ENSURING COMPETITION ON THE INTERNET: NET NEUTRALITY AND ANTITRUST

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

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FEBRUARY 15, 2011

ENSURING COMPETITION ON THE INTERNET: NET NEUTRALITY AND ANTITRUST

TUESDAY, FEBRUARY 15, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:30 p.m., in room 2141, Rayburn House Office Building, the Honorable Bob Goodlatte (Chairman of the Subcommittee) presiding.

Present: Representatives Goodlatte, Smith, Coble, Sensenbrenner, Chabot, Issa, Jordan, Poe, Chaffetz, Reed, Griffin, Marino, Adams, Quayle, Watt, Conyers, Berman, Chu, Sánchez, Lofgren, Waters, and Jackson Lee.

Staff Present: (Majority) Holt Lackey, Counsel; Olivia Lee, Clerk; and Stephanie Moore, Minority Counsel.

Mr. GOODLATTE. Good afternoon. The Subcommittee will come to order. I will now give my opening statement.

Welcome to this hearing of the Intellectual Property, Competition, and the Internet Subcommittee entitled: Ensuring Competition on the Internet: Net Neutrality and Antitrust.

The Judiciary Committee's jurisdiction over the antitrust laws in the Telecommunications Act of 1996 and our long history overseeing the Department of Justice's decades of litigation with the AT&T monopoly, endowed this Committee with a special duty to ensure that the communications and information markets of the United States operate in a free, fair, and legal fashion.

This Committee has long been concerned on a bipartisan basis about allegations and fears that the incumbent telephone and cable companies who provide a majority of this country's Internet service could abuse their power in the Internet service market to discriminate against certain website content or platforms to anticompetitive effect.

Today marks the House Judiciary Committee's third hearing in the past 5 years exploring the net neutrality issue. After hearings in 2006, the Committee adopted bipartisan legislation that would have amended the Clayton Act to enshrine certain net neutrality principles. The Judiciary Committee's bipartisan commitment to protecting competition and freedom online continued under Democratic control, and the Committee visited the issue once again in a 2008 hearing entitled: Net Neutrality and Free Speech on the Internet.

This newly formed Subcommittee on Intellectual Property, Competition and the Internet will continue this tradition of protecting the competition and innovation that has marked the Internet era.

But it is the FCC's recent open Internet order that makes today's hearing both necessary and urgent. That widely criticized order seeks to entrench a one-size-fits-all regulatory approach to net neutrality that circumvents Congress' law making authority and that threatens to stifle innovation on the Internet in a morass of bureaucratic rules.

The FCC is pushing this order notwithstanding the D.C. Circuit's Comcast decision which squarely held that Congress has never given the FCC the broad authority it claims to regulate Internet services.

Today's hearing is a first step in reasserting that under our constitutional system, it is the role of Congress, the people's elected representatives, to make the laws. Most agree that those who provide access to the Internet should not be able to discriminate against certain online content or engage in other anticompetitive behaviors that restrict access to online services.

The question presented by today's hearing is whether potential anticompetitive conduct by Internet service providers is better addressed by the FCC's proposed industry-wide regulations or by a more flexible, antitrust-based regime that targets bad behaviors. I believe that the right approach is a light touch that focuses on punishing anticompetitive behavior, enforcing antitrust laws, and even potentially tweaking those laws to ensure that they still operate as intended in the digital age. Antitrust law will better balance the need for innovation and competition than an FCC regulatory regime possibly can.

Regulatory approaches often result in regimes where innovators must seek permission before rolling out new products or services. However, the Internet is simply too dynamic for that kind of heavy-handed, top-down regime. An antitrust approach would allow the private sector to move forward with innovation subject to being held to account if and when it became anticompetitive.

The FCC's regulations would hinge on a vague standard of whether or not a particular innovation was reasonableness in the eyes of the Commission. Antitrust law would judge that reasonableness and legality of actions according to objective economic principles and more than a century of case law.

FCC regulations would be enforced and interpreted according to the whims of D.C.-based regulators who too often are subject to capture by special interests and repeat players. Antitrust law would be enforced by the independent judiciary in courtrooms throughout our Nation. Furthermore, as Ronald Reagan once said: A government bureau is the nearest thing to eternal life we will ever see on this Earth.

Once the door is opened to FCC regulation of the Internet, it will be hard to both turn back those regulations and prevent the regulations from expanding to reach other online industries, including online content providers.

Both sides of the aisle on this Committee have long agreed that a court-based antitrust approach is preferable to the bureaucratic approach proposed by the FCC.

As Ranking Member Conyers pointed out when the Committee reported an antitrust-based net neutrality bill in 2006, the FCC is like a moss pit, there is nothing that can happen there.

The Internet must be allowed to grow and innovate and continue to deliver the astounding new products and services that have come to characterize it. We must not allow the Internet to be mired in a regulatory moss pit. I look forward to today's hearing and to the light that our distinguished panel of witnesses can shine on this important subject.

It is now my pleasure to yield to the Ranking Member of the full Committee for a further elaboration of the definition of "moss pit," the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Goodlatte, Mr. Chairman. I wish you would be more critical in selecting quotes to read back that I said. I can't deny that I said that, but I can tell you that I have modified my view somewhat and I will not use that kind of terminology today.

And I wanted to thank you and Chairman emeritus Sensenbrenner and even Darrell Issa who have all been people who have been working on this very important subject of how we ensure competition on the Internet. The considerations of the FCC, of antitrust law, and using our own legislative jurisdiction are all things that I would like to continue to work with you and all of the Members of the Committee on.

You have been working on this issue, and, by the way, Howard Berman of California has been on this, too, for quite awhile.

Now, the question that concerns me the most is that the Internet is now a function of free speech in this country and in the world. As a matter of fact, many of the uprisings in the Middle East are all based on—and as a matter of fact they are called Twitter riots. It is a new mode of us talking to one another, not just in this country but everywhere.

In some countries, like China, there are very severe limits on what is acceptable, and we have had cases even in this country where service providers have arbitrarily terminated the services of their customers because they didn't like what they were doing.

So we come here today to consider how we can make sure that this commonly referred to net neutrality, that it is open, that it doesn't turn on what classification you get or how much you pay, but that lawful, legal, content should be available to everybody in as fair and democratic a manner as possible. So we continue these hearings.

The American job market hinges on a dynamic, open Internet. That is how we get innovation and create new ideas that are translated into business and commercial and industrial activity. So we in this country must and do remain committed to technological innovation, including the universal access to broadband technology in order to keep American workers competitive.

But as people watch live sporting events from their cell phones, and bloggers update the world in real-time events, we must remember that most people in the United States can only choose between one, and, sometimes if they are lucky, two Internet service providers for high-speed Internet access. Therein lies the problem. Recent proposed business plans give telecommunication companies

favored treatment to some Internet content and disfavored treatment to other content. So I think that is an important part of what we are here for today. This is an important hearing.

It is now my view, since you have quoted me so accurately in a previous hearing, for me to say that the FCC rulings on net neutrality are weak. They are not overarching or strong. They don't meet up to standards. I am looking forward soon to have hearings in your Committee to make certain that we can deal in a more fulsome way with this subject matter.

I thank you for this opportunity.

Mr. GOODLATTE. I thank you, Mr. Conyers.

We will now stand in recess. There are a series of votes and we will resume the hearing after we return from the votes.

[Recess.]

Mr. GOODLATTE. The Subcommittee will reconvene. And it is now my pleasure to recognize the Chairman emeritus of the Committee, the gentleman from Wisconsin, Mr. Sensenbrenner, who has done a lot of work in this area.

Mr. SENSENBRENNER. Thank you very much, Mr. Chairman. And I want to commend you for holding this hearing so early in this Congress.

The whole issue of access to the Internet—net neutrality, or however it is described—I think is a very important one because the Internet and its expansion has been the principle driving force behind technological innovation, not just in the United States, but worldwide.

I am concerned that the type of regulation approved by the Federal Communications Commission ends up picking winners and losers. And frankly, it is not the job of the government to pick winners and losers, it is the job of the government to protect people against anticompetitive and monopolistic practices. That is why I believe that the proper thing for the Congress to do would be to set aside the FCC's order and make whatever amendments to the antitrust law that are necessary so that antitrust provisions can be effectively enforced.

The other thing is that antitrust laws are supervised by judges, and that is the way it has been for 100 years. That seems to have worked out fairly well in dealing with these issues, rather than either having the Congress do it or the commissioners of the FCC to do it. And I am just convinced, and have been for a while, that the road the FCC has gone down is not good for the Internet, not good for the people, and not good for competition. So I would hope that we would continue vigorously pursuing this issue, and I yield back the balance of my time.

Mr. GOODLATTE. I thank the gentleman.

And I am now pleased to yield to the gentlewoman from California, Ms. Chu.

Ms. CHU. Thank you, Mr. Chair. And I would like to thank Mr. Goodlatte for holding this hearing.

Mr. Watt, the Ranking Member, could not be here today, but he sends his regards. I am just temporarily taking over the Ranking Chair position at this point.

While today it is estimated that more than one-quarter of our world's population, or nearly 2 billion people, use the Internet, from

social working to political campaigns, the Internet is now the leading tool for speech and action. We need only to look at the role that the Internet has played during democratic demonstrations across the globe. Journalists named uprisings in Moldova and Iran during 2009 the "Twitter revolutions," and the Web has played a critical role in disseminating information and rallying crowds as Hosni Mubarak's rule has ended in Egypt.

Furthermore, the future of the American job market hinges on a dynamic, open, and lawful Internet. The United States must remain committed to technological information and investment, including universal access to broadband technology, in order to keep American workers competitive.

But as people watch live sporting events from their cell phones, and bloggers update the world in real-time events in Tahrir Square, we must remember that more than 90 percent of U.S. Consumers can choose only between one or two Internet service providers for high-speed Internet access.

Recent proposed business plans from telecommunication companies would give favored treatment to some Internet content and disfavored treatment to others. What treatment you get could be determined by how much you pay or potentially whether the Internet service provider approves of the content or has a financial interest in it. The problem is that many of the innovations we have enjoyed on the Internet may never have occurred if some of the proposed regimes were left unchecked. We would never have had a Google search engine or eBay auctions or Huffington Post blogs if pay-to-play had been our national policy.

I am concerned that if the U.S. Government stands by and does nothing, we will find that only a handful of companies dictate where and how people access information on the Internet. So as we delve into this issue, we must remember that Congress and the executive branch must tread lightly. Nothing less than free speech and millions of jobs are at stake.

I do want to emphasize that an Open Internet can and must be a lawful Internet. Digital piracy has ravaged U.S. companies and cost America countless jobs. The Internet has also afforded anonymity for criminals who steal identities and exploit children. Network neutrality does not mean safe havens for piracy, child exploitation, or other Internet crimes. Network neutrality fosters fairness.

Our colleague, John Lewis, and esteemed poet, Maya Angelou, a native of Mr. Watt's district, along with several others, are receiving the Presidential Medal of Freedom at a ceremony at the White House at this time, and this is why Ranking Member Watt cannot be here today. He regrets that he cannot attend and will submit his questions to the witnesses in writing. And he looks forward to additional hearings on net neutrality with officials from the FCC.

I look forward to hearing from our witnesses today and to a meaningful discussion on today's topic.

Mr. GOODLATTE. I thank the acting Ranking Member. And without objection, other Members' opening statements will be made a part of the record.

And before we introduce our witnesses, I would ask that they please stand and take an oath.

[Witnesses sworn.]

Mr. GOODLATTE. Thank you. Please be seated.

Our first witness is Larry Downes, a senior adjunct fellow at the newly formed think tank, TechFreedom. He is the author of three books and has held faculty positions at Northwestern University Law School, the University of Chicago Graduate School of Business, and the University of California at Berkeley, where we was associate dean of the School of Information and a senior lecturer at the Haas School of Business. After graduating magna cum laude from the University of Chicago Law School, Mr. Downes served as law clerk to the Honorable Richard A. Posner, Chief Judge of the United States Court of Appeals for the Seventh Circuit.

Mr. Downes is an Internet industry analyst and consultant who works primarily with technology companies to integrate emerging technologies into business strategy, with a special emphasis on legal and regulatory constraints. His clients have included startups as well as leading global technology providers. His expertise in the legal business and regulatory environment of the Internet industry strongly qualify him to testify at this hearing.

After him, we will hear from Mr. Brett Glass. All too often the conversation in the Beltway, whether in Congress or at regulatory agencies like the FCC, becomes dominated by large interest groups with permanent D.C.-based lawyers and lobbyists to advocate for them. There is a tendency to think about these issues in terms of big businesses, but as FCC Commissioner Robert McDowell observed in his dissent from the Open Internet Order, many broadband providers are not large companies, many are small businesses. The same is true of content providers and hardware companies. Many of the businesses who will be affected by the Open Internet Order are small.

It is fundamentally important when settling policy to always bear in mind the effect of the rules made in Washington and what they will have on ordinary Americans and the small businesses that are the primary job creators throughout the country. That's why I am pleased to introduce our next witness, Brett Glass of Laramie, Wyoming, to testify about the effect that he believes the FCC's Open Internet Order will have on his small business and other small businesses like his.

Our final witness will be Gigi Sohn, President and Co-founder of Public Knowledge, a nonprofit organization that seeks to promote openness, access, and the capacity to create and compete in all three layers of our communication system: the physical infrastructure, the systems, and the content. Ms. Sohn is the senior adjunct fellow at the Silicon Flat Iron Center for Law, Technology and Entrepreneurship at the University of Colorado, and a senior fellow at the University of Melbourne Faculty of Law, Graduate Studies Program in Australia. She has been a nonresident fellow at the University of Southern California Annenberg Center and an adjunct professor at Georgetown University and the BenjaminN. Cardozo School of Law at Yeshiva University.

We will begin with Mr. Downes. Welcome.

TESTIMONY OF LARRY DOWNES, SENIOR ADJUNCT FELLOW, TECHFREEDOM

Mr. DOWNES. Mr. Chairman and Subcommittee Members, thank you for inviting me here today.

I commend this Subcommittee for its prompt attention to the dangerous and illegal rulemaking of the FCC on December 23, 2010.

The agency's Report and Order on Preserving the Open Internet, passed by a bare majority of commissioners, just as the 2010 lame duck Congress was about to adjourn, created new regulations for some broadband Internet access providers. These new rules entomb into law one view of what some refer to as the "net neutrality principle."

Now as an early Internet entrepreneur, I share the enthusiasm of all five commissioners—not just the three who voted to approve the new rules—for the Open Internet. I just don't believe there is any need for regulatory intervention to save this robust ecosystem or that Congress ever granted the FCC authority to do so.

As the report itself makes clear, the premise of looming threats to the Open Internet that motivated these proceedings proved chimerical. The rulemaking process is unduly political and disappointingly obtuse. The order rests on a legal foundation the agency cannot seriously expect will hold up in court or in Congress. The result: regulations that no one, other than FEC Chairman Julie Genachowski, publicly supported.

The Report and Order is deeply flawed. And as with any regulation involving disruptive technologies, the risk of unintended consequences is high. In its haste to pass something before the new Congress convened, the FCC has interfered with the continued evolution of this vital technology, preserving Open Internet principles in the same way that amber preserves prehistoric insects—by killing them.

I want to highlight just a few of the fatal defects of the Report and Order.

Number one, there was no need for new regulation. Despite thousands of pages of comments from parties on all sides of the issue, in the end the majority could only identify four incidents in the last 10 years of what it believed to be non-neutral behavior. All four were quickly resolved outside the agency's adjudication processes, yet these four incidents provide the majority's sole evidence of the need to regulate now.

With no hint of market failure, the majority instead issued what it calls "prophylactic rules" it hopes will deter any future problems. But it's worth noting that the rules, as adopted, would, at most, only apply to one of the four incidents which involved a small ISP alleged in 2005 to have blocked its customers' access to Voice Over Internet Protocol telephone service. If anticompetitive practices do emerge, existing antitrust enforcement mechanisms are in place to correct them. Indeed, these laws already provide adequate deterrence.

Therefore, to justify their new rules, the majority preemptively and recklessly rejects the idea that a violation of the new rules requires proof of anticompetitive practices or demonstrable consumer harms—hallmarks of modern antitrust practice.

All one can say charitably is that the majority is reserving to its future discretion a determination of what practices actually violate the spirit of the new rules. It's hard to think of a better example of an arbitrary and capricious decision.

Number two, exceptions reveal a profound misunderstanding of the Open Internet. The Report and Order detail at least 16 significant exceptions, caveats, and exemptions for current non-neutral network management practices, practices the majority acknowledges are "inconsistent" with the Open Internet first principles.

In most cases, the inconsistent practices are exempted only because they have become entrenched and vital features of the online experience for consumers, with no harm to the Open Internet. The long list should have made clear to the majority that network engineering has evolved beyond simplistic slogans of an open and neutral network. The evolution of these network practices is far from over, but the majority's "these and no more" list condemn future innovations to the relatively glacial pace of FCC approval. This will unintentionally skew, slow, or stunt the next-generation Internet ecosystem in ways that threaten U.S. competitiveness in this most global of all markets.

The majority have promised to review the rules no later than 2 years from now, but in Silicon Valley, where I come from, 2 years might as well be forever.

Number three, the FCC lacked authority to issue the rules, and likely knew it. Despite promises that the agency's very smart lawyers had unearthed legal support for their new rules beyond arguments rejected by the D.C. Circuit in the Comcast decision, the Report and Order largely repeated those arguments. This half-hearted effort suggests the agency has little expectation the rules will survive court challenges that have already begun, and issued them solely to get the messy proceedings off its docket.

I have submitted a report examining these and other concerns in detail, and I look forward to your questions. Thank you.

Mr. GOODLATTE. Thank you, Mr. Downes.

[The prepared statement of Mr. Downes follows:]

TECH FREEDOM

Written Testimony of
Larry Downes[1]
Senior Adjunct Fellow, TechFreedom
Hearing on
"Ensuring Competition on the Internet: Net Neutrality & Antitrust"

Before the
Subcommittee on Intellectual Property, Competition & the Internet
Committee on the Judiciary
U.S. House of Representatives

February 15, 2011

Executive Summary

This paper offers a critical reading of the Federal Communications Commission's December 23rd Report and Order on "Preserving the Open Internet."[2] This year-long proceeding, concluded just as the 2010 lame duck Congress was about to adjourn, resulted in significant new regulations for some broadband Internet access providers.

The new rules, aimed at ensuring a "level playing field" for application and other service providers in gaining access to markets, consumers, and devices, entomb into law a version of what is sometimes referred to as the "net neutrality" principle. Proponents of net neutrality regulation argue that the Internet's defining feature—and the key to its unarguable success—is the content-neutral routing and transport of individual packets through the network by Internet service providers, Internet backbones, and other individual networks that make up the Internet.[3]

As evidenced in all of my writings on the digital revolution, I share the enthusiasm of all five Commissioners—and not just the three who voted to approve the new regulations—for the Open Internet. I just don't believe there is any evidence of a need for regulatory intervention to "save" this robust ecosystem, or that the FCC had the authority from Congress to do so.

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[1] Larry Downes (www.larrydownes.com) is a Senior Adjunct Fellow with TechFreedom, a digital policy think tank, and an Internet industry analyst, consultant, and author. His books include UNLEASHING THE KILLER APP: DIGITAL STRATEGIES FOR MARKET DOMINANCE (Harvard Business School Press 1998) and, most recently, THE LAWS OF DISRUPTION: HARNESSING THE NEW FORCES THAT GOVERN LIFE AND BUSINESS IN THE DIGITAL AGE (Basic Books 2009). The author thanks Berin Szoka and Adam Marcus of TechFreedom for helpful comments and corrections.

