WHAT HATH THE FCC WROUGHT?

As Title II “net neutrality” moves toward implementation, some proponents are having second thoughts. What is to be done?

BY GERALD R. FAULHABER

Last February 26th, the Federal Communications Commission officially mandated that the Internet would henceforth be regulated under Title II of the Telecommunications Act. With this action, the FCC totally reversed over 30 years of aggressive “unregulation” of the Internet (and all information services), imposing the most restrictive regulatory framework available under the act, originally adopted in 1934 to regulate the then-monopoly Bell System. (See “Groundhog Day at the FCC,” p. 56.)

In view of the stunning success of the Internet, what could possibly justify this radical action? It was done in the name of “network neutrality,” a term originated by Columbia Law School professor Tim Wu in 2003. Under net neutrality, Internet Service Providers (ISPs) and other Internet carriers cannot discriminate among traffic from all sources on the Internet, providing lower-quality service for some traffic. The concern expressed was that ISPs, whose local markets are typically monopoly or duopoly, would have incentive to discriminate among traffic to their own advantage and to the disadvantage of their customers.

This concern was based on a perceived lack of competitive discipline in the ISP market. In 2005, in response to those concerns, the FCC adopted a policy statement “incorporating net neutrality provisions into its ongoing policymaking.”

Despite predictions of rampant ISP violations of net neutrality, hard evidence of wrongdoing has been in short supply. Among the few instances that have come to light, a telephone company in North Carolina was found to be blocking the Internet phone service Vonage in 2005. And in 2007 Comcast was discovered to be blocking or throttling BitTorrent, a file-sharing service often used to transfer extremely large video files.

In both cases the FCC suitably chastised the firms involved, including levying fines and strong-arming commitments by the firms to change their practices. However, Comcast sued the FCC on grounds that the agency had no authority to punish it because the FCC’s 2005 principles were not an actual regulation. In 2010, the D.C. Circuit Court found for Comcast, noting that FCC claims to broad, if vague, authority over broadband was insufficient (although pointedly not ruling on whether net neutrality is a good idea).

THE FCC TRIES AGAIN

Meanwhile, net neutrality activists raised the heat on the issue. The FCC moved quickly to establish a proceeding followed by an order in late 2010 imposing specific net neutrality obligations on ISPs. I discussed that order in these pages in late 2011 (“The Economics of Network Neutrality,” Winter 2011–2012). In brief summary,

- The FCC adopted broad regulations on transparency and reasonable network management, and prohibited blocking or “unreasonable” discrimination. These regulations include prohibiting ISPs from charging “edge” providers (entities that provide content, applications, or services over the Internet, or provide devices for accessing such content, applications, or services) for access to their customers. They do not prohibit ISPs from providing higher-speed Quality of Service, but suggest the FCC is not likely to approve of such services.
- The agency also noted that there have been allegations of possible bad behavior by ISPs, but the FCC found only four documented instances (including the aforementioned two). The agency was therefore adopting “prophylactic” regulations to guard against future transgressions. The FCC also

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noted that its regulations corresponded to ISPs’ current standard business practices. In short, there was no existing problem to which net neutrality regulation was the answer.

The FCC claimed authority to issue the order under Section 706 of the Telecommunications Act.

As I noted in that article, the economics literature does not support net neutrality (absent empirical evidence demonstrating actual bad behavior). While all ISPs had no objection to non-discrimination, non-blocking, and transparency (which they were mostly doing anyway), the prohibition against charging edge providers access to their customers amounts to price regulation (i.e., the FCC set the price of access to customers at zero). Also, the agency’s disapproval of Quality of Service offerings, while not currently being offered by ISPs, denied the Internet the ability to support services with differing speed and latency requirements.

