenever new regulatory mandates are proposed, it is worth pausing to consider the current state of affairs. Presently, Internet usage in the United States is growing very rapidly and the Internet itself is flourishing. The most recent of the FCC's semiannual reports on broadband penetration shows that the number of subscribers continues to grow rapidly, and, importantly, grow across the various technological platforms. As of June 2006, there were 64.5 high-speed lines in service, an increase of 52% over the prior year.[5] Significantly, the number of broadband wireless subscribers grew exponentially, increasing from 380,000 to over 11 million from June 2005 to June 2006. In fact, 58% of the new broadband subscriptions in the six months preceding June 2006 were wireless, while 15% and 23% were, respectively, cable and telephone company subscriptions. As of June 2006, in 92% of the nation's zip codes there were two or more different broadband providers; in 87% of the nation's zip codes there were four or more different providers.[6]

It is also worthy of note that, at 64 million, the United States has more broadband Internet subscribers than any other country in the world, more even than China. At 211 million, it leads the world in the total number of Internet users.[7] With 49,733, it leads the world in the total number of WiFi hotspots.[8]

Such rapid growth in the number of high-speed subscriber lines and the number of Internet users is likely a good indication that there is not widespread consumer dissatisfaction with the current practices of Internet providers. This should not be surprising. The broadband Internet marketplace already is sufficiently competitive to discipline the marketplace and protect consumers more effectively than would a costly and burdensome regulatory regime. As far back as 2002, the Federal Communications Commission, the federal agency charged with responsibility for regulatory oversight of communications services, stated that "broadband services should exist in a minimal regulatory environment that promotes investment and innovation in a competitive market."[9] Even then, the FCC declared "that residential high-speed access to the Internet is evolving over multiple electronic platforms, including wireline, cable, terrestrial wireless and satellite."[10]

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[5] See FCC, High-Speed Services for Internet Access: Status as of June 30, 2006, Wireline Competition Bureau, January 2007. There is approximately a six month lag in the reporting y the FCC of the data.
[6] All of the preceding figures are from the same January 2007 report.
[7] Internet World Stats, March 2007.
[8] JiWire.com, April 2007.
[9] Inquiry Concerning High-Speed Access to Internet Over Cable and Other Facilities, 17 F.C.C. Rcd 4798, 4802 (2002).
[10] Id.

In the five years since, competition among broadband providers employing different technological platforms has continued to develop at a quick pace. The broadband market participants include telephone, cable, satellite and wireless companies, with power companies and possibly others poised on the sidelines as potential entrants.[11]

In this increasingly competitive broadband marketplace, we would not expect to see broadband providers adopt practices that consumers consider abusive. After all, if they did, subscribers increasingly have the option of simply switching to another provider with practices more to their liking.[12]

III. There Are Legitimate Economic Reasons for "Discrimination" in a Competitive Marketplace

As noted above, at present there are not more than isolated reports of alleged net neutrality-type discrimination, and virtually none alleging instances of the particular kind of discriminatory conduct about which the Resolution appears to be concerned. But it is nevertheless important to understand that, as Internet technology and Internet business models continue to evolve, there may be legitimate economic reasons for broadband providers to offer to prioritize traffic for content providers in some price-related way in order to most efficiently meet consumer demand for all the various types of services that are offered or could be offered.

Make no mistake: Absent such pricing flexibility, which is an inherent feature of all competitive free markets, *all* consumers ultimately will be required to pay *more* for Internet access service than they otherwise would in order to cover the increased capacity costs caused by those websites and applications providers that generate especially intensive bandwidth use. Examples of such websites might be those hosting videogaming or especially dominant search engines that handle millions of searches each day. One way or another, all of the capacity costs imposed on the network ultimately must be recovered. Bluntly put, net neutrality mandates that flatly preclude all pricing flexibility, including the flexibility to charge an entire segment of the most intense users of the Internet's infrastructure resources, risk being regressive in the same sense as regressive taxes. In short, these mandates may well lead low use consumers to subsidize those whose applications impose relatively high costs on the network.

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[11] Especially in a technologically dynamic marketplace such as communications, it is wrong to ignore the impact on *existing* competitors of *potential* competitors looming on the sidelines. In the 1980s, economists refined their understanding of marketplace dynamics by introducing the notion of "contestability". Contestability addresses the ability of potential market entrants to discipline the pricing practices of existing market participants, even if the existing participants have high market shares and economies of scale. See E. Bailey and W. Baumol, *Deregulation and the Theory of Contestable Markets,* 1 Yale Journal of Regulation 111, 117-118 (1984).

[12] It is important to distinguish here—as not all do—between what consumers in general demand, that is a group of consumers large enough to make offering a particular service economically feasible, and what one consumer or a small group might prefer, but which is not economically feasible for the provider to offer to one consumer or a small group.

As use of the Internet continues to grow exponentially and applications and business models continue to evolve, a prohibition on any pricing flexibility—or, to go back to the beginning, the imposition of a traditional public utility common carrier regime—will severely harm overall consumer welfare. It is estimated Internet traffic grew from 1.5 million gigabytes per month in 1996 to 700 million gigabytes per month in 2006. YouTube alone consumes as much bandwidth each day as the entire Internet consumed in 2000. Absent massive government subsidies, which I do not recommend and which are unnecessary if proper market-oriented policies are adopted, broadband providers obviously will be required to invest billions of dollars in building out and maintaining their broadband networks in the coming years. In a free market, private sector firms will not invest billions in infrastructure, however, unless there is a reasonable opportunity to recover their costs.

So, as well as likely proving regressive, laws that flatly prohibit Internet service providers from experimenting with various pricing models based on differences in speed, levels of security, or other aspects of service quality, will cause broader losses to consumer welfare and the overall economy. If broadband providers are not allowed to differentiate their services because of regulatory straitjackets, their ability to compete in the marketplace will be compromised. Lacking the flexibility to find innovative new ways to respond to customer demand, they will lack incentives to invest in new network facilities and innovative applications. This lack of new investment, in turn, will have the perverse effect of dampening competition among existing and potential broadband operators.

Thank you very much for allowing me to present this testimony. I will be pleased to answer any questions.

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