[2] Federal Communications Commission, *In the Matter of Preserving the Open Internet*, FCC 10-201, Dec. 23. 2010, http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db1223/FCC-10-201A1.pdf (hereinafter "Report & Order").

[3] *See* Tim Wu, *Net Neutrality FAQ*, http://timwu.org/network_neutrality.html. Wu is generally regarded as having coined the term "net neutrality," which does not, however, appear in the text of the Report & Order.

As with any lawmaking involving disruptive technologies, moreover, the risk of unintended consequences is high. In its haste to pass something before the new Congress convened, the majority has interfered with the continued evolution of this vital technology, preserving the Open Internet in the same way that amber preserves prehistoric insects.

This paper dissects several key aspects of the Report and Order, including:

- The basis on which the agency issued what it calls "prophylactic" rules (Section II);
- The final rules and how they evolved over the course of a byzantine and often hostile debate (Section III);
- The largely unexamined costs of enforcing the rules (Section IV);
- A long list of approved exceptions, caveats, and exemptions, which reveal a fundamental misunderstanding by the agency of what "the Open Internet" actually is (Section V); and
- A discussion of some of the most significant holes in the agency's legal justification for issuing the rules (Section VI).

In summary, the Report and Order is deeply flawed and potentially dangerous to the Internet ecosystem the FCC is trying to "preserve." The premise of looming threats to the Open Internet that inspired these proceedings proved chimerical, and the rulemaking process was unduly political and disappointingly obtuse.[4] The new rules rest on a legal foundation the agency cannot seriously expect will hold up in court or in Congress. The result was an Order that no one other than FCC Chairman Julius Genachowski publicly supported.[5]

Key Findings

- **There was no need for new regulation** - Despite thousands of pages of comments from parties on all sides of the issue, in the end the majority could only identify four incidents in the last ten years of what it believed to be non-neutral behavior. All four were quickly resolved outside the agency's adjudication processes. Yet these four incidents provide the sole evidence of a need to regulate. With no hint of market failure, the

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[4] As Commissioner Robert McDowell noted in his dissent, the final Report & Order was not made available to Commissioners for review until midnight the night before an early morning vote. The Commission also added over 3,000 pages of documents into the record at the last minute, precluding any opportunity for public review or comment. Report & Order, *supra* note 2, at 145-46 (McDowell, Comm., dissenting).

[5] The final vote was 3 to 2, a bare majority and an atypical lack of consensus for the agency. Commissioners McDowell and Baker dissented from the Report & Order. Commissioner Copps concurred. Commissioner Clyburn approved in part and concurred in part. Each of the Commissioners issued separate statements critical of the final product. Advocacy groups who supported the rulemaking were deeply disappointed with the Report & Order, and opponents of any new federal Internet regulations have already initiated legal challenges. Several Members of Congress, disturbed as much by the process as the end-product, have introduced legislation and begun hearings to nullify the rules before they have even been published in the Federal Register. *See* Larry Downes, *Net Neutrality Fight Far from Over*, CNET News.com, Jan. 7, 2011, http://news.cnet.com/8301-1035_3-20027724-94.html.

majority instead has issued what it calls "prophylactic rules"[6] it hopes will deter any actual problems in the future. But it is worth noting that the ruled as adopted would only apply to at most one of the four incidents, which involved a small local ISP alleged in 2005 to have blocked its customers' access to Voice over Internet Protocol (VoIP) telephone service.[7]

- **The final rules reflected little change from the original draft** - In contrast to heated claims that the FCC sold out the net neutrality principle over the course of its year-long proceedings, the final rules differed very little from those first proposed in October, 2009. The most significant change was to scale back regulation of mobile broadband based on overwhelming evidence of the fragility of this emerging platform. But even the Notice of Proposed Rulemaking (NPRM)[8] issued in October 2009 expressed doubts about the wisdom of subjecting wireless to the new regime.
- **Enforcement mechanisms are complex and expensive** - The enforcement provisions, longer than the rules themselves, create a dangerously unbalanced private right of action for individuals to initiate complaints based on little or no evidence of violations. The costs of investigation and enforcement are outsourced to the defendants and to the agency, creating perverse incentives that will likely generate numerous frivolous adjudications. The Report and Order includes little to no discussion of these costs, yet proudly concludes that the rules will impose few new burdens on broadband Internet access providers.[9]
- **Exceptions reveal a profound misunderstanding of "the Open Internet"** - The Report and Order detail over a dozen significant exceptions, caveats and exemptions for non-neutral network management practices, services, and outright exclusion for some classes of broadband Internet access providers. In some cases, the services are new; in most, the non-neutral techniques have become entrenched and vital features of the online experience for consumers.

  While the agency was correct to limit its new rules, the list is by no means complete nor is the evolution of network practices mature. The "these and no more" exceptions, arbitrarily dated to the point of issuing the rules in late 2010, means that future developments will be subject to FCC approval. This will unintentionally skew, slow, or stunt the next generation Internet ecosystem in ways that will threaten U.S. competitiveness in the most global of all markets. The majority have promised to

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6 The phrase "prophylactic rules" appears eleven times in the Report & Order.

7 *Madison River Communications*, File No. EB-05-IH-0110, Order, 20 FCC Rcd 4295 (EB 2005). *Madison River* was resolved via consent decree that the FCC agreed "does not constitute either an adjudication on the merits or a factual or legal finding regarding any compliance or noncompliance...."

8 Federal Communications Commission, *In the Matter of Preserving the Open Internet*, FCC 09-93, Oct. 22, 2009, http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-93A1.pdf (hereinafter "NPRM").

9 *See* Report & Order, *supra* note 2, ¶ 4 ("We expect the costs of compliance with our prophylactic rules to be small, as they incorporate longstanding openness principles that are generally in line with current practices and with norms endorsed by many broadband providers.").

review the rules no later than two years from now. But in Silicon Valley, two years may as well be forever.

- **The FCC lacked authority to issue the rules—and likely knew it** - Despite promises that the agency's "very smart lawyers" had found jurisdictional support for the new rules beyond arguments rejected by the D.C. Circuit in its *Comcast* decision,[10] the Report and Order largely repeated those arguments, offering only a slightly modified and unpersuasive reading of Section 706 of the Communications Act. The half-hearted effort suggests the agency has little expectation the rules will survive court challenges that have already begun,[11] and issued the rules solely to get the messy proceedings off its docket.

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[10] *Comcast v. FCC*, 600 F.3d 642 (D.C. Cir. 2010).

[11] Larry Downes, *Verizon Loses Early Skirmish in Net Neutrality Litigation*, CNET News.com, Feb. 3, 2011, http://news.cnet.com/8301-13578_3-20030479-38.html.

I. Introduction

At the last possible moment before the 2010 Christmas holiday, the FCC published its Report and Order on "Preserving the Open Internet," capping off years of largely content-free "debate" on the subject of whether or not the agency needed to step in to save the Internet.[12]

In the end, only FCC Chairman Julius Genachowski fully supported the Frankenstein's monster that emerged from this process. His two Democratic colleagues concurred in the vote (one approved in part and concurred in part), and issued separate opinions indicating their belief that stronger measures and a sounder legal foundation were required to withstand likely court challenges. The two Republican Commissioners vigorously dissented in strident terms unusual in this kind of regulatory action. Independent regulatory agencies, like many of the U.S. Courts of Appeal, strive for and generally achieve consensus in their decisions.[13]

So for now we have a set of "net neutrality" rules that a bi-partisan majority of the last Congress, along with industry groups and academics, strongly urged the agency *not* to adopt, and which were deemed unsatisfactory by four of the five Commissioners. It's hardly a moment of pride for the agency, which has been distracted by the noise around these proceedings since Genachowski was first confirmed by the Senate. Important work freeing up radio spectrum for wireless Internet, reforming the corrupt Universal Service Fund, and promoting the moribund National Broadband Plan have all been sidelined.

How did we get here? In October, 2009, the agency first proposed new rules, but their efforts were sidetracked by an April 2010 court decision that held the agency lacked authority to regulate broadband Internet.[14] After flirting with the dangerous (and likely illegal) idea of "reclassifying" broadband to bring it under the old telephone rules ("Title II"), sanity seemed to return. Speaking to state regulators in mid-November, the Chairman made no mention of net neutrality or reclassification, saying instead that "At the FCC, our primary focus is simple: the economy and jobs."[15]

Just a few days later, at a Silicon Valley event, the Chairman abruptly reversed course, promising that net neutrality rules would be finalized. He also complimented the "very smart lawyers" in his employ who had figured out a way to do it without the authorization of Congress, which has consistently failed to pass enabling legislation since the idea first surfaced

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[12] *See, e.g.*, Declan McCullagh, *Ten Things that Finally Killed Net Neutrality*, CNET News.com, Sept. 6, 2007, http://news.cnet.com/8301-13578_3-9773538-38.html.

[13] *See* Report & Order *supra* note 2, at 145 (McDowell, Comm., dissenting) ("For those who might be tuning in to the FCC for the first time, please know that over 90% percent of our actions are not only bipartisan, but unanimous. I challenge anyone to find another policy making body in Washington with a more consistent record of consensus.")

[14] *Comcast*, 600 F3d at 642.

[15] Federal Communications Commission Chairman Julius Genachowski, *Our Information Infrastructure: Opportunities and Challenges*, Prepared Remarks at NARUC Annual Meeting (Nov. 15, 2010), http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db1115/DOC-302802A1.pdf.

in 2003.[16] (Most recently, Democratic Congressman Henry Waxman floated a targeted net neutrality bill days before the mid-term elections, but never introduced it.[17])

From then until the Commission's final meeting before the new Congress came to town in January 2011, Commissioners and agency watchers lobbied hard and feigned outrage with the most recent version of the rules, which the agency did not make public until after the final vote was taken on Dec. 21.[18] In oral comments delivered at the December meeting, two commissioners complained that they hadn't seen the version they were to vote on until midnight the night before the vote. Journalists covering the event didn't have the document all five Commissioners referenced repeatedly in their spoken comments, and had to wait two more days for all the separate opinions to be collated and published.

Why the Midnight Order? FCC Commissioners do not serve at the whim of Congress or the President, so the mid-term election results technically had no effect on the chances of agency action. Chairman Genachowski has had the votes to approve pretty much anything he wanted all along, and will for the remainder of his term.

Even with a Republican House, successful legislation to block or overturn FCC actions is unlikely. The Republicans would have to get Democratic support in the Senate, and perhaps overcome a Presidential veto.[19] But Republicans could use net neutrality as a bargaining chip in future negotiations, and Congress can make life difficult for the agency by holding up its budget or by increasing its oversight of the agency, forcing the Chairman to testify and respond to so many written requests that it ties the agency in knots.

So doing *something* just as Congress was nearly adjourned and was too busy to do much but bluster, was perhaps the best chance the Chairman had for getting something—anything—in the Federal Register.

More likely, the agency was simply punting the problem. Tired of the rancor and distraction of net neutrality, the new rules—incomplete, awkward, and without a solid legal foundation—

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[16] Sara Jerome, *FCC Chairman Knocks Google, Verizon for Slowing Net Neutrality Efforts*, THE HILL, Nov. 17, 2010, http://thehill.com/blogs/hillicon-valley/technology/129745-genachowski-knocks-google-verizon-for-slowing-net-neutrality-efforts.

[17] Cecelia Kang, *Waxman Says Net Neutrality Bill Dead, FCC Should Assert Regulatory Authority*, THE WASHINGTON POST, Sept. 29, 2010, http://voices.washingtonpost.com/posttech/2010/09/rep_waxman_says_net_neutrality.html.

[18] Ryan Singel, *FCC Net Neutrality Rules Slammed from All Sides*, WIRED, Dec. 20, 2010, http://www.wired.com/epicenter/2010/12/fcc-rule/; Joel Rose, *Critics: 'Net Neutrality' Rules Full of Loopholes*, NPR Morning Edition, Dec. 22, 2010, http://www.npr.org/2010/12/22/132250803/Critics-Net-Neutrality-Rules-Full-Of-Loopholes.

[19] Congress is already pursuing two avenues for overturning the rules and limiting the FCC's ability to enact future Internet regulations. Under the Congressional Review Act, Congress can undo agency action with a Resolution of Disapproval, a filibuster-proof measure. At the same time, Rep. Marsha Blackburn (R-TN), introduced legislation in the opening days of Congress to prohibit the agency from regulating the Internet in any way. *See* Larry Downes, *Tech Priorities for New Congress: From Old to New*, CNET News.com, Jan. 19, 2011, http://news.cnet.com/8301-13578_3-20028935-38.html.

move the issue from the offices of the FCC to the courts[20] and Congress. That will still tie up agency resources and waste even more taxpayer money on protracted litigation, of course, but now the pressure of industry and "consumer advocate" groups will shift its direction away from FCC headquarters. Perhaps this was the only chance the Chairman had of getting any real work done.

II. Why Now? The Need for "Prophylactic" Rules

Too much ink has already been spilled on both the substance and the process of this order, but there are a few tidbits from the documents that are worth calling out. This section examines the basis for issuing what the agency itself calls "prophylactic rules." Section III considers the final text of the rules themselves and compares them to the initial draft, as well as to alternatives offered by Verizon and Google and by Congressman Waxman. Section IV discusses the likely costs of enforcing the rules, while section V looks at the exceptions and other carve-outs for existing "non-neutral" practices and what they reveal about the FCC's misunderstanding of fundamental Internet engineering. Finally, section VI reviews the legal basis on which the rules were issued, and outlines likely jurisdictional challenges to the agency's authority.

Even the FCC acknowledges that the "problem" these new regulations solve doesn't actually exist—yet. The rules are characterized as "prophylactic"—a phrase that appears eleven times in the 87-page Report. Rather, the majority fears that the lack of robust broadband competition in much of the U.S. ***could*** lead to ISPs using their market influence to squeeze content providers, consumers, or both.[21]

This hasn't happened in the ten years broadband Internet has been growing in both capability and adoption, of course. But still, there's a chance. As the Report puts it in challenged grammar, "broadband providers potentially face at least three types of incentives to reduce the current openness of the Internet."[22]

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[20] Even before the rules had been published in the Federal Register, Verizon and MetroPCS filed appeals in the U.S. Court of Appeals for the D.C. Circuit, challenging their validity. *See* Marguerite Reardon, *Verizon files Legal Shot Against Net Neutrality Rules*, CNET News.com, Jan. 20, 2011, http://news.cnet.com/8301-30686_3-20029105-266.html?tag=mncol;txt; Marguerite Reardon, *FCC Moves to Dismiss Net Neutrality Lawsuits*, CNET News.com, Jan. 31, 2011, http://news.cnet.com/8301-30686_3-20030087-266.html.

[21] Outside the scope of this paper is the question of how much competition in consumer broadband Internet access advocates of FCC intervention would consider adequate for the market to police itself. The combination in the most populous regions of cable, DSL, satellite and cellular providers doesn't appear to be enough. Many advocates are nostalgic for the days of multiple dial-up ISPs created by the unbundling requirements of the 1996 Communications Act. But as all competitors were using the same infrastructure, it was a strange kind of competition, one that resulted in the destruction, not the awakening, of the communications industry. *See* Adam D. Thierer, *UNE-P and the Future of Telecom 'Competition,'* CATO Institute, Feb. 1, 2003, http://www.cato.org/pub_display.php?pub_id=11525.

[22] Report & Order, *supra* note 2, ¶ 21. These "potential" "incentives" include economic incentives, such as the temptation to disadvantage VoIP phone service providers who compete with similar services offered by the ISP or a parent company; incentives to increase revenues by charging "edge" application providers for access

We'll leave to the side for now the undiscussed potential that these new rules will themselves cause unintended negative consequences for the future development or deployment of technologies built on top of the Open Internet. Instead, let's look at the sum total of the FCC's evidence, collected over the course of more than a year with the help of advocates who believe the "Internet as we know it" is at death's door,[23] that broadband providers are lined up to destroy the technology that, ironically, is the source of their revenue.

A. Four Incidents

To prove that these "potential" incentives are neither "speculative or merely theoretical," the FCC cites four and only four incidents between 2005 and 2010 in which the agency believes broadband providers may have responded to these potential incentives in ways that threatened the Open Internet.[24] These are:

1. A local ISP (Madison River) that was "a subsidiary of a telephone company" settled claims it had interfered with Voice over Internet Telephony (VoIP) applications used by its customers.
2. Comcast agreed to change its network management techniques when the company was caught slowing or blocking packets using the BitTorrent protocol (the subject of the 2010 court decision holding that the agency lacked jurisdiction over broadband).
3. After a mobile wireless provider contracted with an online payment service, the provider "allegedly" blocked customers' attempts to use competing services to pay for purchases made with mobile devices.
4. AT&T initially restricted the types of applications—including VoIP and Slingbox—that customers could use on their Apple iPhones.

In the world of regulatory efficiency, this much attention being focused on just four incidents of potential or "alleged" market failures is a remarkable achievement indeed. (Imagine if the EPA, FDA, or OSHA reacted with such energy to the same level of consumer harm.)

But in legal parlance, regulating on such a microscopically thin basis goes well beyond mere "pretense"—it's downright embarrassing the agency couldn't come up with more to justify its actions. Of the incidents, (1) was resolved with a consent decree that explicitly avoided any factual determinations. (2) was resolved quickly long before the agency completed its adjudication, (3) was merely alleged and apparently did not even lead to a complaint being filed with the FCC (the FCC's footnote for this case is to comments filed by the ACLU, so it's unclear

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to the ISP's customers, and incentives to degrade the performance of edge providers who do not pay for priority. *Id.* ¶¶ 21-34. As the verb tense implies, all the supporting citations for these paragraphs are to hypotheticals, largely posed by legal academics with little or no training in business.

[23] *See, e.g.*, Megan Tady, *The End of the Internet as we Know it?*, In These Times, Dec. 20, 2010, http://www.inthesetimes.com/article/6790/the_end_of_the_internet_as_we_know_it/; Timothy Karr, *Obama FCC Caves on Net Neutrality—Tuesday Betrayal Assured*, The Huffington Post, Dec. 20, 2010, http://www.huffingtonpost.com/timothy-karr/obama-fcc-caves-on-net-ne_b_799435.html.

[24] Report & Order, *supra* note 2, ¶ 35.

who is being referenced) and (4) was resolved—as the FCC acknowledges—when customers put pressure on Apple to allow AT&T as the (then) sole iPhone network provider to allow the applications.

Even under the rules adopted, (2) would almost surely still be allowed. That's because the Comcast incident involved use of the BitTorrent protocol. Even as the company that developed the protocol has worked to expand its use since 2008 to non-infringing file transfers, academic studies performed since the *Comcast* case was decided ***find that 90-99% of BitTorrent traffic still involves unlicensed copyright infringement.***[25] Thus the vast majority of BitTorrent traffic is not "lawful" traffic and, therefore, is not subject to the FCC's new rules. The no-blocking rule only prohibits blocking of "***lawful*** content, applications, services or non-harmful devices."[26]

Indeed, even as the Report and Order repeatedly cites the BitTorrent incident as the leading case justifying the rules,[27] the majority repeatedly ***encourages*** network providers to move more aggressively to stop customers who use the Internet to violate intellectual property law. The Report makes crystal clear that the new rules "do not prohibit broadband providers from making reasonable efforts to address the transfer of unlawful content or unlawful transfers of content" and that the "open Internet rules should not be invoked to protect copyright infringement ...."[28] (Perhaps the FCC, which continues to refer to BitTorrent as an "application" or believes it to be a website, simply doesn't understand how the BitTorrent protocol actually works.[29])

So what is a broadband Internet access provider to do? The vast majority of BitTorrent traffic, even after the adoption of new rules motivated to protect that traffic, can and indeed should—according to the Order—be blocked. Worse, in order to determine the small percentage of lawful BitTorrent packets that cannot and should not be blocked, a broadband access provider would presumably need to develop sophisticated and invasive techniques that would of necessity involve deep packet inspection of a great number of BitTorrent-related packets.