These are quite draconian and unrealistic restrictions. It is hard to find a product or service that does not offer speedier or higher-quality options to customers, including firms that are tightly regulated as common carriers. The U.S. Postal Service, for example, offers regular mail (49¢) and Express mail ($5.25). “Latency” is the term network engineers use for the time interval between a stimulus and its response, such as a person speaking and then hearing the response (round-trip latency). Voice conversations require very low latency, as do certain video streams. Video or music downloads (as opposed to streaming) generally are tolerant of high latency. Thus to provide consumers with quality outcomes across a variety of Internet experiences, Internet service providers must offer different latency periods.

STRIKE TWO

Verizon sued the FCC to rescind the 2010 order, claiming that the agency had gone beyond its cited jurisdiction in enacting the regulations. Again, the D.C. Circuit agreed, and the order was remanded to the FCC in early 2014. The Court agreed with the FCC that Section 706 gave it the authority to regulate broad-
Again, the D.C. Circuit made clear it was making no judgment on the substance of the order, and made clear that the FCC is granted authority to regulate broadband Internet under Section 706. The FCC chose not to appeal the decision, but instead went back to the drawing board, attempting to create a net neutrality order than could withstand judicial scrutiny.

Following the Court’s decision, Tom Wheeler, the then–newly appointed chair of the FCC, sought to base any new order on Section 706, as the Court had suggested. Reclassifying Internet firms as subject to Title II was mentioned, but considered to be too draconian. Wheeler sought to craft a compromise order, but also sought to avoid Title II regulation.

By the time of the remand, public sentiment about net neutrality was running very strong, even at a fever pitch. Supporters of the idea launched campaigns to “Save the Internet,” adding “paid prioritization” (offering higher quality services for pay) to the list of net neutrality no-nos. Wheeler attempted to form a compromise solution and requested comments from the public on the best way to move forward. He got far more than he bargained for; the FCC website logged four million comments, mostly favorable to net neutrality—more comments than the FCC had ever received on any issue by several orders of magnitude.

Where did that outpouring come from? According to one sympathetic source, this was the result of “one of the most sustained and strategic activist campaigns in recent memory,” which successfully “framed net neutrality as a social justice issue, warning about how an Internet with fast lanes would harm the ability of activists to spread their message.”

One activist in particular weighed in on the issue: President Obama sent a clear message to Wheeler via YouTube that the “strongest possible regulation” was needed in the form of Title II. On the same day, activists picketed Wheeler’s home, demanding strong Title II net neutrality regulation. At this point, all hope of a compromise went out the window; Title II regulation went from being too draconian to being the preferred option, and the new order was adopted (by a 3–2 party line vote) classifying ISPs as telecommunications carriers and thus subject to Title II. The order specified what regulations would apply, which were basically those of the 2010 order, and which regulations would not apply (from which the FCC would “forebear”), which included, among many other Title II regulations, rate regulations for ISPs.

**TITLE II ARRIVES**

Paid prioritization was explicitly enjoined. The new order asserts a litany of nasty things that could happen if paid prioritization were permitted, and states that its “conclusion is supported by a well-established body of economic literature.” In fact, the articles cited in the order were mostly written prior to 2001 and refer to price discrimination, which is not the same as paid prioritization. Price discrimination involves charging different consumers different prices for the same good or service; paid prioritization involves charging different prices for different services, viz., standard speed and latency vs. high speed and low latency Internet service.

Very little of the recent economics articles reach the same conclusion stated in my earlier article: economic theory can only conclude that paid prioritization can be beneficial to consumers and competition; there are also circumstances in which it can be harmful. Empirical analysis is required to determine, in any particular circumstance, whether paid prioritization is helpful or harmful. No such evidence has been produced, either in the literature or in the FCC order.

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Beyond ISPs/The new order (and Wheeler) are quite explicit that this is not blanket regulation of the Internet, only ISPs. Presumably, requests for regulatory extensions would be ignored by the FCC. But the record refutes that claim. When Cogent and Netflix asked the FCC to extend net neutrality regulations to force Comcast to provide traffic exchange for free (in violation of 30 years of private Internet interconnection contracts), then-chair Julius Genachowski refused, noting that interconnection was not covered by net neutrality. Later, Wheeler stated at a news confer-
ence, “I have said all along ... that peering [interconnection] is not a net neutrality issue.” And yet here we are: interconnection issues regulated on a case-by-case basis under Title II.