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[25] *See* Ed Felten, *Census of Files Available via BitTorrent*, Princeton Center for Information Technology Policy, Jan. 29, 2010, http://www.freedom-to-tinker.com/blog/felten/census-files-available-bittorrent; Mike Masnick, *Of Course Most Content Shared on BitTorrent Infringes, but that's Meaningless*, Techdirt, Feb. 2, 2010, http://www.techdirt.com/articles/20100201/1720597993.shtml; Renai LeMay, *89% of BitTorrent is illegal: Study*, PC WORLD, July 23, 2010, http://www.pcworld.idg.com.au/article/354282/89_bittorrent_illegal_study/.

[26] Report & Order, *supra* note 2, §§8.5, 8.9 (emphasis added). *See also* Cindy Cohn, *A Review of the Verizon and Google Net Neutrality Proposal*, The Electronic Frontier Foundation, Aug. 10, 2010, http://www.eff.org/deeplinks/2010/08/google-verizon-netneutrality. The nominal complainants in the *Comcast* case were using the protocol for legal file transfers, so the question of infringement and the meaning of "lawful" content under the FCC's earlier Open Internet policy statements was not raised in either the adjudication or in the appeal. Federal Communications Commission, *In the Matters of Formal Complaints of Free Press and Public Knowledge*, 28 F.C.C.R. 13028 (2008) ¶ 42.

[27] Report & Order, *supra* note 2, ¶¶ 35, 36 n. 111, 63 n. 168, 75 n. 227, 78 n. 245.

[28] *Id.* ¶¶ 107, 111. *See also* § 8.9 ("Nothing in this part prohibits reasonable efforts by a provider of broadband Internet access service to address copyright infringement or other unlawful activity.")

[29] *Id.* ¶ 36 n. 11; ¶ 78 n. 245.

But no. The majority also discourages that approach, preferring instead that providers operate at a higher level in efforts to control infringement over their networks. The majority, after all, maintains that:

> [O]pen Internet rules applicable to fixed broadband providers should protect all types of Internet traffic, not just voice or video Internet traffic. This reflects, among other things, our view that it is ***generally preferable to neither require nor encourage broadband providers to examine Internet traffic in order to discern which traffic is subject to the rules***.[30]

So if a broadband Internet access provider wanted—or felt compelled—to take more aggressive steps to discourage copyright infringement, the majority would prefer something less invasive. Such as, perhaps, identifying a protocol that is almost exclusively used for illegal file sharing and, without investigating individual packets, block its use on the network. Which, of course, is exactly what Comcast did in the first place. Under the Order, that practice would need to be disclosed under the transparency rule. But otherwise the very activity the rules were most eager to outlaw remains not only legal but encouraged.

Under the more limited wireless rules adopted, (3) and (4) would probably not violate the regulations. We don't know enough about (3) to really understand what is "alleged" to have happened, but the no-blocking rule says only that mobile broadband Internet providers "shall not block consumers from accessing lawful websites, subject to reasonable network management; nor shall [providers] block applications that compete with the provider's voice or video telephony service, subject to reasonable network management."[31]

A mobile payment application is neither a website nor a competing voice or video service, leaving incident (3) outside the new rules. In the case of the iPhone (incident (4)), it was Apple, not AT&T, that wanted to limit VoIP, arguing that it "alter[ed] the iPhone's distinctive user experience by replacing the iPhone's core mobile telephone functionality and Apple user interface with its own user interface".[32] Apple is not a provider of broadband Internet access.

Even if a VoIP app was considered "competing," the Report makes clear that the wireless rule doesn't apply in any case to app stores: "The prohibition on blocking applications that compete with a broadband provider's voice or video telephony services does not apply to a broadband provider's operation of application stores or their functional equivalent."[33] So if the software

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[30] *Id.* ¶ 48 (emphasis added). Prior to the FCC's adjudication of Comcast, the company voluntarily modified its practice to focus on high-bandwidth users rather than particular protocols. *See* Arun Radhakrishnan, *Comcast and BitTorrent Collaborate on Network Traffic Management*, TechRepublic, Mar. 28, 2008, http://www.techrepublic.com/blog/tech-news/comcast-and-bit-torrent-collaborate-on-network-traffic-management/2132. The majority approves of the new approach, *See* Report & Order, *supra* note 2, ¶ 56 n. 177.

[31] Report & Order, *supra* note 2, § 8.5.

[32] Apple Answers the FCC's Questions, http://www.apple.com/hotnews/apple-answers-fcc-questions/.

[33] Report & Order, *supra* note 2, ¶ 102.

involved in incidents (3) and (4) involved rejection of proposed apps for the respective mobile devices, there would be no violation under the new rules regardless of whether the device manufacturer or the broadband Internet access provider made the decision.

And the caveat for "reasonable network management" says only that a practice is "reasonable if it is appropriate and tailored to achieving a legitimate network purpose, taking into account the particular network architecture of the broadband Internet access service."[34] Voice and video apps, depending on how they have been implemented, can put particular strain on a wireless broadband network. In other words, blocking particular VoIP services or apps like Slingbox might be allowed anyway as reasonable network management.

So that's it. Only four or fewer actual examples of non-open behavior by ISPs in ten years. And the rules adopted to curb such behavior would probably only apply, at best, to first instance, a case involving a local telephone carrier with six hundred employees that the FCC agreed to drop without a formal finding of any kind nearly six years ago. The FCC has made a regulatory mountain out of Madison River's molehill.

B. Is the Real Problem a Lack of Competition?

But maybe these four incidents are not what's really driving the push for FCC regulation of Internet access. Maybe the real problem is, as many regulatory advocates argue vaguely, the lack of "competition" for broadband.[35] According to the National Broadband Plan, 5% of the U.S. population still doesn't have access to any wireline broadband provider, while 2% do not have access to a wireless provider. In many parts of the country, only two providers are available and in others, the offered speeds of alternatives vary greatly, leaving users without high-speed alternatives.[36]

If lack of competition is the problem, though, why not solve that problem? Well, perhaps the FCC would rather sidestep the issue, since it has consistently demonstrated it is the wrong agency to encourage more competition. Since the first deployment of high-speed Internet, multiple technologies have been used to deliver broadband access to consumers, including DSL (copper), coaxial cable (cable), satellite, cellular (3G and now 4G), wireless (WiFi and WiMax), and broadband over power lines (BPL), the latter of which is a particularly promising technology for rural users, a group that is more likely that others to have no or limited broadband options today.[37]

But rather than promote multiple technologies, the FCC has done just the opposite. For example, the agency has sided with some state governments, who argued successfully that they can prohibit municipalities from offering telecommunications service to maintain lucrative local

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[34] *Id.* § 8.11(d).

[35] *Id.* ¶¶ 32-34.

[36] Federal Communications Commission, *Connecting America: The National Broadband Plan*, Chapter 4, Exhibits 4A and 4E, March, 2010, http://download.broadband.gov/plan/national-broadband-plan.pdf (hereinafter "National Broadband Plan")

[37] *Id.* at 37.

franchising monopolies.[38] And the Commission has dragged its feet on approving trials for BPL, contributing to continued setbacks in deploying the technology.[39]

Indeed, if there are anti-competitive behaviors now or in the future, existing antitrust law, enforceable by either the Department of Justice or the Federal Trade Commission, provide much more powerful tools both to prosecute and remedy activities that genuinely harm consumers. (Both agencies continue to describe the broadband Internet market as competitive.[40])

The legal response to problems of so-called "vertical exclusion," in which a dominant provider abuses its power over access to a key input to an upstream or downstream business, has undergone a sea change in recent decades, with the Supreme Court moving from a rule of *per se* illegality to one requiring proof of "demonstrable economic effect."[41] Mere market dominance is not enough to trigger antitrust remedies, nor should it be.

And even if limited competition in some areas of the country does lead to genuine consumer harm, as may have been the case in *Madison River*, there is no reason to believe any version of net neutrality rules would correct it. As Christopher S. Yoo has long argued, even if antitrust issues do arise in broadband Internet access, net neutrality regulation is not the solution:

> The imposition of network neutrality would not increase the number of last-mile options one iota and thus would not change the bargaining power between last-mile providers and end users. Given that network neutrality would, however, leave last-mile providers bargaining power vis-à-vis end users unaffected, one would not expect network neutrality to lead to any reduction in the prices charged to end users. Network neutrality would have a dramatic effect on the other side of the two-sided market by affecting how last-mile providers and content/applications providers divide up those rents. From this perspective, network neutrality has less to do with benefiting consumers and more to do with adjusting the bargaining power between the Verizons and the Googles of the world.[42]

Perhaps this is why the majority veers dangerously away from anti-competitive justifications for its new anti-discrimination rule. "The broad purposes of this rule," according to the majority, "cannot be achieved by preventing only those practices that are demonstrably anticompetitive or harmful to consumers." Instead, "the rule rests on the general proposition that broadband

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38 Nixon v. Missouri Municipal League, 541 U.S. 125 (2004).

39 *See* American Radio Relay League, Inc. v FCC, 524 F.3d 227 (D.C. Cir. 2008); Karl Bode, *Nation's First Major Broadband over Power Line Deployment Shuts Down*, Techdirt, Apr. 13, 2010, http://www.techdirt.com/articles/20100409/0826178949.shtml.

40 *See* Report & Order, *supra* note 2, at 148, 152 (McDowell, Comm., dissenting).

41 Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 724, 726 (1988).

42 Christopher S. Yoo, *What can Antitrust Contribute to the Network Neutrality Debate?*, 1 INTERNATIONAL JOURNAL OF COMMUNICATIONS 493-530 (2007).

providers should not pick winners and losers on the Internet—even for reasons that may be independent of providers' competitive interests or that may not immediately or demonstrably cause substantial consumer harm."[43]

This is a novel theory of protecting the "public interest" indeed—one that requires a showing of neither anti-competitive behavior nor harm to consumers before imposing sanctions on a broadband Internet access provider for "unreasonable discrimination." All one can say charitably is that the majority recognizes there are no threats it can credibly point to today, and is reserving to its future discretion the determination of practices it finds violate the spirit of the "Open Internet."[44]

That fuzziness underlines the folly of past efforts by the FCC to police technologies and markets that are evolving rapidly—or, in any case, much faster than the agency's traditional milieu of mature technologies and regulated industries. Even if the Open Internet were indeed under genuine threat, in other words, it's hard to find many examples in the long history of the FCC where the agency has used its sometimes vast authority to solve genuine problems.

The *Carterfone* decision, which Commissioner Copps cites enthusiastically in his concurrence, and (finally) the opening of long distance telephony to competition, certainly helped consumers.[45] But both (and other examples) could also be seen as undoing harm caused by the agency in the first place. And both dealt with technologies and applications that were mature. Why does anyone believe the FCC can "prophylactically" solve a problem dealing with an emerging, rapidly-evolving new technology that has thrived in the last decade in part because it was unregulated?

The new rules, which are aimed at ensuring "edge" providers do not need to get "permission to innovate" from ISPs, may have the unintended effect of requiring ISPs—and edge providers—to get "permission to innovate" from the FCC. That hardly seems like a risk worth taking for a problem that hasn't presented itself.

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[43] Report & Order, *supra* note 2, ¶ 78. *See also id.* ¶ 42 n. 141. *See also* Randolph May, *Infamous No. 78 (of the Net Neutrality Order)*, Free State Foundation, Jan. 5, 2011, http://freestatefoundation.blogspot.com/2011/01/infamous-no-78-of-net-neutrality-order.html.

[44] Channeling Justice Stewart's confidence if not his candor in confessing that whatever obscenity means, "I know it when I see it." *Jacobellis v. Ohio*, 378 U.S. 184 (1964) (Stewart, J., concurring).

[45] Report & Order, *supra* note 2, at 141 (Copps, Comm., concurring).

III. "Not Neutrality" or Government Takeover? The Rules Revealed

In the end, the FCC voted to approve three new rules that apply to broadband Internet providers. One requires broadband access providers to disclose their network management practices to consumers.[46] The second prohibits blocking of content, applications, services, and non-harmful devices.[47] The third forbids fixed broadband providers (*e.g.*, cable and telephone) from "unreasonable" discrimination in transmitting lawful network traffic to a consumer.[48]

There has been a great deal of criticism of the final rules, much of it reaching a fevered pitch even before the text was made public. At one extreme, advocates for stronger rules have rejected the new rules as meaningless, as "fake net neutrality," "not neutrality," or the latest evidence that the FCC has been captured by the industries it regulates.[49] On the other end, critics decry the new rules as a government takeover of the Internet, censorship, and a dangerous and unnecessary interference with a healthy digital economy.[50] (I agree with that last one.)

One thing that has not been seriously discussed, however, is just how little the final text differs from the rules originally proposed by the FCC in October, 2009. Indeed, many of those critical of the weakness of the final rules seem to forget their enthusiasm for the initial draft, which in key respects did not change at all in the intervening year of comments, conferences, hearings, and litigation.

The differences—significant and trivial—that have been made can largely be traced to comments the FCC received on the original draft, as well as interim proposals made by industry and Congress, particularly the framework offered by Verizon and Google in August and a bill circulated (but never introduced) by Rep. Henry Waxman just before the mid-term elections.[51] In that sense, reviewing the not only the final rules but the editing that led to them illuminates a great deal about the politics behind the Report and Order.

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[46] *Id.* § 8.3.

[47] *Id.* § 8.4.

[48] *Id.* § 8.5.

[49] *See, e.g.*, Brian Montopoli, *Liberals Lash out at 'Fake Net Neutrality,'* CBS News, Dec. 21, 2010, http://www.cbsnews.com/8301-503544_162-20026286-503544.html; Nate Anderson, *Why Everyone Hates New Net Neutrality Rules—Even NN Supporters*, Ars Technica, Dec. 21, 2010, http://arstechnica.com/tech-policy/news/2010/12/why-everyone-hates-new-net-neutrality-ruleseven-nn-supporters.ars.

[50] *See, e.g.*, Gene Rodgers, *Reaction to FCC's 'Net Neutrality' Coup*, Richmond Tea Party, Dec. 22, 2010, http://www.richmondteaparty.com/2010/12/reaction-to-fccs-net-neutrality-coup/; Sara Jerome, *Cato: Glenn Beck 'Mistaken' About Net Neutrality*, The Hill, Dec. 9, 2010, http://thehill.com/blogs/hillicon-valley/technology/132967-cato-glenn-beck-mistaken-about-net-neutrality.

[51] Ars Technica's Nate Anderson has done a great service in laying out the text of the final rules side-by-side with the proposed legislative framework offered by Verizon and Google. *See* Nate Anderson, *Why is Verizon Suing over Rules it once Supported?*, Ars Technica, Jan. 15, 2011, http://arstechnica.com/tech-policy/news/2011/01/verizon-sues-over-net-neutrality-rules-it-once-supported.ars.

A. Transparency

Compare, for example, the final text of the transparency rule with the version first proposed by the FCC:

> **Proposed**: Subject to reasonable network management, a provider of broadband Internet access service must disclose such information as is reasonably required for users and content, application and service providers to enjoy the protections specified in this part.[52]
>
> **Final**: A person engaged in the provision of broadband Internet access service shall publicly disclose accurate information regarding the network management practices, performance and commercial terms of its broadband Internet access service sufficient for consumers to make informed choices regarding use of such services and for content, application, service and device providers to develop, market and maintain Internet offerings.[53]

The final rule is much stronger, and makes clearer what it is that must be disclosed. It is also not subject to the limits of reasonable network management, Rather than the vague requirement of the draft for disclosures sufficient to "enjoy the protections" of the Open Internet rules, the final rule requires disclosures sufficient for consumers to make "informed choices" about the services they pay for, a standard more easily enforced.

By comparison, the final rule comes close to the version that appeared in draft legislation circulated but never introduced by Rep. Henry Waxman in October of 2010.[54] It likewise reflects the key concepts in the Verizon-Google Legislative Framework Proposal from earlier in the year.[55]

As the Report makes clear, the transparency rule has teeth.[56] Though the agency declines for now from making specific decisions about the contents of the disclosure and how it must be posted, the Report lays out a non-exhaustive list of nine major categories of disclosures, including network practices, performance characteristics, and commercial terms, that must be included. It's hard to imagine a complying document or posting that will not run to several pages of very small text.

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[52] NPRM, *supra* note 8, § 8.15.

[53] Report & Order, *supra* note 2, § 8.3.

[54] The bill was widely leaked to THE HILL and others, *See* http://thehill.com/images/stories/whitepapers/pdf/proposed_net_neutrality_legislative_framework-1.pdf (hereinafter "Waxman Bill")

[55] Verizon-Google Legislative Framework Proposal, Aug. 9, 2010, http://www.scribd.com/doc/35599242/Verizon-Google-Legislative-Framework-Proposal (hereinafter "V-G Proposal"); Alan Davidson, *A Joint Policy Proposal for an Open Internet*, Google Public Policy Blog, Aug, 9, 2010, http://googlepublicpolicy.blogspot.com/2010/08/joint-policy-proposal-for-open-internet.html.

[56] Report & Order, *supra* note 2, ¶¶ 53-61.

That generosity, unfortunately, may be the rule's undoing. As anyone who has ever thrown away a required disclosure that accompanies a complex product or service (*e.g.*, mortgage, credit card, pharmaceutical, electronic device, public financial statement, medical insurance, privacy notice, etc.) knows full well, information "sufficient" to make an informed choice is far more information than any non-expert consumer could possibly absorb and evaluate, even if they wanted to. The more information consumers are given, the less likely they'll pay attention to any of it, including what may be important.[57]

The FCC recognizes that risk, however, but believes it has an answer. "A key purpose of the transparency rule," the Commission notes, "is to enable third-party experts such as independent engineers and consumer watchdogs to monitor and evaluate network management practices, in order to surface concerns regarding potential open Internet violations."[58]

Perhaps the agency has in mind here organizations like the Broadband Internet Technical Advisory Group (BITAG), which has been established by a wide coalition of participants in the Internet ecosystem to develop "consensus on broadband network management practices or other related technical issues."[59] Or perhaps the agency imagines that some of the public interest groups who have most strenuously rallied for the rules will become responsible stewards of their implementation, trading the acid pens of political rhetoric for responsible analysis and advocacy to their members and other consumers.

We'll see. I wish I shared the Commission's confidence that, "for a number of reasons" (none cited), "the costs of the disclosure rule we adopt today are outweighed by the benefits of empowering end users and edge providers to make informed choices…"[60]—but I don't.

B. Blocking

The final version of the blocking rule consolidated the "Content, Applications and Services and Devices" rule of the original draft. The final rule states:

> A person engaged in the provision of fixed broadband Internet access services, insofar as such person is so engaged, shall not block lawful content, applications, services or non-harmful devices, subject to reasonable network management.[61]

A more limited rule applies to mobile broadband providers, who:

> [S]hall not block consumers from accessing lawful websites, subject to reasonable network management, nor shall such person block applications that

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[57] Florencia Marotta-Wurgler, *Does Disclosure Matter?* NYU Law and Economics Research Paper No. 10-54, Nov. 23, 2010, http://papers.ssrn.com/sol3/papers.cfm?abstract_*id*=1713860.

[58] Report & Order, *supra* note 2, ¶ 60.

[59] Broadband Internet Technical Advisory Group, http://members.bitag.org/kwspub/home/.

[60] Report & Order, *supra* note 2, ¶ 59.

[61] *Id.* § 8.5.

> compete with the providers' voice or video telephony services, subject to reasonable network management.[62]

Much of the anguish over the final rules expressed thus far relates to a few of the limitations added to the blocking rule. First, many copyright "reform" activists object to the word "lawful" appearing in the rule.[63] "Lawful" content, applications, and services do not include activities that constitute copyright and trademark infringement. Therefore, the rule allows broadband providers to use whatever mechanisms they want (or may be required to use) to reduce or eliminate traffic that involves illegal file-sharing, spam, viruses and other malware.[64]

A provider who blocks access to a site selling unlicensed products, in other words, is not violating the rules. And as the agency finds it is "generally preferable to neither require nor encourage broadband providers to examine Internet traffic in order to discern which traffic is subject to the rules,"[65] there will be a considerable margin of error given to providers who block sites, services, or applications which may include some legal components.

A second concern is the repeated caveat for "reasonable network management," which gives access providers leeway to balance traffic during peak times, limit users whose activity may be harming other users (*e.g.*, continuous and very large file transfers), and other "legitimate network management" purposes.

Finally, some disappointed regulatory advocates object to the special treatment for mobile broadband providers, which may block applications, services or devices without violating the rule. There is an exception to the exception for applications, such as VoIP and video, which compete with the provider's own offerings, but that special treatment doesn't keep mobile providers from using "app stores" to exclude services of which they don't approve.[66]

Of course even the original draft of the rules included the limitation for "reasonable network management," and refused to apply any of the rules to unlawful activities. The definition of "reasonable network management" in the original draft is different, but functionally equivalent, to the final version.[67]

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[62] *Id.*

[63] Cindy Cohn, *A Review of the Verizon and Google Net Neutrality Proposal*, The Electronic Frontier Foundation, Aug. 10, 2010, http://www.eff.org/deeplinks/2010/08/google-verizon-netneutrality.

[64] Report & Order, *supra* note 2, ¶¶ 107, 111. *See also Id.* § 8.9 ("Nothing in this part prohibits reasonable efforts by a provider of broadband Internet access service to address copyright infringement or other unlawful activity.")

[65] *Id.* ¶ 48.

[66] *Id.* ¶ 102.

[67] Compare NPRM, *supra* note 8, § 8.3 ("Reasonable network management consists of: (a) reasonable practices employed by a provider of broadband Internet access service to: (i) reduce or mitigate the effects of congestion on its network or to address quality-of-service concerns; (ii) address traffic that is unwanted by users or harmful; (iii) prevent the transfer of unlawful content; or (iv) prevent the unlawful transfer of content; and (b) other reasonable network management practices.") with Report & Order, *supra* note 2, § 8.11(d) ("A

The carve-out for mobile broadband is a significant departure from the original rules. Though the Oct. 2009 NPRM expressed concern about applying the same rule to fixed and mobile broadband,[68] the draft blocking rule did not distinguish between fixed and mobile Internet access. The FCC did note, however, that different technologies "may require differences in how, to what extent, and when the principles apply."[69] The agency sought comment on these differences (and asked for further comment in a later Notice of Inquiry[70]).

Needless to say, the agency heard plenty.

Wireless broadband is, of course, a newer technology, and one still very much in development. On the one hand, competition, for the most part, is robust.[71] Spectrum, on the other hand, is limited, and capacity cannot easily be added. Those are not so much market failures as they are regulatory failures. The FCC is itself responsible for managing the limited radio spectrum, and has struggled by its own admission to allocate spectrum for its most efficient and productive uses—indeed, even to develop a complete inventory of who has which frequencies of licensed spectrum today.[72]

Adding additional capacity is another regulatory obstacle. Though mobile users rail against their providers for inadequate or unreliable coverage, no one, it seems, wants to have cellular towers and other equipment near where they live. Local regulators, who must approve new infrastructure investments, take such concerns very much to heart.[73] (There is also rampant corruption and waste in the application, franchising, and oversight processes at the state and local levels; a not-very-secret secret.)

The FCC, it seems, has taken these concerns into account in the final rule. Its original Open Internet policy statements—from which the rules derive—applied only to fixed broadband access,[74] and the October, 2009 draft's inclusion of mobile broadband came as a surprise to many.

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network management practice is reasonable if it is appropriate and tailored to achieving a legitimate network management purpose, taking into account the particular network architecture and technology of the broadband Internet access service.")

[68] NRPM, *supra* note 8, ¶¶ 13, 154-174.

[69] *Id.* ¶ 13.

[70] FCC, *Further Inquiry into Two Underdeveloped Issues in the Open Internet Proceeding*, DA 10-1667, Sept. 1, 2010, http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0901/DA-10-1667A1.pdf.

[71] National Broadband Plan, *supra* note 36, at 40. 77% of American consumers have a choice of three of more providers. *See* Exhibit 4E.

[72] Larry Downes, *Spectrum Crisis Amnesia: What Happened in Vegas Stayed in Vegas, Unfortunately*, Jan. 10, 2011, http://larrydownes.com/spectrum-crisis-amnesia-what-happened-in-vegas-stayed-in-vegas-unfortunately/; Larry Downes, *Tech Priorities for New Congress*, *supra* note 19.

[73] *See, e.g.*, Tracey Taylor, *Opponents of New Cellphone Towers Try a New Tack*, THE NEW YORK TIMES, May 7, 2010, http://www.nytimes.com/2010/05/07/us/07sfcell.html.

[74] Federal Communications Commission, *In the Matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, FCC 05-151, Sept. 23, 2005.

The first indication that the agency was considering a return to the original policy came with the Verizon-Google proposal (V-G), where the former net neutrality adversaries jointly released a legislative framework—that is, something they hoped Congress, not the FCC, would take seriously—that specified different treatment for mobile. As the V-G proposal noted, "Because of the unique technical and operational characteristics of wireless networks, and the competitive and still-developing nature of wireless broadband services, only the transparency principle would apply to wireless at this time."[75]

The Waxman proposal didn't go as far as V-G, however, adding a provision that closely tracks what the FCC adopted as the final rule. Under the Waxman bill, mobile providers would have been prohibited from blocking "lawful Internet websites", and applications "that compete with the providers' voice or video communications services."[76]

So the trajectory of the specialized treatment for mobile broadband is at least clear and, for those following the drama, entirely predictable. Yet the strongest objections to the final rule and the loudest cries of betrayal from neutrality advocates came from the decision to burden mobile providers less than their fixed counterparts. (Many providers offer both, of course, so will be subject to different rules for different parts of their service.)

At the very least, the advocates should have seen it coming. Many did. A number of "consumer advocacy" groups demonized Google for its cooperation with Verizon,[77] and refused to support Rep. Waxman's bill.[78] (It should also be noted that none of the groups objecting to the final rules or any interim version ever actually proposed their own version—that is, what they actually wanted as opposed to what they didn't want.)

C. Unreasonable Discrimination

The final rule, applicable only to fixed broadband providers, demands that a provider not "unreasonably discriminate in transmitting lawful network traffic over a consumer's broadband Internet access service."[79]

Though subtle, the difference in language between the NPRM and the final rule is significant, as the FCC acknowledges. The NPRM draft rule noted plainly that "a provider of broadband

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[75] V-G Proposal, *supra* note 55, at 1.

[76] Waxman bill, *supra* note 54, at 1-2.

[77] Michael Scherer, *Is the Google-Verizon Plan Bad for Net Neutrality?*, TIME, Aug. 10, 2010, http://www.time.com/time/business/article/0,8599,2009541,00.html; Marguerite Reardon, *Net Neutrality Crusaders Slam Verizon, Google*, CNET News.com, Aug. 9, 2010, http://news.cnet.com/8301-30686_3-20013118-266.html.

[78] Sara Jerome, *Sources: OIC Not Supporting Waxman Net-Neutrality Bill*, THE HILL, Sept. 28, 2010, http://thehill.com/blogs/hillicon-valley/technology/121493-sources-oic-will-not-support-waxman-net-neutrality-bill.

[79] Report & Order, *supra* note 2, § 8.7, ¶¶ 68-79.

Internet access service must treat lawful content, applications, and services in a nondiscriminatory manner."[80]

The difference here is between "nondiscrimination," which prohibits all forms of differential network treatment, and "unreasonable discrimination," which allows discrimination so long as it is reasonable.

The migration from a strict nondiscrimination rule (subject, however, to reasonable network management) to a rule against "unreasonable" discrimination can be traced through the interim documents. The V-G proposal, which called for a "Non-Discrimination Requirement," nonetheless worded the requirement to ban only "undue discrimination against any lawful Internet content, application, or service ***in a manner that causes meaningful harm to competition or to users***."[81]

Rep. Waxman's draft bill, likewise, would have applied a somewhat different standard for wireline providers, who "shall not unjustly or unreasonably discriminate in transmitting lawful traffic over a consumer's wireline broadband Internet access service," also subject to reasonable network management.[82]

Over time, the FCC recognized the error of its original draft and now agrees "with the diverse group of commenters who argue that any nondiscrimination rule should prohibit only unreasonable discrimination."[83]

As between the proposed limiting terms "undue," "unjust" and "unreasonable," the FCC chose the latter for the final rule. Though many have complained that "unreasonable" is a nebulous, subjective term, it should be noted that of the three it is the only one with understood (if not entirely clear) legal meaning, particularly in the context of the FCC's long history of rulemaking and adjudication.

For example, the earliest railroad regulations, which also provided the beginning of the FCC's eventual creation and authority over communications industries, required reasonable rates of carriage, and empowered the Interstate Commerce Commission to intervene and eventually set the rates itself, much as the FCC later did with telephony.[84]

One lesson of the railroad and telephone histories, however, is the danger of turning over to regulators decisions about which behaviors are reasonable. (Briefly, regulatory capture often

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[80] NPRM, *supra* note 8, ¶ 16.

[81] V-G Proposal, *supra* note 55, at 1 (emphasis added).

[82] Waxman Bill, *supra* note 54, at 1.

[83] Report & Order, *supra* note 2, ¶ 77.

[84] The Hepburn Act, 59th Congress, Sess. 1, ch. 3591, 34 Stat. 584, (1906); The Mann–Elkins Act, 61st Congress, ch. 309, 36 Stat. 539 (1910);

ends up leaving the industry unable to respond to new forms of competition from disruptive technologies, with disastrous consequences.[85])

The V-G proposal gets to the heart of the problem by regulating only discrimination that "causes meaningful harm to competition or to users." This is essentially the consumer welfare standard at the heart of antitrust law, one that has long been proposed as the basis for meaningful regulation of the Open Internet.[86] Despite the negative connotations of the word in common use, "discrimination" isn't inherently bad. As the Report makes clear, in managing Internet access and network traffic there are many forms of discrimination—which means, after all, affording different treatment to different things—that are entirely beneficial to overall network behavior and to the consumer's experience with the Internet. (More on this in section V.)

The draft rule, as the FCC now acknowledges,[87] was dangerously rigid. For one thing, users may *want* some kinds of traffic—*e.g.*, voice and video—to receive a higher priority over text and graphics, which do not suffer from latency problems. Companies operating Virtual Private Networks for their employees may likewise want to limit Web access to selected sites and activities for workers while on the job.

A strict nondiscrimination rule would have also discouraged or perhaps banned tiered pricing, harming consumers who do not need the fastest speeds and the highest volume of downloads to accomplish what they want to do online. Without tiered pricing, such consumers effectively subsidize power-users who, not surprisingly, are the most vociferous objectors to pricing based on usage.

Discrimination may also be necessary to manage congestion during peak usage periods or when failing nodes put pressure on the backbone. Discrimination against spam, viruses and other malware, much of which is not "lawful," is also permitted and indeed encouraged.[88]

The Report notes three types of provider discrimination that are of particular concern:

1. Discrimination that harms competitors (*e.g.*, VoIP providers of over-the-top telephone service, such as Skype or Vonage, that competes with the provider's own telephone service);
2. "Inhibiting" end users from accessing content, services, and applications of their choice (but see the no-blocking rule, above, which already covers this); and

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[85] *See* LARRY DOWNES, UNLEASHING THE KILLER APP, *supra* note 1; LARRY DOWNES, THE LAWS OF DISRUPTION, *supra* note 1. *See also* Timothy B. Lee, *The Durable Internet: Preserving Network Neutrality Without Regulation*, Cato Policy Analysis 625 (Nov. 12, 2008), http://www.cato.org/pub_display.php?pub_id=9775.

[86] Randolph J. May et. al, *Digital Age Communications Act - Proposal of the Regulatory Framework Working Group*, Release 1.0, The Progress & Freedom Foundation, June 2005, http://www.pff.org/issues-pubs/other/050617regframework.pdf. *But see* Yoo, *What can Antitrust Contribute to the Network Neutrality Debate? supra* note 42.

[87] Report & Order, *supra* note 2, ¶ 77.

[88] *Id.* ¶ 90-92.

3. Discrimination that "impairs free expression," including slowing or blocking access to a blog whose message the broadband provider does not approve.[89]

On that last point, it's important to note that the FCC's ability to police restrictions on "free expression" is greatly limited. Fifteen years ago, Congress wisely gave broadband Internet access providers (and others) broad leeway to filter and otherwise curate content they do not approve of or which they believe their customers don't want to see. Under Section 230 of the 1996 Communications Act,

> No provider or user of an interactive computer service shall be held liable on account of … any action voluntarily taken in good faith to restrict access to or availability of material that ***the provider or user*** considers to be obscene, lewd, lascivious, filthy, excessively violent, harassing, or otherwise objectionable, whether or not such material is constitutionally protected.[90]

The goal of Section 230 was to immunize early Internet providers like CompuServe and Prodigy from efforts to exercise editorial control over message boards whose content was provided by customers themselves. But the law gives providers broad discretion in determining what kind of content it believes its customers don't want to see. So long as the filtering is undertaken in "good faith" (*e.g.*, not with the intent of harming a competitor), there is no liability for the provider, who does not, for example, become a "publisher" for purposes of defamation law.[91]

The FCC acknowledges the limit that Section 230 puts on the discrimination rule: Simply put, the majority notes that "Our rule will not impose liability on a broadband provider where such liability is prohibited by section 230(c)(2) of the Act."[92]

Here too there is a likely First Amendment concern lurking in the background: The Constitution forbids the FCC, and not private parties, from regulating in ways that violate basic free speech principles. A decision by a broadband Internet access provider to block specific content, so long as it is not motivated by anticompetitive objectives, is likely to be a form of protected speech for the provider. (Local cable companies, which may be owned by individuals with strong religious or other moral convictions, can likewise refuse to carry programming and channels the owner finds objectionable.)[93]

On the harm-to-competitors prong, the FCC waffles on whether "pay for priority"—the bugaboo that launched the neutrality offensive in the first place—actually constitutes a

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[89] *Id.* ¶ 75.

[90] 47 U.S.C. 230(c)(2)(A) (1996) (emphasis added).

[91] *Id.* at (c)(1).

[92] Report & Order, *supra* note 2, ¶ 89.

[93] *Id. But see Id.* ¶141 ("Unlike cable television operators, broadband providers typically are best described not as 'speakers,' but rather as conduits for speech"). *Compare Id.* ¶ 143 ("Broadband providers are also free under this Order to offer a wide range of 'edited' services. If, for example, a broadband provider wanted to offer a service limited to 'family friendly' materials to end users who desire only such content, it could do so under the rules we promulgate today.")

violation of the rules.[94] While a broadband provider's offering to prioritize the traffic of a particular source for a premium fee "would raise significant cause for concern," the majority acknowledges that such behavior has occurred and thrived for years, especially in the form of third party Content Delivery Networks (CDN). Briefly, CDNs replicate popular content on servers placed in strategic proximity to key hubs in the Internet, making it possible to speed such content to users when they request it. The Report and Order makes clear that CDNs, despite being "inconsistent" by design with the theory of an Open Internet, are allowed.[95] (More on CDNs in section V.)

So in the end, the discrimination rule doesn't appear to add much to the blocking rule or to existing antitrust law. Discrimination against competing over-the-top voice and video providers would violate antitrust law. Blocking or slowing access to disfavored content is already subject to the blocking rule. And broadband Internet access providers have significant leeway in interfering with "free expression" rights of users both through Section 230 of the Communications Act and as an expression of their own First Amendment rights.

What's left? Perhaps everything. As noted earlier, the majority rejects a view of discrimination cabined by antitrust law and its economic foundations, but neither does it offer any alternative foundation for its future enforcement of the rule. "The rule rests on the general proposition," the majority concludes, "that broadband providers should not pick winners and losers on the Internet," even when doing so is independent of competitive interests. What exactly this means—and how "reasonable" discrimination will be judged in the course of enforcing the rules—remains to be seen.[96]

IV. Hidden Costs: Coase & the Problems of Enforcement Error

Nobel prize-winning economist Ronald Coase, a remarkable man I have had the great fortune to know personally, recently celebrated his 100th birthday. Among his many contributions to the field, Coase has always advocated for more empirical research and other data collection to help lead the field out of its theoretical quagmire. To that end, Coase co-founded the International Society for New Institutional Economics, and served as its first President in 1996.

Unfortunately, the FCC, which owes a great debt to Coase for his early championing of auctions for radio spectrum,[97] does not seem to have learned much else from his work. In a section optimistically captioned, "The Benefits of Protecting the Internet's Openness Exceed the Costs,"

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94 *Id.* ¶ 76.

95 *Id.* ¶ 76 n. 235. ("We reject arguments that our approach to pay-for-priority arrangements is inconsistent with allowing content-delivery networks (CDNs).")

96 *Id.* ¶ 78; Randolph May, *Infamous No. 78 (of the Net Neutrality Order), supra* note 43 ("Paragraph No. 78 is so important because, by disclaiming reliance only on anticompetitive injury and consumer harm (generally present only when an Internet provider possesses market power), the Commission leaves itself largely at sea in enforcing its rules.").

97 L. Gordon Crovitz, *Better Broadband is No 'Joke,'* THE WALL STREET JOURNAL, Mar. 22, 2010, http://online.wsj.com/article/SB10001424052748704550004575133802210396886.html.

the Commission makes no effort to calculate either with any hint of rigor.[98] Wishing away serious economic analysis, the Report simply states that "By comparison to the benefits of these prophylactic measures, the costs associated with the open Internet rules adopted here are likely small."[99]

The sole source of authority cited for this remarkable claim is to comments filed by Free Press, "a national, nonpartisan, nonprofit organization working to reform the media."[100] This is one of fifty citations to Free Press in the Report and Order. So far as I know, Free Press does not keep economists on staff, nor did they perform any economic analysis of the benefits or costs of rules that, of course, weren't in any case finalized until months after its comments were filed.

So the belief that the costs are likely small, let alone that the value of the benefits not of the Open Internet but of the rules adopted to salvage it, is simply that—a belief, or, more likely, a mere hope. Hope may well "spring eternal in the human breast,"[101] but it is hardly the basis for "reality-based" policymaking.

The Report goes on to note that openness and no-blocking are already the "norm" and the "status quo" for broadband Internet providers. (So, again, why are new rules so urgently required?) Therefore, the only significant compliance cost the FCC envisions is for the new transparency rule, which will require disclosure of network management practices that consumers could, the FCC imagines, use in deciding which broadband provider to choose.[102]

Assuming that the transparency rule represents the only significant change required by the new rules, it probably won't add enormous new costs. On the other hand, this is also the rule least likely to deliver much in the way of benefits.

A. The Nature of Enforcement

Unfortunately, the transparency rule is not the only source of new costs associated with the rules. What about the costs to the FCC of enforcing the new regulations, or the costs to broadband Internet access providers to defend against claims that they have violated those regulations? The Report here is eerily silent.