Are we supposed to believe that requests by interested parties to extend regulation, so easy under Title II, will be ignored by the FCC? It has already failed its first real test. Title II gives the players in the regulatory game unlimited scope; must actors now get FCC permission to make their own business decisions? Or must they wait until a competitor requests the FCC to investigate if a business practice is “unjust and unreasonable,” wait for over a year while the FCC decides, then suffer the consequences?

Title II regulation is designed to control public utilities such as the old Bell System. In fact, many advocates of net neutrality explicitly advocated Title II because they thought the Internet should be regulated as a public utility. Perhaps advocates under the age of 35 have no memory of the old Bell System and its regulated monopoly. But they asked to turn the Internet into the Bell System, and in the long run that is exactly what they will get. The regulators operating under Title II will see to that.

WHO THINKS TITLE II REGULATION IS A GOOD IDEA?

Once the new order imposed Title II regulation on ISPs, some supporters of net neutrality began having second thoughts. Among them:

- The Internet Society: “We are concerned with the FCC’s decision to base new rules for the modern Internet on decades-old telephone regulations designed for a very different technological era.”
- TechAmerica: “However, we have some concerns about the path the FCC has taken to reach these new rules. Regulatory certainty is key to investment in the communications and information technology industry, and these rules do not provide the certainty we had hoped for.”
- The Electronic Frontier Foundation: ‘A ‘general conduct rule,’ applied on a case-by-case basis, may lead to years of expensive litigation to determine the meaning of ‘harm’ (for those who can afford to engage in it).”
- Netflix CFO David Wells: “Were we pleased [the FCC] pushed to Title II? Probably not. We were hoping there might be a non-regulated solution.”
- Google CEO Eric Schmidt reportedly called the White House to express reservations about Title II regulation and was rebuffed.

One of the claims made in the order is that net neutrality and Title II will increase innovation. Of course it is hard to imagine that innovation in the Internet and wireless ecosystems can increase over what competitive forces without regulation have accomplished in the last two decades, but perhaps Wheeler has a case. Perhaps we should ask actual, real-live innovators—people with a track record of innovating, rather than regulating—what they think.

But we don’t have to ask; several of the Internet’s great innovators communicated with Wheeler prior to the order’s adoption, and here’s what they said:

- George Gilder (popular author): “We’ve had 15 years of marvelous success, just stunning success on the Internet. Our seven top technology companies are all related to the Internet. The U.S. has four times the investment in fixed broadband than Europe, with its government intervention, and twice the investment in wireless. Most of Internet traffic in the world flows through the U.S. What on earth is wrong that the FCC thinks it has to reduce it to a public utility?”
- Both Bryan Martin (8x8) and Jeff Pulver (Zula and Vonage): “Trying to be VoIP innovators in a Title II regime, [our] efforts drew negative attention from regulators.”
- Pulver: “I am very concerned that in the era of the Title II Internet, we will see many fewer communication innovators come forward because of regulatory uncertainty. Innovators are less likely to act if they think they have to get permission from the FCC.”

Despite receiving this information prior to the order, the FCC ignored the comments and went forward claiming Title II will improve innovation. So the regulators say Title II will improve innovation; the innovators say it will suppress innovation. The reader is left to decide who is right.

Investment/ Many experts have suggested that Title II regulation will dampen investment in both networks and edge providers. Wheeler dismisses this, claiming that investment in wireless networks has held up despite the announcement of Title II. That is just happy talk that supports similar language in the new order.