As an initial matter, it's worth noting that the Procedural Rules for enforcing the Order are longer than the rules themselves.[103] They describe three types of actions that may be taken to enforce the rules, and a set of procedures for complaints, discovery, hearings and appeals that in some sense incorporate much of the same protocols that govern actions and appeals in federal district courts and in the courts of appeal.

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98 Report & Order, *supra* note 2, ¶¶ 38-42.

99 *Id.* ¶ 39.

100 http://www.freepress.net/about_us.

101 Alexander Pope, *An Essay on Man, Epistle I*, 1733.

102 Report & Order, *supra* note 2, ¶¶ 39, 43, 53-61.

103 *Id.* at Appendix B, §§ 8.12-8.17.

First, any individual or organization may file an informal complaint through the FCC website without paying any fee.[104] Though such complaints will not automatically lead to agency action, "the Enforcement Bureau will examine trends or patterns in complaints to identify potential targets for investigation and enforcement action."[105]

Second, the agency itself may initiate actions, perhaps based on trends or patterns it notes in the informal complaints.[106]

The third avenue for enforcement, the filing of a formal complaint, is the most worrisome. Under § 8.12 of the Order, "***Any person*** may file a formal complaint alleging a violation of the rules...."[107] A modest filing fee is required.

In his greatest single work, "The Nature of the Firm,"[108] Coase laid out a simple but inescapable theory of why organizations exist in the first place. For Coase, the market in reality is not a magic font of perfect efficiency that theoretical economists assume in their models. Each transaction between a buyer and a seller has inefficiencies or costs associated with it, costs Coase referred to as "transaction costs."

Firms are formed and reach their optimal size solely to avoid or reduce these transaction costs. Businesses exist, in other words, only to the extent that their internal costs are less than the costs of using the market to perform every activity associated with the production and marketing of the firm's products and services.

I have written in all of my books about the importance of transaction costs in understanding how the Internet—which reduces transaction costs—is putting unique pressures on the structure of firms, and there's no need to repeat that discussion here.[109]

But of the six categories of transaction costs Coase described in 1937, the one that seems not to have penetrated the FCC's analysis is what he called "enforcement costs." In the event the terms of a transaction are not met to the satisfaction of buyer or seller or both, various mechanisms—including arbitration, negotiation, regulators and/or the courts—must be invoked to ensure the bargain made is the bargain received.

In many cases these costs can be exorbitant; indeed, far greater than the value of the underlying transaction. To take a trivial example, a rational consumer won't sue the maker of a rubber band that breaks the first time she uses it. The costs—time, effort, and out-of-pocket

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[104] *Id.* ¶ 153.

[105] *Id.* ¶153.

[106] *Id.* ¶ 160.

[107] *Id.* § 8.12 (emphasis added). *See also* ¶¶ 154-159.

[108] R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 16 (New Series), pp. 386-405 (Nov., 1937).

[109] LARRY DOWNES, UNLEASHING THE KILLER APP, *supra* note 1, Chapter 2; LARRY DOWNES, THE STRATEGY MACHINE: BUILDING YOUR BUSINESS ONE IDEA AT A TIME (HarperBusiness 2002), Chapter 3; LARRY DOWNES, THE LAWS OF DISRUPTION, *supra* note 1, Chapter 2.

expenses for lawyers, filing fees, and the like—so obviously exceed the value of the best possible outcome (replacement of the broken item) that no one would bother.

The loss of value from the broken rubber band is a fraction of a penny. The cost of initiating—let along prosecuting—a lawsuit would exceed that price by several orders of magnitude. And, in most situations, the most the consumer could hope to win would be the fraction of a cent. The cost of enforcing the implied promise of a working rubber band—and the seller's cost of defending itself—are lost. They are inefficiencies of the market, or "transaction costs." Even without knowing exactly how much they are, no consumer would undertake them.

At least, that is, not when the consumer has to bear those costs herself.

But what if the consumer can offload nearly all of the enforcement costs on someone else—on the FCC, perhaps, or their broadband Internet access provider? If "any person" who believes something is amiss can file a network neutrality complaint and pay only a small filing fee to start the machinery of enforcement, why not bring a complaint for any perceived infraction, no matter how small or, indeed, illusory?

And that, unfortunately, is exactly the kind of incentive system created by the Order.

The existence of the new Open Internet rules, of course, might operate as a deterrent against the behaviors they prohibit. But it is also likely that the agency will be called upon to enforce the rules against broadband access providers who are accused of violating them. The enforcement costs can be significant—including the costs to the agency itself (that is, to the taxpayers), as well as to the companies accused, rightly or wrongly, of violations.

Bizarrely, the Report makes no mention of the costs of enforcement or their potential impact on the cost-benefit analysis that is dispensed with so quickly. Yet the rules as written are likely to introduce substantial enforcement costs, as evident by looking at the mechanisms for making and resolving complaints.[110]

B. The Danger of a Private Right of Action

In legal terms, the ability of any individual to initiate an enforcement action is known as a private right of action. Federal law grants very few such broadly-written rights. There are, of course, hundreds of millions of American consumers, and giving all of them the right to initiate a formal proceeding that the government and the complained-of party must address can generate enormous costs.

You believe a medication advertised on television has a side-effect on some patient. You suspect the actions of a far-off manufacturer create environmental hazards in another state. Your car pulls to the left when you drive on certain roads. While there are avenues both private and public to bring such concerns to the attention of the potentially-responsible regulators and private parties, there is no private right of action that allows you to file a formal complaint with the federal government—a complaint that must be answered line by line.

[110] Report & Order, *supra* note 2, ¶¶ 151-160.

But that is precisely what the new rules allow. Regardless of the merits or specifics of a complaint, "the defendant must submit an answer." In cases where the "facts" are disputed, "a thorough analysis of the challenged conduct might require further factual development and briefing."[111] Moreover, "the broadband provider must answer each claim with particularity and furnish facts, supported by documentation or affidavit, demonstrating reasonableness of the challenged practice."[112]

In resolving formal complaints, "the Commission will draw on resources from across the agency—including engineering, economic, and legal experts—to resolve open Internet complaints in a timely manner."[113]

These are the general comments in the Report. Specific "pleading requirements" laid out in the Order provide the procedures for filing complaints, answers and replies, conducting discovery, developing and supporting legal arguments, verifying facts and documents submitted, and more.[114]

For example, any broadband provider served with a complaint must respond within 20 days, and must respond to each and every fact referenced in the complaint, supported with documentation including affidavits, legal authority, and other evidence. The Commission "may specify other procedures," including hearings and oral arguments, and "may require the parties to submit any additional information it deems appropriate for a full, fair, and expeditious resolution of the proceedings, including copies of all contracts and documents reflecting arrangements and understandings alleged to violate" the rules.[115]

Again, a party filing a formal complaint can be any person or organization so long as they have a good faith belief that the broadband provider has violated the rules. They need not themselves even be a customer of the broadband provider.

Since the kind of blocking and traffic discrimination the rules prohibit can only be distinguished from "reasonable network management" practices (or indeed, behavior that may appear to involve ISP activity but which may simply be a function of overall network conditions at any given time) by detailed discovery, we can expect a great many complaints to be filed in good faith that will nonetheless turn out not to reveal violations of the rules.

Since consumers aren't likely to know with any certainty that the behaviors they observe are in fact violations of the rules without extensive and technically complicated discovery, in other words, any slow-down, hiccup, temporary outage or other network artifact that appears to suggest interference will constitute a good faith belief that a violation has occurred, and therefore put the broadband provider (and the FCC) to the cost of demonstrating otherwise.

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[111] *Id.* ¶ 156.

[112] *Id.* ¶ 157.

[113] *Id.* ¶ 159.

[114] *Id.* §§ 8.13-8.17.

[115] *Id.*

Is your Internet connection acting up today? Did it take a long time to watch the latest YouTube video? Did you have trouble finding the website you were looking for? Could be that your ISP is blocking or otherwise discriminating against particular content, so perhaps you should submit a formal complaint to the FCC—just in case.

And why *not* do so? All the costs will be borne by others—the provider for the most part and the FCC to a lesser, but still substantial, degree.

C. It's Not Just Money that's Being Wasted

Such an open-ended grant of standing to "any person," whether for good or for evil, cannot be squared with the belief that "the costs associated with the open Internet rules adopted here are likely small."[116] Even if no violation of the rules is ever found—even if no broadband provider ever interferes illegally with the Open Internet in the future—providers and the agency will find themselves buried under mountains of complaints, all of which must be investigated and responded to within 20 days of the filing, no less.

It isn't just money that will be wasted. The process of enforcement could undermine basic Constitutional protections as well. If a complaint alleges that a broadband provider is interfering with traffic—perhaps on an on-going basis—in ways that violate the rules, the FCC will, of necessity, need to analyze large volumes of traffic to determine if a service is being blocked or unreasonably discriminated against. And that means not just looking at traffic patterns but at the contents of the packets themselves.[117]

The FCC, in other words, in the name of enforcement, will be looking at the Internet behavior not only of the person making the complaint but perhaps of many other customers of the same provider or of other providers for comparison.

Economists were clearly absent from discussions about the cost of the rules. But one would have thought at least that civil libertarians, privacy advocates, and others concerned about the expansion of federal law enforcement powers with regard to online content would pause at new rules that, in the name of an open and transparent Internet, give the FCC the ability to observe traffic—to perform deep packet inspection—that in any other context would require a search warrant based on probable cause of a crime.

But no. So far, not a peep.

If not enforcement through the FCC and litigation-like procedures, how else can consumers ensure the Open Internet remains the engine of economic, social and political change that has made it one of the most profound inventions of the last few decades?

Though a detailed answer is outside the scope of this paper, I believe that regulatory supporters and detractors alike both greatly undervalue the ability of online consumers and

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[116] *Id.* ¶ 39.

[117] This is a concern I first raised before the NPRM was even issued. *See* LARRY DOWNES, THE LAWS OF DISRUPTION, *supra* note 1, at Chapter 6.

citizens to take collective action without the need for regulatory proxies in the form of government agencies or self-styled "consumer advocates."

In many cases, consumers can police practices they do not approve of by voting with their wallets. As in other markets, consumers can change to providers whose practices they prefer. Switching costs for broadband Internet access providers are low, and in much of the country there are multiple choices for providers using different technologies. Competition in the mobile broadband market, as the National Broadband Plan indicated, is particularly robust.

Beyond switching providers, consumers in their increasingly active digital lives have other ways of influencing corporate behavior. The Internet's power, as noted earlier, is its ability to reduce transaction costs across the board, making possible new kinds of ad hoc organizations and governance structures that require little in the way of formal constitutions and adjudicatory bodies.

One need only look at how users of social networking products including Facebook, Yelp, Groupon, Twitter, Google Buzz, Second Life and others have used the very tools provided by those services to express their opinions and often exact modifications to terms of service historically dictated by the service provider. Indeed, in many if not all of the examples cited by the majority as cases of dangerous non-neutral behavior, it was consumer objections that usually led to changes to the practices in question long before the FCC's deliberative processes had creaked into gear.

The methods adopted by consumers in these examples may sometimes be crude, but they are effective, and evolving quickly. Self-enforcement by consumers is also much more efficient and cost-effective. If nothing else, the agency should have, but did not, give serious consideration to the likelihood that consumers can solve any future Open Internet problems without the need for federal enforcement, limited by definition to issues within U.S. jurisdiction even when most Internet services are inherently global.[118]

V. "Nostalgia for the Future"—*Which* Internet is Being Preserved?

The idea of the "Open Internet" is relatively simple: consumers of broadband Internet access should have the ability to surf the web as they please and enjoy the content of their choice, without interference by access providers who may have financial or other anti-competitive reasons to shape or limit that access.

In the act of trying to translate that idea into enforceable rules—enforceable, inexplicably, by a federal regulatory agency with no legislative authority over any substantial feature of the Internet economy and no real justification for creating rules of any kind for a system that is working nearly flawlessly so far—the FCC has found itself tied in unholy knots.

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[118] *See* David G. Post & David R. Johnson, *Law and Borders: The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367 (1996).

The rules as enacted carved out exceptions and caveats that, taken together, render the final regulations not meaningless but certainly incoherent.

In exempting from the rules a host of important innovations in network management and infrastructure optimization developed over the last decade, the FCC has stepped back from the brink of its original plan, which would have returned the Internet to the days of unreliable dial-up access and static websites.

But carving out so many exceptions has also revealed the danger of trying to regulate a rapidly-evolving life form, and risked the unintended consequence of denying it future forms of nutrition and good health. If these rules stand and are vigorously enforced, the Internet's further growth and development will surely be stunted.

A. The Mythical Neutrality Principle

Back in the stone age of 1998, I wrote in UNLEASHING THE KILLER APP that one of the fundamental bases on which the Internet became an engine of innovation and even social change was that its basic protocols are non-proprietary.[119] Anyone can make use of them, any device can support them, and every node is a peer—without paying royalties or other tribute to anyone. As the "lowest common denominator" standard, TCP/IP benefited from network effects to overtake several popular proprietary standards, including IBM's SNA and DEC's DECnet.[120]

The technical and legal openness of TCP/IP has been romanticized over the years, particularly by legal scholars and journalists who know less about technology than they think they do, into a view of the Internet as a Platonic ideal, a vehicle for true collaboration and consciousness-raising. The web, on this view, was nothing less than the fruition, as Web 2.0 Summit's Tim O'Reilly put it, "of "what we were talking about at [New Age HQ] Esalen in the '70s—except we didn't know it would be technology-mediated."[121] (The Esalen Institute, situated on California's Big Sur coast, offers visitors or "seminarians" the "intellectual freedom to consider systems of thought and feeling that lie beyond the current constraints of mainstream academia ... ancient wisdom in the motion of the body, poetry in the pulsing of the blood ... [and] the miracle of self-aware consciousness."[122])

The ideal of neutrality—of a level playing field in which every website, application, and device is no more prominent than any other—is a persistent and compelling myth. It evokes the heroism of the entrepreneur in the garage, developing the next Yahoo or Google or YouTube or Facebook or Twitter or Groupon, with little more than a great idea, technical skills, and the willingness to sacrifice sleep and social life for the promise of a future liquidity event—

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[119] Larry Downes, UNLEASHING THE KILLER APP, *supra* note 1.

[120] *Id.*, at Chapter 1.

[121] Steven Levy, *The Trend Spotter*, WIRED 13.10, Oct. 2005, http://www.wired.com/wired/archive/13.10/oreilly.html

[122] Esalen Institute, http://www.esalen.org/ (last accessed Feb. 13, 2011).

optimally, a fortune-making Initial Public Offering—or to change the world and make it a better place by connecting people and information in new and unexpected ways (*e.g.*, Wikipedia.)

Whatever the motivation, after a grueling race against the clock, the app is released. If all goes well, it reaps the benefit of network effects, goes viral, and becomes the next Big Thing—all in the span of time between one South by Southwest conference and the next Web 2.0 Summit.

No large corporation can stop the plucky inventor, or ransom a part of her invention. No access provider can hold its invaluable user base hostage. No competing content provider, no matter how giant, can buy up all the available market channels and freeze out the upstart start-up. No government regulator need approve or license the invention before human testing and general use can begin.

B. When Worlds Collide

A considerably more mundane version of that ideal world *did* exist in the last half of the 1990's. It still exists today. But it has become much more complex and nuanced in the last decade.

The Internet, the Web, the Cloud and the app-based economy of wireless computing devices, TVs and increasingly other things (including cars and other non-traditional computing platforms such as consumer electronics and home appliances—ultimately a trillion items of all shapes and sizes) have evolved in interesting and productive ways, often under the covers of the network infrastructure.

Few consumers know—or would care to know—about the existence, let alone the details, of network optimization algorithms, content delivery networks, complex peering arrangements, caching and edge servers, file torrenting, mirror sites, specialized services, virtual private networks, packet prioritization based on media type, spam and other malware filters, dynamic IP addresses or domain name redirection.

All of these (and more) are mechanisms for speeding up the delivery of the most popular or the most bandwidth intensive content. Many have been developed by entrepreneurs or by the large access and hosting services, often working in concert with the voluntary protocol and technical committees of the Internet Engineering Task Force (IETF), the principle body that maintains the technical standards that are, in fact, the true meaning of "Internet."

The IETF keeps the standards alive, flexible, and responsive to new opportunities for expansion and reinvention made possible through the agency of Moore's Law, which continues to drive the basic technological components of digital life into the uncharted realm of the faster, cheaper, and smaller.

Strictly speaking, of course, all of these innovations violate the neutrality principle. They recognize that some packets, either because of file size or popularity or media characteristics or importance to the recipient, requires special treatment in the transport from host to client via an unknown and unpredictable number of intermediate computers following the Internet protocols.

Video (*e.g.*, YouTube, Hulu, Netflix), for example, can consist of very large files, and the component packets must arrive at their destination with relatively short delays in order to maintain the integrity of high-quality display.

Hosted services, such as medical monitoring, use parts of the same infrastructure as the public Internet, but cannot safely be left to the normal ebb and flow of Internet traffic patterns. Limitations of the 3G wireless infrastructure—in large part a result of regulatory restrictions on cell siting and spectrum mismanagement—make it difficult to satisfy exploding customer demand for ever-more of the most bandwidth-intensive apps.

When all is said and done, the core problem with the FCC's Open Internet Report and Order comes down to a clash of the idealized view of the neutral Internet with the reality of an always-evolving, always-improving technology infrastructure.

Chairman Genachowski, himself a former venture capitalist, is clinging to the myth of the Internet as virtual frontier, an understandable but highly dangerous indulgence in nostalgia, a remembrance of Internets past.[123] He's not alone. The romance of the American west has persisted more than a hundred years since historian Frederick Jackson Turner famously declared the frontier closed.[124]

As Chairman Genachowski said in introducing the Open Internet proceeding in September, 2009, shortly after taking office:

> The Internet's creators didn't want the network architecture—or any single entity—to pick winners and losers. Because it might pick the wrong ones. Instead, the Internet's open architecture pushes decision-making and intelligence to the edge of the network—to end users, to the cloud, to businesses of every size and in every sector of the economy, to creators and speakers across the country and around the globe. In the words of Tim Berners-Lee, the Internet is a 'blank canvas'—allowing anyone to contribute and to innovate without permission.[125]

Many of us fortunate enough to have been there at the moment the Internet reached its tipping point and became an unstoppable force—a kind of network magnetism—share this nostalgia. It was a moment that changed the trajectory of computing, upended giants, and unleashed tremendous creativity. For me, it utterly transformed my career, much as my first FORTRAN course as an undergraduate had unintentionally started it.

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[123] Larry Downes, *FCC's Net Neutrality Ruling: Misplaced Nostalgia*, CNET News.com, Dec. 21, 2010, http://news.cnet.com/8301-1035_3-20026326-94.html.

[124] Frederick Jackson Turner, *The Significance of the Frontier in American History*, address before the American Historical Association, Chicago, 1893.

[125] Federal Communications Commission Chairman Julius Genachowski, *Preserving a Free and Open Internet: A Platform for Innovation, Opportunity, and Prosperity*, Prepared Remarks at Brookings Institution (Sept. 21, 2009), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-293568A1.pdf.

But the majority's passion for alchemizing nostalgia into federal law—assuming, but only for the moment, that the FCC is the appropriate agency to preserve an Internet that has long since passed even if it was ever the way we old-timers remember it—has produced no gold, only more lead. What the agency learned along the way gave the majority every opportunity to see the fool's errand they were on, but that knowledge was heroically explained away. The result are regulations filled with exceptions, exemptions, and exclusions that leave the final Report and Order sadly reminiscent of late efforts to explain the geocentric view of the solar system in the face of unassailable evidence that the Earth actually did revolve around the Sun and not the other way around.