But perhaps we should seek advice from investment professionals, people who are steeped in the financial markets and understand the telecommunications and Internet business as well. Anna-Maria Kovacs is a visiting scholar at Georgetown University, following a career as a financial analyst and consultant. She is also quite plain-spoken:

From the perspective of investors, Title II reclassification makes no sense. It does not solve the problem of paid prioritization that the vast majority of net neutrality advocates are demanding the FCC solve, but it carries the risk of enormous collateral damage to both infrastructure and edge providers. It would bring stultifying regulation that would choke the Internet ecosystem that has become one of the primary engines of economic growth for the U.S. and the world. It would encourage other governments to follow suit, endangering the success of American digital service and application.

She goes on to say:
The Internet has grown phenomenally and has become a critical underpinning for the U.S. economy. The U.S. government is vigorously opposing governmental control of the Internet abroad, and Title II reclassification within the U.S. would make that opposition a travesty. But the most important point is that section 706 allows the FCC to write on a clean slate, while Title II would bring with it a multitude of rules from which it may well not be able to forbear and which could reach not only [Broadband Internet Access providers] but edge providers. The FCC would have far more control over its own actions and risk far less collateral damage using section 706.

Why have investors continued to support investment over the past year while facing the possibility of Title II regulation? Is this because, as Wheeler would have it, Title II would not suppress investment? Kovacs addresses this question by noting comments from half a dozen financial analysts, all of whom doubted that the FCC would actually implement Title II because to do so would make no sense. Surprise.

So the regulators say Title II will improve investment, but the investment guys say it will suppress investment. Again, the reader is left to decide who is right.

The unseen! The saddest and most frustrating aspect of our current Title II muddle is that we will never know what we missed—what new innovations could have occurred, what investment in broadband could have happened.

 Competitors could have objected to the “fast lane” that Amazon got from Sprint at the launch of the Kindle to ensure speedy e-book downloads. The FCC could have blocked Apple from integrating Internet access into the iPhone. Activists could have objected to AOL bundling access to the Wall Street Journal in its early dial-up service.

Among the first targets of the FCC’s “unjust and unreasonable” test are mobile-phone contracts that offer unlimited video or music. Netflix, the biggest lobbyist for utility regulation, could be regulated for how it uses encryption to deliver its content.

**WHAT IS TO BE DONE?**

Assuming no dramatic change of course at the FCC, Title II issues will be litigated against the agency for the next several years (at least), casting a fog of uncertainty over the Internet. This uncertainty alone is sufficient to suppress investment and cut off innovation, even without the directly negative effects of Title II regulation.

Both during and after this period of litigation, the FCC’s Title II regulation will briskly move the Internet to a regulated public utility—no new competitive entry, minimal investment, reduced innovation, gradual expansion of regulation from ISPs to backbone networks to edge providers. The history of regulation provides us a sure guide, as expressed by University of Chicago professors Dennis Carlton and Randal Picker in a 2006 working paper:

Competition is diverted from the marketplace to the regulator’s office, and the tools for success—ranging from subtle influence to out-and-out bribery—may be very different. Instead, we should regulate only when we must—natural monopoly being the core case—and leave general antitrust doctrine and the court system to handle the rest.

If we wish to avoid the Internet being sucked into the vortex of Title II public utility regulation, we must depend upon Congress to act. In these times of partisan stasis in Congress, this appears to be a slender reed, but it is all the Internet has. What can Congress do?

The simplest and most direct congressional action is to pass new legislation vacating the recent order and restoring the actions of the 2010 order. The 2010 order has very serious problems, but it is far less onerous than Title II public utility regulation. This option, while the easiest to implement, would not “fix” the underlying issues, but would avoid the worst excesses of Title II.

Many would argue, however, that a return to the 2010 order, combined with the competitive discipline of the market, would be an inadequate solution because the extent of Internet provider competition would be insufficient. Are there other policies Congress could adopt?
In response to a perceived lack of competitive discipline to correct potential bad behavior, the recent order proposes heavy regulation. This is not a fix; the fix is to move toward more competition and away from regulation. Two policies would help to accomplish this:

Free up spectrum for wireless broadband competition. / If the basic issue is limited competition in the broadband market, there is a clear and obvious solution (which apparently the FCC has missed): wireless broadband. Mobile broadband volume doubled between 2012 and 2013, and is projected to increase 650 percent by 2018. Yet the United States has relatively little spectrum for each LTE (the most efficient wireless broadband protocol) device. Wireless broadband is clearly a substitute for wired broadband for many applications and many users.