C. The Exceptions that Expose the Rules

The process of explaining away Internet reality began long before the final vote. Even the original Notice of Proposed Rulemaking and draft order released for comment in October, 2009 included many (necessary) exceptions from strict adherence to the neutrality principle.

The proposed rules, most important, limited all six neutrality regulations to an exception for "reasonable network management."[126] Reasonable network management was defined as all "reasonable practices" broadband Internet access providers undertook to, among other things, "reduce or mitigate the effects of congestion on the network or to address quality-of-service concerns."[127] And bowing to legal limits imposed by existing criminal and intellectual property law, reasonable network management did not apply to efforts by broadband access providers to "address unlawful conduct on the Internet," including unlicensed sharing of copyrighted content.[128]

In explaining "reasonable network management,"[129] the FCC acknowledged that the technology by which a user accessed the Internet could play a significant role in determining when a provider could act "inconsistently" with the neutrality principle but still not violate the rules. Access over coaxial cable follows a different architecture—with different constraints—than fiber, copper, satellite, or cellular access. Moreover, for purposes of "quality of service," the agency acknowledged that it might be appropriate for an access provider to implement a "network management practice of prioritizing classes of latency-sensitive traffic," such as VoIP, gaming, and streaming media traffic.[130]

Since the FCC has up until now had little role to play in the regulation of the Internet, it's not surprising that the agency began this process with a highly outdated view of how the Internet "worked." So the NPRM here ***and in eighty other sections,*** sought comment on the current state of the Internet ecosystem, the technologies of broadband access, network management

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[126] NPRM, *supra* note 7, §§ 8.5-8.15.

[127] *Id.* § 8.3.

[128] *Id.* ¶ 139.

[129] *Id.* ¶¶ 135-141.

[130] *Id.* ¶137.

principles in place, and the nature of the broadband access market throughout the U.S.—the latter a subject the agency took up again in the National Broadband Plan.

Not surprisingly, the FCC heard plenty. The final Report lists over 450 sources of comments and replies to the NPRM, many of which addressed themselves to educating the FCC on the technologies it had undertaken to regulate.

As a result of this formal (and no doubt a great deal of informal) feedback, the final rules added numerous additional exceptions, authorizing a wide range of practices that allow providers of broadband Internet access to act "inconsistently"[131] with the neutrality principle but still not be judged to have violated them. I have compiled the following list of exceptions. Taken together, they offer a window into the majority's education on how the Internet has evolved since 1996 and their struggle to rationalize that reality with the pre-determined decision to regulate in the name of "neutrality" no matter what they learned along the way:

1. Exemption from many of the rules for providers of mobile broadband Internet access, including the "no unreasonable discrimination" rule and some of the "no blocking" rule.[132]
2. Explicit exemption from the "no blocking" rule for app stores and other control mechanisms used by mobile broadband providers.[133]
3. A change from a strict "nondiscrimination" rule for wireline providers to a rule prohibiting only "unreasonable discrimination."[134] (See section III for a discussion of the difference between those two formulations.)
4. A limited definition of "broadband Internet access service" that constrains the rules only to providers of "mass market retail service" providing "the capability to transmit data to and receive data from all or substantially all Internet endpoints."[135] That change leaves out a range of relatively new Internet devices and services—including the Amazon Kindle, game consoles, cars, TVs and home appliances—that offer some form of web access incidental to their main purpose in connecting to the network.[136]
5. A broader definition of "reasonable network management," that includes any practice that is "appropriate and tailored to achieving a legitimate network management purpose."[137]

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[131] The term "inconsistently" was used in the NPRM, *Id.* ¶ 136. ("There appear to be several types of situations that could justify a broadband Internet access service provider's acting inconsistently with the six open Internet principles described above.")

[132] Report & Order, *supra* note 2, § 8.5, 8.7.

[133] *Id.* ¶ 102.

[134] *Id.* § 8.7.

[135] *Id.* § 8.11(a).

[136] *Id.* ¶ 47.

[137] *Id.* § 8.11(d) and ¶ 82.

6. Exemption for virtual private networks, which use much of the same infrastructure as the public Internet.[138]
7. Exemption for Content Delivery Networks and co-located servers that put particular content in closer proximity to important network nodes and therefore speed its transmission to requesting users.[139]
8. Exemption for multichannel video programming services (*e.g.*, AT&T's U-verse) that use TCP/IP protocols and existing Internet infrastructure to deliver television programming to customers.[140]
9. Exemption for Internet backbone services.[141]
10. Exemption for hosting or data storage services.[142]
11. Exemptions for "coffee shops, bookstores, airlines and other entities when they acquire Internet service from a broadband provider to enable their patrons to access the Internet from their establishments."[143]
12. Exemption from the discrimination rule for "existing arrangements for network interconnection, including existing peering arrangements."[144]
13. Exemption (for now) for "specialized services," including multichannel video programming (see above) or facilities-based VoIP (*e.g.*, Comcast Digital Voice), that "share capacity with broadband Internet access services over providers' last-mile facilities."[145]
14. A hedge on whether "paid priority" of some content, either that of the access provider or a third party, would necessarily violate the "unreasonable discrimination" rule and an explicit rejection of the argument that CDNs constitute illegal "pay for priority" though they have the same effect on consumer experience as prohibited prioritization schemes.[146]
15. Recognition that end-users may elect to subscribe to Internet access that limits their choice of content, including services that support parental controls or which "allow end users to choose a service that provides access to the Internet but not to pornographic websites."[147] Further, "[b]roadband providers are also free under this Order to offer a

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[138] *Id.* ¶ 47.

[139] *Id.* ¶ 47 and ¶76 n. 235.

[140] *Id.* ¶ 47.

[141] *Id.*

[142] *Id.*

[143] *Id.* ¶ 52.

[144] *Id.* ¶ 67 n. 209. Note that this exception probably means the public fight between Comcast and Level 3 over their secret peering agreements probably does not violate the rules. *See* Marguerite Reardon and Elinor Mills, *Level 3 Takes Spat with Comcast Public*, CNET News.com, Nov. 29, 2010, http://news.cnet.com/8301-1023_3-20024070-93.html.

[145] Report & Order, *supra* note 2, ¶¶ 112-114.

[146] *Id.* ¶¶ 76-77.

[147] *Id.* ¶ 89.

wide range of 'edited' services," including a "service limited to 'family friendly' materials."[148]

16. Recognition that existing federal law allows all Internet Service Providers to "restrict access to or availability of material that the provider or user considers to be obscene, lewd, lascivious, filthy, excessively violent, harassing, or otherwise objectionable."[149]

D. Finding the Forest Amid the Exemptions

These exceptions, particularly the measured approach to mobile broadband access and the provisional reprieve for specialized services, generated howls of indignation from advocacy groups hoping for "pure" neutrality, and led many of the Chairman's initial supporters to abandon him over the course of the year the NPRM was publicly and privately debated.[150]

My concern is quite different. I think each of these exceptions makes good sense, and will keep the new rules, at least in the short-term, from causing life-threatening damage to the Internet ecosystem. Rather, what the laundry list of exceptions demonstrates is that the majority just isn't seeing the forest for the trees: ***What the exceptions have in common is that each of them represents a change to the Internet's architecture and service models that have evolved over the last decade and a half.*** They are new services, technologies, or service providers who, in these and other ways, act "inconsistently" with the neutrality principle but who nonetheless are providing crucial and valuable benefits to consumers.

These innovations have been developed for beneficial and not evil purposes. The network today is better in every sense imaginable largely because of these innovations. It will continue to improve in speed, efficiency, and usability so long as future innovations don't run afoul of the rules and their enforcement. The Internet is not "open" in the way it may have been in 1996 (and it was never as open as the idealists imagine). But in order for the Internet we have today—faster, cheaper, better—to exist, each of these changes had to be made.

The genius of a virtual infrastructure is that it can absorb redesign without any interruption in service. One generally positive but here unfortunate side-effect of that ease of transformation is that users don't see the construction cones and highway workers. Consumers—and the FCC—don't realize that we're now traveling on a multi-lane highway rather than the old dirt road. The technology is utterly changed, and the rules of the road have changed with it. For better or worse, but largely for the better.

The final rules, with all their exceptions, suggest a majority clinging to the idealized past, and a stubborn refusal in the end to admit that the Internet has evolved and continues to evolve—that it needs to change.

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[148] *Id.* ¶ 143, but cf. ¶ 141.

[149] *Id.* ¶ 89 n. 279.

[150] Sara Jerome, *FCC Chairman Told to Put on 'Man Pants'*, THE HILL, Oct. 27, 2010, http://thehill.com/blogs/hillicon-valley/technology/126133-fcc-chairman-told-to-put-on-man-pants; Timothy Karr, *Obama FCC Caves on Net Neutrality—Tuesday Betrayal Assured*, The Huffington Post, Dec. 20, 2010, http://www.huffingtonpost.com/timothy-karr/obama-fcc-caves-on-net-ne_b_799435.html.

The exceptions, for example, for the "inconsistent" and non-neutral effects of CDNs, specialized services, peering arrangements, e-readers and game consoles, and app stores have no logical rationale, other than that the FCC has now learned that they are part of the current status quo. They are being exempted simply because they are in place, and they work.

For example, paying a CDN to replicate your content and co-locate servers at key network access points is surely "paying for priority." The cached content will arrive faster when requested by a consumer than similar or even competing content that does not subscribe to a CDN. It puts a start-up without the funds for similar services at a competitive disadvantage. But for consumers, that feature is a good thing—an improvement—even though it is not "neutral."[151] It ensures the most popular and therefore most frequently accessed content is not slowed down by its popularity.

Likewise, the mobile Internet is given special treatment because it is "evolving rapidly."[152] But the fixed Internet is evolving rapidly as well, as many of these exemptions implicitly recognize.

The majority is fixated on maintaining an Open Internet even though it now understands that neutrality is a virtue more honored in the breach. The final report uses the word "traditionally" 25 times, the word "historically" nine times, and the word "typically" 21 times. These are the only justifications for the exceptions, and they undermine the purpose of the rules that remain. There is no neutral Internet to preserve. There's only one that works.

The reality is that we're moving away from websites to the mobile, app-based economy, specialized services and high-bandwidth applications such as video that shouldn't be treated the same. A "level playing field" doesn't mean everyone gets a trophy.

The good news is that the final rules grandfather-in many existing technologies that are "inconsistent" with the neutrality principle. That's essential, even if each of the exceptions is granted in isolation and begrudgingly at that.

But the bad news is that the Open Internet regulations as approved allow little flexibility for future innovations in network optimization. The FCC sees ominous clouds of non-neutral and therefore prohibited behavior on the network horizon, ignoring that tomorrow's violations are only as dangerous as the "traditions" that have been established up until this random moment in Internet time. The vote comes at a politically significant moment, but not a time that has any particular meaning for network engineering. The new rules, in the worst case, may arbitrarily freeze today's particular status quo, for no good (and lots of bad) reasons.

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[151] Report & Order, *supra* note 2, ¶ 76 n. 235. The majority justifies the exemption for CDNs on the basis that "Unlike broadband providers, third-party CDN providers do not control the last-mile connection to the end user." So are non-neutral network management practices allowed only if they are offered by third parties? Does that mean that a broadband Internet access provider cannot develop or acquire a CDN company without violating the new rules?

[152] *Id.* ¶ 8.

Nostalgia can be fun. I enjoy sitting around with my fellow veterans of the pre-bubble dot com boom talking about the good old days, toasting to our irrational exuberance. But translating that wistfulness into federal law, even as here with rules pockmarked by the blemishes of a reality that looks far different than our idealized view of the past, is a dangerous way to celebrate it.

VI. "Badges? We Don't Need No Stinking Badges!"[153]

The FCC has built its new broadband Internet access regulations on a legal foundation of jurisdictional quicksand. I discuss that problem only briefly here because the extended legal analysis already been admirably detailed by FCC Commissioner Robert McDowell. His dissent calmly, systematically and completely dismantles the legal case made by the majority.[154]

This is no theoretical discussion of statutory interpretation. Even before the rules have been published in the Federal Register, two broadband providers—Verizon and then MetroPCS—filed lawsuits in the D.C. Circuit Court of Appeals challenging the FCC's authority to regulate.[155] The arguments sketched out in Commissioner McDowell's dissent are likely to mirror the complainants' briefs in these and likely other Petitions for Review of the Order.

A. The Need for Authorization

Nate Anderson of Ars Technica asks the key question, "Why is Verizon suing over net neutrality rules it once supported?"[156]

I wouldn't and didn't go as far as Anderson, who concludes that Verizon, "on substance ... got exactly what it wanted." As I noted above, both the final rules and the Verizon-Google proposal closely tracked, with important differences, the original order the FCC proposed in October, 2009. But there are material differences between what Verizon-Google proposed and what the FCC ultimately voted on, notably in the treatment of mobile broadband—a subject of particular concern to Verizon.

Those details aside, there is one crucial difference that Anderson acknowledges. As he writes, "the Verizon/Google proposal did make one other suggestion: it should be passed by Congress, not the FCC ...."[157]

That might seem like a small enough difference. Rules are rules, what difference if the FCC passed them under its rulemaking authority or if Congress had put them into a new statute,

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[153] The Treasure of the Sierra Madre (Warner Brothers 1948). *See* http://en.wikipedia.org/wiki/Stinking_badges.

[154] Report & Order, *supra* note 2, ¶¶ 115-150.

[155] On Verizon's effort to secure exclusive jurisdiction for the D.C. Circuit, *See* James DeLong, *Which Court Gets to Hear the Net Neutrality Appeal?,* Digital Society, Jan. 21, 2011, http://www.digitalsociety.org/2011/01/which-court-gets-to-hear-the-net-neutrality-appeal/; Larry Downes, *Verizon Loses Early Skirmish in Net Neutrality Litigation*, CNET News.com, Feb. 3, 2011, http://news.cnet.com/8301-13578_3-20030479-38.html.

[156] Anderson, *Why is Verizon Suing over Rules it once Supported?*, *supra* note 51.

[157] *Id.*

such as the Internet Freedom Preservation Act, which would have given the FCC authority to enforce them anyway?[158]

But in fact, that procedural difference embodies the principal and most principled objection not only to the Report and Order but to the process by which it was completed. Put simply: Congress alone has the power to regulate; the FCC can only act on authority delegated to it by Congress. Any rulemaking undertaken without authority is not only dangerous, also it is unconstitutional.

And Congress, it's clear, has not delegated authority to the FCC to regulate broadband Internet access. What most worries Verizon and others—including net neutrality-sympathizers like the Electronic Frontier Foundation[159]—is that if the FCC gets away with passing new rules anyway, the agency will have established a dangerous precedent. Any time in the future that the FCC or any other federal regulatory agency wants to extend its power, it need only deputize itself.

That is the feature of the Open Internet Report and Order that has most alarmed the communications industry, members of Congress, and advocates of limited government. And that is principally why several leading members of Congress have promised to reverse the ruling, even as Verizon and others challenge it in court.[160] In short, the substance of the rules aside, it very much matters that the FCC, and not Congress, took up elements of the framework proposed by Verizon and Google.

B. Regulatory Overreach Is Not a New Problem

The problem of regulatory overreach goes far beyond net neutrality. Under a novel and somewhat fragile arrangement that was worked out during the New Deal, independent federal regulatory agencies can exercise considerable authority that the Constitution, on its face, reserves to the Legislative and Judicial branches. Indeed, the early New Deal Supreme Court overturned much of FDR's regulatory agenda under the so-called "nondelegation doctrine."

After FDR threatened to "pack the court" with more sympathetic Justices, a key swing Justice changed sides,[161] saving the Court and the New Deal. (The so-called "switch in time that saved nine," which few people realize is a pun on the sewing parable of a "stitch in time saves nine.")

But even so, federal regulators operate under strict controls that ensure they stay close to their implementing statutes, lest their authority become untethered. FCC Commissioners are appointed by the President and confirmed by the Senate, and can only be removed from office

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158 Internet Freedom Preservation Act of 2009, H.R. 3458, July 31, 2009.

159 *See, e.g.*, Fred von Lohmann, *Net Neutrality: FCC Trojan Horse Redux*, EFF Deeplinks Blog, May 3, 2010, http://www.eff.org/deeplinks/2010/05/net-neutrality-fcc-trojan-horse-redux; and Corynne McSherry, Is Net Neutrality a FCC Trojan Horse?, EFF Deeplinks Blog, Oct. 21, 2009, http://www.eff.org/deeplinks/2009/09/net-neutrality-fcc-perils-and-promise.

160 Larry Downes, *Tech Priorities for New Congress: From Old to New*, *supra* note 19.

161 West Coast Hotel v. Parrish, 300 U.S. 379 (1937).

by impeachment. At least two of the five Commissioners must be members of a party different from the President's.[162]

Both the rulemaking (legislative) and adjudicatory (judicial) powers of the agency are strictly limited by implementing statutes passed by Congress. If the agency isn't given explicit powers to regulate, regardless of the appearance or reality of significant market failures, only Congress can delegate additional powers. And the courts, in the checks-and-balance system, are the final determinants of what powers have and have not been granted to an agency.

So the FCC has a problem. It wants to regulate broadband Internet providers to ensure the "level playing field" it believes essential to the success of the Internet. But Congress has never given them authority to do so, and has failed since 2004 to pass new legislation that would grant additional authority.

The FCC actually lost ground during the rulemaking process. The rulemaking was, in some sense, an effort to formalize earlier policy statements, whose authority had not been challenged. But an effort to enforce the 2005 Open Internet policy statement through adjudication against Comcast was reversed by the D.C. Circuit in April, 2010, on the grounds that Congress had not authorized the FCC to regulate broadband Internet access.[163] As the NPRM had based its authority on the identical legal theory used in the *Comcast* case, the agency found itself with little wiggle room to complete the rulemaking it began in October 2009.

What's the problem? Briefly: Under the Communications Act of 1996, and consistent with earlier versions of the FCC's implementing statute, the agency was given broad authority over common carrier telephone service (Title II of the Act) but almost no authority over information services or what used to be known as "enhanced" or "ancillary services" (pre-Internet access, these included call waiting and other supplements to telephone service) (Title I of the Act). The one exception was Internet access provided by dial-up modems, which is no longer a significant source of access.

The *Comcast* case, in line with several earlier D.C. Circuit and Supreme Court cases, made clear that Congress did not delegate authority over broadband access under Title I.

There was nothing new in that. The FCC has made numerous efforts to attach otherwise unauthorized regulations to Title I's so-called "ancillary jurisdiction," but the courts frequently reject these efforts as overreaching.

For example, in 2005 the D.C. Circuit rejected regulations the FCC approved that would have required consumer products manufacturers to include "broadcast flag" technology in any device capable of receiving a television signal.[164] The new regulations were grounded in the

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[162] FCC, About the FCC, http://www.fcc.gov/aboutus.html (last accessed Feb. 13, 2011).

[163] *Comcast v. FCC*, 600 F.3d 642.

[164] American Library Association v. FCC, 406 F.3d 689 (D.C. Cir. 2005).

agency's ancillary jurisdiction over television broadcasters. But while the agency had unquestioned authority over broadcasters, they could not require non-broadcasters to comply with rules aimed at helping the broadcasters control unauthorized home taping.