Many have argued that wireless broadband is not a good substitute for wired broadband (e.g., cable or fiber) for truly high speed applications; it is too slow and expensive. But encouraging entry by bringing lots more spectrum to market will clearly drop the price. Even today, wireless broadband growth rates suggest many customers find it a good substitute; it is also the principal means of Internet access for many low-income customers.

How can we bring much more (and much cheaper) spectrum to the wireless broadband market quickly? The FCC (which controls privately held spectrum) and the federal government (which controls federally held spectrum) have been agonizingly slow in bringing spectrum to market. For example, the FCC has been working on an incentive auction that would pay current spectrum license holders to transfer their rights to broadband providers. This is a great idea, but the FCC has been incredibly slow (over five years) at making that happen.

An innovation that would expedite both the transfer of private and federal spectrum to mobile broadband is to create a commission to review all spectrum, identify the spectrum bands that can be moved to civilian use for wireless broadband and the bands that can be shared for civilian broadband use quickly (say, less than a year). The commission would then present a list of those bands to Congress for an up-or-down vote. If approved, the list would move to the FCC for immediate auction (within, say, three months) and then to the relevant federal agency to remove and relocate current spectrum use. Costs of relocation, including compensation of existing rights holders, can be met by funds raised at auction.

The model for this proposed commission is the Base Realignment and Closure Commission established by Congress in 1990, which periodically identifies and lists military bases that it judges are no longer militarily necessary and can be closed. Congress then must either accept or reject the commission’s lists, without amendment, thus avoiding local political lobbying in exchange for an overall benefit to the country. This process has met with great success in saving billions of dollars while avoiding individual nitpicking in Congress. This concept should work well if applied to spectrum.

Indeed, this is not a new suggestion. In 2010, Sen. Mark Kirk (R-Ill.) and Rep. Adam Kinzinger (R-Ill.) formally proposed this idea to a fiscal “supercommittee” of Senate and House lawmakers. Unfortunately, the idea went nowhere. Now is the time to revive the legislation and enact it—quickly.

Shift jurisdiction over the Internet from the FCC to the FTC. / The second important component is to remove the FCC’s jurisdiction over the Internet and vest authority in the Federal Trade Commission. The FTC has two overarching and relevant roles in this market:

- Police the industry for anticompetitive behavior and take antitrust actions when and where appropriate.
- Police the industry to protect consumers from fraud and corporate misbehavior.

The FTC’s track record in both areas is credible. Most recently, the agency filed a complaint that AT&T Mobility had misled customers who had purchased unlimited data plans for their smart phones but were throttled by the company (a task one would have looked to the FCC to undertake).

This shift would remove jurisdiction of the Internet from a commission that appears to have lost its understanding of regulation, markets, antitrust, and consumer protection and place it with a commission that has a demonstrated understanding of those issues. FTC Commissioner Joshua Wright recently presented an excellent paper on net neutrality, regulation, and competition that spells this out in compelling detail.

These two proposals would be a tough agenda to adopt, particularly for a Congress that seems to have trouble getting the simplest things done. However, increasing competition and avoiding Title II regulation would seem to have real bipartisan potential.

CONCLUSION

Activists supporting net neutrality carried signs reading “Save the Internet” when it didn’t need any saving. They got Title II regulation for their troubles. Now, the Internet really does need saving; we can only hope that Congress is up to this task.

We are now about to exchange our beloved Internet for a public utility. I am reminded of the Joni Mitchell lyrics: Don’t it always seem to go / That you don’t know what you got ’til it’s gone. / They paved Paradise and put up a parking lot.

READINGS