At oral argument, the judges nearly laughed the FCC out of court. "You're out there in the whole world, regulating. Are washing machines next?" asked Judge Harry Edwards. Judge David Sentelle added, "You can't regulate washing machines. You can't rule the world."[165]

The result in the *Comcast* case was much the same. And the October, 2009 NPRM had grounded its authority to proceed solely with Title I. With that avenue all but foreclosed to the agency by *Comcast*, the Chairman found himself in one of several lonely corners he inhabited for much of 2010. Congress was unlikely to move on any of the net neutrality bills floating around committees (and indeed, did not do so), but Chairman Genachowski was committed to the rulemaking.

C. The FCC's "Very Smart Lawyers" Try Again

What to do? One option was to undertake a "reclassification" of broadband Internet to categorize it as a telephone service subject to Title II, a section of the law that comes with fifty-plus years of baggage from the regulation of the former telephone monopoly. The Commission has (for now) wisely avoided taking that step, which itself would have been subject to substantial legal challenges.[166]

The authority stalemate seemed to doom the net neutrality proceeding. But then, in late fall, FCC Chairman Julius Genachowski told the audience at the Web 2.0 Summit that the FCC's "very smart lawyers" had figured out a way to get around the Title I/Title II problem. The net neutrality faithful and faithless waited, holding their collective breath.

In the final Report and Order, however, all we really get is a rerun of the argument that had failed in the *Comcast* case, with only minor tweaking. Again, Commissioner McDowell's detailed dissent explains the weakness of the argument without the need for much added commentary.

The courts have consistently told the FCC that to invoke ancillary jurisdiction, a rulemaking must be reasonably related to a specific delegated power elsewhere in the Communications Act. It has to be "ancillary" to some other authority the Commission already has, in other words. Title I gives no powers on its own over "information services." In the *Comcast* case, the FCC listed off several provisions in hopes that at least one of them would stick, but the court rejected all of them.

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[165] Declan McCullagh, *Court Questions FCC's Broadcast Flag Rules*, CNET News.com, Feb. 22, 2005, http://news.cnet.com/Court-questions-FCCs-broadcast-flag-rules/2100-1030_3-5585533.html.

[166] The majority refused requests to close the Title II docket, however. *See* Report & Order, *supra* note 2, at 182 n. 7 (Baker, Comm., dissenting).

In the Order, the FCC tries several new provisions.[167] Obviously the best bets were already exhausted in the *Comcost* case; the majority here poses even more attenuated provisions for ancillary authority over broadband Internet than the laundry list rejected in *Comcast*. Most get only perfunctory explanation. The FCC knows it is on thin ice.

Instead, the Order relies principally on a new and unconvincing reading of Section 706 of the Communications Act.[168] Section 706 had formed the leading argument in *Comcast* as well, but there the agency argued that Section 706 was the provision that gave it ancillary authority over a Title I Information Service such as broadband Internet access. The court rejected that argument.[169]

The revised Section 706 argument argues that that provision in and of itself provides independent authority for the FCC to implement the Open Internet rules. In relevant part, Section 706 reads:

> SEC. 706. ADVANCED TELECOMMUNICATIONS INCENTIVES.
>
> (a) IN GENERAL-The Commission and each State commission with regulatory jurisdiction over telecommunications services shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans (including, in particular, elementary and secondary schools and classrooms) by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.
>
> (b) INQUIRY-The Commission shall, within 30 months after the date of enactment of this Act, and regularly thereafter, initiate a notice of inquiry concerning the availability of advanced telecommunications capability to all Americans (including, in particular, elementary and secondary schools and classrooms) and shall complete the inquiry within 180 days after its initiation. In the inquiry, the Commission shall determine whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion. If the Commission's determination is negative, it shall take immediate action to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market.
>
> (c) DEFINITIONS- For purposes of this subsection:

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[167] *Id.* ¶¶ 124-137.

[168] *See Id.* ¶¶ 117-123.

[169] *Comcast*, 600 F.3d at 658-59.

> (1) ADVANCED TELECOMMUNICATIONS CAPABILITY- The term `advanced telecommunications capability' is defined, without regard to any transmission media or technology, as high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology.[170]

On its face, neither 706(a) nor 706(b) appears to give the FCC power to put regulatory constraints of any kind on how broadband Internet access providers operate. Indeed, the goal of this section is to encourage the FCC to promote broadband adoption by "regulating methods that remove barriers to infrastructure investment," including forbearance from use of its existing powers. The history of this provision, as Commissioner McDowell explains, was aimed at ***removing regulations*** of Title II telephone carriers that hindered their ability to provide advanced telecommunications capability.[171]

The reliance on Section 706(b) is even stranger, and deeply cynical. It requires the FCC to issue a regular report on broadband deployment and, if it finds such deployment is not taking place in a "reasonable and timely manner," to take "immediate action to accelerate deployment" by "removing barriers" to investment.

Again, as Commissioner McDowell notes, the 706(b) Reports have consistently found broadband deployment to be proceeding at a rapid pace, confirming what everyone already knows. Americans are signing on to the Internet faster than any previous information technology, whether through wireline or, increasingly, wireless broadband.[172]

That is, until July, 2010, a few short months after the *Comcast* decision. For the first time ever, the 706(b) Report found that "broadband deployment to *all* Americans is not reasonable and timely."[173] (The Report, along with the Open Internet Order, was approved on a party-line 3-2 vote of the Commission.) This despite the fact that broadband availability grew from 15% of Americans in 2003 to 95% in 2010.[174]

The negative 706(b) Report was clearly a pretext to give the agency the ability to trigger the "immediate action" language of the 706(b), but even then, the action the FCC is supposed to take is in the nature of deregulating broadband, not adding additional regulations. How will rules that limit the operational flexibility of broadband providers "accelerate deployment"?

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[170] 47 U.S.C. § 706 (1996).

[171] Report & Order, *supra* note 2, at pp. 189-192 (McDowell, Comm., dissenting).

[172] *Id.*

[173] Federal Communications Commission, *Sixth Broadband Deployment Report*, FCC 10-129, ¶2, July 16, 2010, http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-129A1.pdf.

[174] *Id.* fn. 81. National Broadband Plan, *supra* note 36 at 20. See also Report & Order, *supra* note 2 at p. 147 (McDowell, Comm., dissenting).

The majority argues simply that "Section 706(b) provides express authority for the pro-investment, pro-competition rues we adopt today."[175] Hardly!

The effort to tether the Open Internet rules to Section 706 is, charitably, flimsy at best. But there's yet another problem. The FCC itself has already foreclosed that interpretation. The agency has long rejected the view it now adopts that Section 706 provides any explicit authority for rulemaking, whether on its own (the new argument) or as a hook for ancillary jurisdiction under Title I.

As the D.C. Circuit noted in the *Comcast* case, "In an earlier, still-binding order, the Commission ruled that section 706 'does not constitute an independent grant of authority.' Instead, the Commission explained, section 706 'directs the Commission to use the authority granted in other provisions ... to encourage the deployment of advanced services.'"[176] So Section 706 doesn't give the agency any regulatory authority, just guidance on how to apply (or not) other provisions in the Act. That, at least, has long been the FCC's own view of the law, a view courts will give considerable deference.

In dispensing with the Section 706 argument in Comcast, the court concluded that "Because the Commission has never questioned, let alone overruled, that understanding of section 706, and because agencies 'may not ... depart from a prior policy *sub silentio*,' the Commission remains bound by its earlier conclusion that section 706 grants no regulatory authority."[177]

That last sentence seemed to leave the door open just a crack for the FCC to "depart from its prior policy" in an explicit way. And, it's possible to read the Report and Order as doing just that.[178]

But not so fast. While agencies have broad discretion to overrule earlier decisions, there must be some rational basis for doing so. There must be some changed circumstances, some evidence, some explanation that passes the sniff test. A reviewing court will at least look to see if there is some external data that justifies the majority's reversal of the agency's prior interpretation of Section 706.

And there's nothing here that meets even that minimal standard. Again, to quote Commissioner McDowell, "This move is arbitrary and capricious and is not supported by the evidence in the record or a change of law."[179] The only thing that changed, in fact, is that the agency lost the *Comcast* case. That's not reason enough, but that seems to be all that justifies this surprising new understanding of a 15 year-old provision in the FCC's implementing statute.

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[175] Report & Order, *supra* note 2, ¶ 123.

[176] Comcast, 600 F.3d at 658.

[177] *Id.* (citations omitted)

[178] *See* Report & Order, *supra* note 2, ¶ 122 for an unintentionally hilarious explanation for why the agency had never before noticed that Section 706 granted explicit authority.

[179] *Id.* at 148 (McDowell, Comm., dissenting).

D. Preserving *Which* Internet, Again?

The rest of the FCC's "Authority" section, as noted, throws in what's left of the kitchen sink, largely provisions of Title II that *Comcast* didn't already dispose of. The connection between the Open Internet rules and the Commission's regulatory powers over telephone service, television and radio broadcasting, cable TV and spectrum management are just too tenuous to be convincing to a reviewing court. If that authority is close enough to support net neutrality, it's close enough to support anything, including, for example, the broadcast flag rules already overturned.

The majority's straining to find authority exposes more than just the clear intent of Congress not to provide any. Trying the net neutrality rules to problems of VoIP, IP-based television broadcasting, IP radio, and other video and audio services proves too much. It actually undermines the FCC's position by bringing into sharp focus the reality behind the agency's fundamental problem here.

Since Congress last updated the agency's authority in 1996, a revolution has utterly transformed the industries the FCC deals with. The Internet's packet-switching protocols have quickly and unexpectedly taken over as the super-dominant technology for all forms of communications, traditional and new. The world of television, radio, and computing have changed and converged, leaving little left of the world the 1996 Act authorized the FCC to regulate. Even the "Internet" as we knew it in 1996 looks nothing like the thriving ecosystem of digital life that we enjoy today.

Which brings us squarely back to the problem of "nostalgia." The FCC is operating under a statute that has its origins in the 1930s, and which was lasted updated (fitfully) fifteen years ago. Congress then had telephone regulations very much on their minds, not the nascent consumer Internet. In 1996, the communications, computing and entertainment industries operated in silos with little overlap. Each had its own established leaders and long histories of regulatory intervention.

These and other related industries have undergone nearly complete transformation in the intervening years, largely outside the notice of the FCC or its authority to intervene. Device and content convergence is a reality. Consumers now use far more computing resources than do businesses. Telephone providers offer television and Internet, cable companies offer voice. The Internet giants of 1996 are nearly all gone.

Those aspects of the industry still under strict FCC control—including Plain Old Telephone Service (POTS) and over-the-air television and radio—have gone into deep decline. They've become a legacy business that owners can't even exit from, because there's no one interested in the dwindling assets.[180]

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[180] Larry Downes, *Spectrum Worries at CES: Déjà vu all Over Again*, CNET News.com, Jan 8, 2011, http://news.cnet.com/8301-1035_3-20027902-94.html.

That's no coincidence. Those businesses (in some cases parts of companies whose unregulated operations are thriving), thanks to the regulatory environment in which they operate, are simply unable to respond quickly to rapidly emerging new technologies, applications, and consumer demands. They suffer from a regulatory disease closely related to what Harvard's Clayton Christensen famously termed the Innovator's Dilemma: They can't adapt, even if they had the will to do so.[181]

Continued efforts, including this one, to fit square regulations into round statutory pegs underscores not only the lack of FCC authority over what has evolved to be our new and magical communications platform but also the agency's continued and unintentional effort to demonstrate its own obsolescence.[182]

At the same time, the majority's incantations of outmoded, obsolete, and inapplicable provisions of the old communications law reminds the rest of us just how much progress has been made during the period when the FCC has been unable or unwilling to interfere in the evolution of the Internet platform.

That's probably not the conclusion the FCC was hoping to have drawn from a year of genuinely hard labor and a nearly 200-page Report. But there you have it.

[181] CLAYTON M. CHRISTENSEN, THE INNOVATOR'S DILEMMA, (Harvard Business School Press 1997).

[182] *See, e.g., FCC v. Fox Television Stations*, 129 S.Ct. 1800 (2009).

Mr. GOODLATTE. Mr. Glass, welcome.

TESTIMONY OF LAURENCE BRETT ("BRETT") GLASS, OWNER AND FOUNDER, LARIAT

Mr. GLASS. Thank you, Chairman Goodlatte, Ranking Member Chu, Members of the Committee, thank you very much for inviting me to testify. It's a great honor for me to be the first of my relatively young industry to speak before Congress.

To stay as close as I can to my allotted time, I would like to offer you an abridged version of my prepared testimony, which I hope you will enter into the record in full.

First, some background. I'm an electrical engineer. I received my bachelor's of science from the Case Institute of Technology in 1981 and my master's at Stanford in 1985. I have designed computer chips, written popular computer software, and penned more than 2,500 published articles. In the early 1990's, I moved from Palo Alto, California, to the beautiful small college town of Laramie, Wyoming.

Laramie is roughly the size of Stanton, Virginia. When I arrived, I discovered there was no ready access to the Internet outside of the University of Wyoming campus, so I founded LARIAT, the world's first fixed Wireless Internet Service Provider, or WISP. LARIAT began as a nonprofit cooperative whose purpose was to teach, promote, and facilitate the use of the Internet.

Fast forward 11 years to 2003, the Internet was well established and the membership decided they no longer wanted to be members of a co-op, they simply wanted to buy good Internet service from a responsible local provider. So the board prevailed upon me and my wife, who had served as caretakers of the network, to take it private.

We did, and we've been running LARIAT as a small, independent Internet service provider ever since. We have very slim margins. Our net profit is less than $5 per customer per month, but we're not doing it to get rich, we're doing it because we love to do it and want to help our community.

We at LARIAT have always been the strongest possible advocates for consumer choice, of free speech, and of inexpensive, high-quality Internet access. It's our mission and it's our passion. And while I now have more help, I still climb rooftops and towers to install Internet with my own hands, to train my employees, and to check the quality of every job.

Now, since LARIAT has started, the cable and telephone companies have also gotten into the broadband business. We compete gamely with them within the city limits, but our services, unlike theirs, extend far into the countryside. Other WISPs were started and set up shop in our town, forcing us to compete harder and innovate more. We estimate that there are now between 4,000 and 5,000 WISPs, as shown on the map in the written version of my testimony. WISPs now serve more than 2 million people and reach approximately 70 percent of all U.S. homes and businesses, including many with no access to DSL or cable. We create local, high-tech jobs and we stimulate the development of other businesses. We can cost effectively serve areas where there is no business case for any other form of terrestrial broadband.

We also provide vigorous competition where other kinds of broadband do exist. For example, a WISP called D.C. Access serves homes and businesses here on Capitol Hill. It even provides the free Wi-Fi on the Supreme Court steps. Unfortunately, I'mhere to tell you today that the network neutrality rules enacted by the FCC will put WISPs' efforts to provide competitive broadband and to deploy to rural and urban areas who do not have access or competition at risk.

Firstly, the rules address prospective harms rather than any actual problem. Contrary to what advocates of regulation say, ISPs have never censored legal, third-party Internet content. Secondly, even before the rules were issued, the Commission's notice of proposed rulemaking created uncertainty which drove away investors. The final rules are vague, permitting reasonable network management, but not fully defining what the word "reasonable" means. As Commissioner Robert McDowell pointed out in his well-written dissent, this lays the groundwork for protracted, expensive, legal wrangling that no small business can afford.

The rules also allow anyone, whether or not he or she has service from a particular provider, to file a formal complaint alleging violations. Even, now before the rules have taken effect, groups here in D.C. have filed complaints against MetroPCS for offering a great, affordable Smart phone service plan which prohibits a few bandwidth-hogging activities. My own company could suffer a similar fate. Our most popular residential service plan comes with a minor restriction; it does not allow the operation of servers.

Now, Mr. Chairman, most Internet users would not know what a server was if it bit them, and they have no problem uploading content to a Web site such as YouTube for distribution. This means customers that do need to operate a server could obtain that capability by paying a bit more to cover the additional cost. But if the FCC decides against MetroPCS, we will almost certainly be forced to shift everyone to the more expensive plan. We will therefore be less competitive, offer less value to consumers, and especially less value to economically disadvantaged ones.

We will also hesitate to roll out innovative services for fear that the Commission could find fault with some aspect of them. For example, selling priority delivery of data, even for a new high-tech service such as Telepresence, is strongly disfavored by the rules. This is like telling UPS or FedEx that they cannot offer shippers overnight delivery because it's somehow unfair to those who use ground service.

Now in my FCC filings, I urged the Commission to promote competition rather than requiring us to ask permission to innovate, but the majority rejected this approach in favor of onerous regulations which address a problem that does not exist.

I therefore urge Congress—which is the ultimate source of the FCC's authority—to set things right. Rather than the excessive regulation which would extinguish small competitors like WISP and create a duopoly that did require constant oversight, we should facilitate competition, crack down on anticompetitive tactics, and then allow markets to do the rest. Only by adopting this approach can we allow American small businesses to create jobs, innovate, and prosper while solving a very real problem, providing ubiquitous broadband access to our Nation.

Thank you.

Mr. GOODLATTE. Thank you, Mr. Glass.

[The prepared statement of Mr. Glass follows:]

PREPARED TESTIMONY OF LAURENCE BRETT ("BRETT") GLASS
OWNER AND FOUNDER, LARIAT
A WIRELESS INTERNET SERVICE PROVIDER SERVING
ALBANY COUNTY, WYOMING

HEARING ON:
"ENSURING COMPETITION ON THE INTERNET;
NET NEUTRALITY AND ANTITRUST"

BEFORE THE COMMITTEE ON THE JUDICIARY,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET

Tuesday, 15 February 2011
2141 Rayburn House Office Building

Chairman Goodlatte, Ranking Member Watt, and Members of the Committee:

Thank you very much for inviting me to testify. It is a great honor for me to be the first of my relatively young industry to testify before Congress. I hope that there will be many more opportunities for myself and my colleagues to communicate with our nation's decision makers regarding Internet policy.

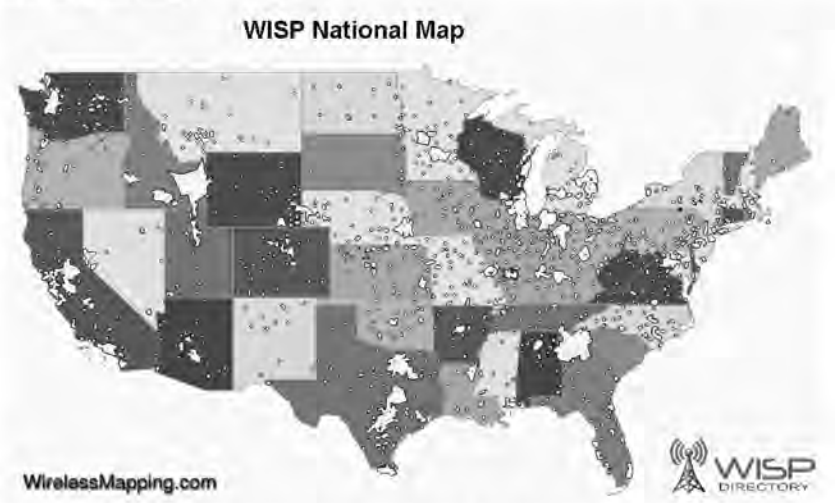
First, some background. I am an Electrical Engineer. I received my Bachelor of Science from the Case Institute of Technology in 1981 and my Master's from Stanford in 1985. While at Stanford, I worked on fixing bugs in the brand new network called the Internet, and also on digital radio technology which laid the groundwork for Wi-Fi. I have designed computer chips, written popular computer software, and penned more than 2,500 published articles for technology-oriented magazines such as BYTE, InfoWorld and PC World.

In the early 1990s, I moved from Palo Alto, California to the beautiful, small college town of Laramie, Wyoming. Laramie is roughly the same size as Staunton, Virginia, though it is more isolated. When I arrived, I discovered that there was no ready access to the Internet outside of the University campus. Working with others who also wanted access, I founded LARIAT, the world's first fixed wireless Internet service provider, or WISP. LARIAT began as a nonprofit cooperative whose purpose was to teach, promote, and facilitate the use of the Internet.

Fast forward 11 years, to 2003. The Internet was well established, and the membership decided that they no longer wanted to be members of a co-op. They simply wanted to buy good Internet service from a responsible local provider. So, the Board prevailed upon me and my wife – who had served as caretakers of the network and had built most of the equipment with our own hands – to take it private. We did, and we've been running LARIAT as a small, independent ISP ever since. After all these years, our passion for bringing people fast, affordable Internet service hasn't changed. Nothing can beat the sense of achievement we feel when we hook up a rural customer who couldn't get broadband before – or when we connect a customer who has decided to "cut the cord" to the telephone company or cable company. We have very slim margins; our net profit is less than $5 per customer per month. But we're not doing this to get rich. We're doing this because we love to do it and want to help our community. We at LARIAT have always been the strongest possible advocates of consumer choice, of free speech, and of inexpensive, high quality access to the Internet. It's our mission and it's our

passion. And while I now have more help, I still climb rooftops and towers to install Internet with my own hands, to train employees, and to check the quality of every job.

Now, since LARIAT started, the incumbent telephone and cable companies have also gotten into the broadband business. We compete gamely with them within the city limits, but our services, unlike theirs, extend far into the countryside. As we grew, others saw what we'd done or independently came up with the same idea. Some even set up shop in our town, forcing us to compete harder and innovate more. We estimate that there are now between 4,000 and 5,000 independent wireless ISPs like ours, as shown on this map:



The map, compiled by wireless consultant Brian Webster, understates WISPs' coverage. It shows the service areas of only about 40% of all WISPs, and it's about a year old; our industry has expanded dramatically since that time. WISPs now serve more than 2 million people and reach approximately 70% of all US homes and businesses, including many with no access to DSL or cable. We create local high tech jobs, and we stimulate the development of other businesses in our communities. Because WISPs don't use fiber or wires for the "last mile," we can cost-effectively serve areas where there is no business case for any other form of terrestrial broadband.

We also provide vigorous competition in areas where other kinds of broadband do exist. For example, a WISP called DC Access serves many homes and businesses here on Capitol Hill and provides the free Wi-Fi on the Supreme Court steps, a few blocks from this chamber. If you stop for refreshment at Ebenezer's coffeehouse, near Union Station, you can open your laptop and browse the Web thanks to this same provider.

Unfortunately, I am here to tell you today that the "network neutrality" rules enacted by the FCC will put WISPs' efforts to provide competitive broadband, and to deploy it to rural *and urban* areas that do not have access or competition, at risk. Firstly, the rules address prospective harms rather than any actual problem. Contrary to what some advocates of regulation say, ISPs have never censored legal third party Internet content. Customers would quickly move to competitors if they dared to try. Secondly, even before the rules were issued, the Commission's NPRM created uncertainty, which, in turn, drove away investors. The final rules are vague, permitting "reasonable network management" but not fully defining what the word "reasonable" means. As FCC Commissioner Robert McDowell pointed out in his well written dissent, this lays the groundwork for protracted, expensive legal wrangling that no small business can afford. And such factors as the political agendas of the Commissioners who happen to be sitting at that moment may determine the outcome.

The rules also allow anyone – whether or not he or she has service from the provider in question – to file a formal complaint alleging violations. Even now – before the rules have taken effect! – groups here in Washington, DC have filed complaints against MetroPCS for offering an affordable smartphone service plan which prohibits a few bandwidth-hogging activities. There are other plans available for those who do not like those terms, and the minor restrictions are more than worth the fantastic deal users get. But MetroPCS, one of the shrinking number of competitive mobile wireless providers, must answer the complaint and may be forced to stop offering service plans that customers willingly choose and enjoy.

My own company, which is much smaller than MetroPCS, could suffer a similar fate. Our most popular residential service plan comes with a minor restriction: it does not allow the operation of servers. Mr. Chairman, most Internet users would not know what a server was if it bit them, and have no problem uploading content to a Web site such as YouTube for distribution. Business customers that do need to operate servers can obtain that capability by paying a bit more to cover the additional cost of expensive rural bandwidth. But if the rules take effect and the FCC decides against MetroPCS,

we'll almost certainly be forced to shift everyone to the more expensive plan. We will therefore be less competitive and offer less value to consumers.

We will also hesitate to roll out innovative network management practices and services, for fear that the Commission would find fault with some aspect of them. For example, selling priority delivery of data – even for a new high tech service, such as telepresence – is strongly disfavored by the rules. This is the equivalent of telling UPS or FedEx that they cannot offer shippers overnight delivery, because it is somehow unfair to those who use less expensive ground service.

Such undue micromanagement is not necessary in a competitive market. Even in our small, remote community, there are 10 facilities-based broadband providers, and many more non-facilities-based providers who deliver service via DSL lines. The resulting market discipline is far more effective than static rules could ever be.

There are other problems in the rules, but due to limited time I can only mention one more. That is that the rules are not evenhanded. There are carve-outs for mobile carriers, who are claimed to be part of a nascent industry that faces significant challenges. But ironically, these exemptions were not extended to fixed wireless providers such as WISPs. Mobile phones' market penetration is far higher than that of WISPs, who are still working diligently to achieve similar market share and recognition. And WISPs' customers expect higher performance than mobile customers, even though our service is delivered over noisy, shared unlicensed spectrum. If mobile wireless providers deserve special consideration, then WISPs certainly do as well.

In any event, in my FCC filings, I urged the Commission to take measures to promote competition rather than imposing onerous regulations which would require us to ask permission to innovate. But the majority rejected this approach in favor of onerous regulations which address a "problem" that does not exist.

I therefore urge Congress – which is the ultimate source of the FCC's authority – to set things right. Rather than excessive regulation, which would extinguish small competitors like WISPs and create a duopoly requiring constant oversight, we should facilitate competition, crack down on anticompetitive tactics, and then allow markets to do the rest. Only by adopting this approach can we allow American small businesses to create jobs, innovate, and prosper while solving a very *real* problem: providing ubiquitous broadband access to our nation.

Mr. GOODLATTE. Ms. Sohn, welcome.

TESTIMONY OF GIGI B. SOHN, PRESIDENT AND CO-FOUNDER, PUBLIC KNOWLEDGE

Ms. SOHN. Chairman Goodlatte, Members of the Subcommittee, thank you for the opportunity to discuss the importance of network neutrality to protect consumers and competition on the Internet.

An Open Internet is vitally important to political and social discourse, commerce, innovation, and job creation in the U.S. Past ac-

tions by incumbent broadband Internet access providers have threatened the Open Internet, requiring the FCC to set enforceable baseline rules.

Contrary to assertions by incumbents that consumers enjoy competition when it comes to broadband Internet access and can simply switch providers, the FCC's national broadband plan reported that nearly 91 percent of all Americans reside either within a monopoly or duopoly broadband market. Given this reality, it is important that the Subcommittee work to promote net neutrality to ensure competition on the Internet.

In its Competitive Impact Statement in a Comcast-NBCU merger, the Justice Department laid out how the competitive harms presented by the merger were matters of antitrust and how they warranted clear network neutrality protections. The DOJ recognized that online videos distributors, OVDs, represent an emerging class of competitors to traditional multichannel video service providers, MVPDs, like Comcast. Although new MVPDs have endured nationally, incumbent video service providers like Comcast remain dominant in their regions.

Because OVDs are able to provide service in any geographic area, they are a source of direct competition to cable in the geographic area in which it is dominant. At the same time, because the profit margins from subscription video are far greater than that of program distribution, Comcast and other traditional MVPDs have a strong incentive to interfere with nascent OVD competitors. Thus, the DOJ found that Comcast had a much greater incentive to prevent the emergence of rival video services such as OVDs than it does to cultivate them as customers for video service. Comcast simply cannot hope to make up lost revenue caused by cable subscribers cutting the cord through the sale of programming to OVDs.

Network neutrality rules, such as the conditions imposed by the DOJ and Comcast, work against this anticompetitive danger. While the DOJ was specifically addressing Comcast, these antitrust concerns apply across the broadband market. A customer may wish to cut the cord and drop the video subscription, but the monopoly or duopoly broadband Internet access provider, also offering a video package, will have the incentive and ability to prevent this by interfering with the delivery of online video.

That same harmful incentive exists in the market for telephony. Just as the incumbent cable provider has a strong incentive to interfere with broadband delivery of competing video, the incumbent telephone provider has a strong incentive to degrade competing voice traffic. These harms are not speculative. There is a documented history of anticompetitive actions taken by broadband access providers.

Aside from the Madison River and Comcast/BitTorrent cases, AT&T has blocked several applications, such as SlingBox video streaming and VoIP applications like Skype, from its mobile network while permitting similar products to use its network. Cox and RCN both admitted to slowing or degrading Internet traffic, and despite claims that these practices were designed to handle congestion, neither provider disclosed their traffic management practices to subscribers.

Despite proclaiming that they have no intention of ever actually blocking or degrading content, broadband Internet access providers include within their terms of service provisions that allow them to engage in precisely these practices. And let me emphasize, these are only the cases we know about. Organizations like mine don't have the kind of money to track everything that ISPs do.

Now, I want to make clear that while I believe that antitrust law has a role to play in ensuring an Open Internet, it cannot do the job alone. Broadband providers can discriminate against applications of service providers without that discrimination rising to the level of an antitrust violation. And as the Judiciary Committee recognized when it introduced Open Internet-related legislation in 2006, the Supreme Court's Trinko decision severely limits the applicability of antitrust laws to regulated industries like cable and telephone companies. Thus, the recently enacted FCC rules are crucial to preserving an Open Internet.

Public Knowledge is deeply concerned about recent decisions in Congress to invoke the Congressional Review Act to repeal those rules. Should Congress enact a CRA repeal, the FCC's power to protect an Open Internet and not just the recently enacted rules, would be virtually eliminated.

Mr. Chairman, through the years, the Judiciary Committee and this Subcommittee have played a vital role in making certain that American consumers were protected by the vigilant enforcement of antitrust laws. This mission is now more critical than ever. As a DOJ analysis shows, anticompetitive activities by large carriers have the potential to affect millions of consumers in what may be net neutrality issues or may not. We urge the Subcommittee to keep a close watch on today's communications markets and to be alert to the kind of abusive market power that can affect consumers, companies, and the economy as a whole.

I thank you and look forward to your questions.

Mr. GOODLATTE. Thank you, Ms. Sohn.

[The prepared statement of Ms. Sohn follows:]

Testimony of Gigi B. Sohn, President
Public Knowledge

Before the
U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Intellectual Property, Competition, and the Internet

Hearing On:
"Ensuring Competition on the Internet: Net Neutrality and Antitrust"

Washington, DC
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Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee, thank you for this opportunity to discuss the importance of network neutrality for consumer protection and for competition on the Internet. My name is Gigi Sohn and I am the President of Public Knowledge, a nonprofit public interest organization that addresses the public's stake in preserving an open Internet.

Introduction

An open Internet is vitally important to political discourse, societal interactions, commercial transactions, innovation, entrepreneurship, and job creation in the United States. However, past actions by incumbent broadband Internet access providers have threatened the preservation of an open Internet resulting in the need for clear enforceable baseline network neutrality rules. The Federal Communications Commission (FCC) recently acted last year to establish baseline rules, but critical protections are still needed to truly ensure an open Internet, especially in wireless broadband access.

Network Neutrality rules are necessary to protect consumers against the monopoly and duopoly behavior of broadband Internet access providers in our country. Contrary to assertions by industry incumbents that consumers enjoy competition when it comes to broadband access choice and can simply switch, the FCC's National Broadband Plan reported that 13% of Americans have only one broadband access provider and 78% of Americans have only two broadband Internet access providers[1]. In other words nearly 91% of all Americans reside either within monopoly or duopoly broadband markets.

Given this reality on the ground, it is important that this Committee work to enact and preserve open Internet policies that promote competition between Internet application and service providers. Public Knowledge has and will continue to advocate for enforceable network neutrality rules that ensure:

- Broadband Internet access providers offer a minimum level of broadband service to all broadband consumers and are not allowed to create a "private Internet" that grants exclusive access to higher bandwidth levels to certain providers selected by the network operator.
- Paid prioritization is presumptively unreasonable and is applicable to all broadband access services.
- Broadband Internet access providers are not forced to obtain government pre-approval to manage their networks.
- The rules can be enforced through a simple complaint process in which the network operator must bear the burden of demonstrating that any interference with traffic is necessary to support a lawful goal.

[1] FEDERAL COMMUNICATIONS COMMISSION, CONNECTING AMERICA: THE NATIONAL BROADBAND PLAN 37 (2010).

Recent action by the Department of Justice (DoJ) on the Comcast-NBCU merger demonstrates the role of antitrust in network neutrality

Antitrust law's focus on protecting consumers from anticompetitive conduct, such as raising prices above what a truly competitive market would allow and ensuring that incumbents in the market do not take actions that stifle innovation, are part of what network neutrality rules seek to address. Recently the DoJ, in its review of the Comcast-NBCU merger, highlighted the antitrust harms to online video distributors (OVDs) the merger presented. Unlike traditional multichannel video programming distributors (MVPDs), OVDs do not own distribution infrastructure, and instead must rely on unfettered access to the Internet to compete. In its Competitive Impact Statement, the DoJ laid out plainly the competitive harms to OVDs that were matters of anti-trust and how they warranted network neutrality protections[2].

OVDs represent an emerging class of competitors to traditional cable services such as Comcast. Although many new competitors have entered on a national level, traditional incumbent cable services such as Comcast remain dominant in their regions. Indeed, as DoJ explained, Comcast's share of the video market at the local level can remain as high as 70%. Because OVDs are able to provide service in any geographic area, they are a source of direct competition to Comcast (and other traditional MVPDs) in the geographic areas in which it is dominant.

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[2] Competitive Impact Statement of Department of Justice, United States v. Comcast Corp., No. 1:11-cv-00106 (D.C. Cir. Jan. 18, 2011), *available at* http://www.justice.gov/atr/cases/f266100/266158.pdf.

At the same time, because of the profit margins from subscription video services, Comcast and other traditional MVPDs have a strong incentive to interfere with the ability of OVDs to compete. As the DoJ observed, *over 94%* of Comcast's revenue prior to the merger came from the sale of cable services. Even after the merger, when Comcast would receive NBCU's 51% programming revenue through the joint venture (the other 49% going to NBCU's former parent, GE), Comcast will earn more than three times as much revenue from selling cable subscriptions as from distributing programming. Accordingly, Comcast has a much greater incentive to prevent the emergence of rival video subscription services such as OVDs than it does to cultivate OVDs as customers for video service. Comcast simply cannot hope to make up lost revenues caused by cable subscribers "cutting the cord" through the sale of programming to OVDs.

These twin incentives, the desire to maintain local dominance in video subscription and the importance of subscription video to profit margins, give Comcast and other MVPDs that are also broadband Internet access providers strong incentive to interfere with the ability of broadband subscribers to download either streaming video or other video programming such as iTunes (the latter competing with MVPD video on demand services). Network Neutrality, such as the conditions imposed by the DoJ on Comcast, works against this anticompetitive danger. Without regulation in place, broadband providers that are also MVPDs – and nearly all broadband providers are also MVPDs – would have the same strong incentive to interfere with a broadband subscriber's online experience to protect their subscription video revenue.

While the DoJ was speaking specifically about Comcast, these antitrust concerns apply across the broadband market. A customer may wish to "cut the cord" and drop their cable subscription, but the monopoly or duopoly broadband Internet access provider also offering a video package will be able to prevent this by interfering with the delivery of online video. The ability to switch to a DBS provider or a telephone company-operated MVPD will not help the consumer seeking to save money (a key benefit of competition) by dropping the more expensive traditional MVPD service in favor of online video.

It is also important to note that these same competitively harmful incentives that exist for video competition also exist for competition over telephony services. Indeed, the first instance of blocking content by a provider, the *Madison River* case, involved a local telephone provider blocking competing voice-over-IP (VOIP) services. In many markets, the chief broadband competitor to the local cable provider is the local exchange carrier (LEC). Just as the incumbent cable provider has a strong incentive to interfere with broadband delivery of competing video, LECs have a strong incentive to degrade competing voice traffic. Such degradation need not be as crude as blocking. LECs trying to preserve their traditional dominance in voice can discourage switching to VOIP by dropping calls at random or making the audio quality poor enough that the majority of would-be VOIP subscribers are frustrated enough to remain LEC customers.

An extensive record produced by the FCC demonstrates that an open and free Internet was threatened without baseline rules

Cable and telephone incumbents have asserted that Network Neutrality rules are unnecessary and that the market has never demonstrated the need for rules. However, there is a documented history of harmful actions taken by broadband Internet access providers. In its December *Report and Order* on network neutrality, the FCC summarized a number of actions in the broadband market as indicators that anti-competitive incentives exist and action under its public interest authority were warranted.

The Commission observed that it had acted on two high profile incidents of blocking, but recounted evidence of numerous other incidents where broadband providers subsequently acknowledged that they had blocked or degraded traffic.[3] It is therefore simply not true that the only known cases of blocking are the *Madison River* case in 2005, where a rural telephone provider blocked competing VOIP services, and the *Comcast/BitTorrent* case, where Comcast blocked access to BitTorrent and other peer-2-peer applications. In addition, AT&T blocked certain applications, such as SlingBox video streaming, Skype and Google voice, from its mobile network while permitting its own streaming and voice products to use the same network. Cox and RCN both admitted to slowing or degrading Internet traffic at various times. Both providers deny wrongdoing and claim that these practices were designed to handle congestion, but in neither case did providers disclose their traffic management practices to subscribers. It is ironic that providers which publicly proclaim they have no intention of ever actually blocking or

[3] *Preserving the Open Internet,* Docket No. 09-191 ¶¶35-36 (released December 23, 2010).

degrading content routinely include statements in their terms of service that would allow them to engage in precisely these practices – and without prior notice to consumers.

Congressional Review Act (CRA) repeal of the FCC's network neutrality rules would end an open Internet

While I understand this is not the focus of today's Committee hearing and not a matter under its jurisdiction, I want to mention Public Knowledge's concerns with recent discussions in Congress to invoke the Congressional Review Act (CRA) to repeal the recent FCC network neutrality rules. Should the Congress decide to undergo a repeal of the current FCC rules through the CRA, it will result in long-term damage to the Internet economy.

Prior to the FCC's December decision, broadband Internet access providers recognized that anticompetitive actions would be subject to public scrutiny and that public outcry have prompted consumer focused responses by the FCC. However, enactment of a CRA repeal of the FCC's network neutrality rules would virtually eliminate the agency's authority to protect an open Internet and would not just repeal its recently enacted rules. As currently implemented, a CRA repeal would prohibit the federal agency from adopting the same or substantially similar rules until a new act of Congress was passed. This type of repeal would have the negative effect of hindering the FCC's ability to address any issue that touched on preservation of an open Internet, a necessary component to preserving competition in the Internet marketplace.

I urge members of the Committee to recognize the significant collateral damage that would occur through a CRA repeal and to resist utilizing it as a vehicle for repeal.

Conclusion

As Congress continues to focus on policies that promote job creation, I firmly believe that a policy that permanently preserves an open Internet will be an enormous driver for economic growth and job creation for our country. I urge members of the Committee to recognize that the economic benefits of the Internet are entirely based on ensuring that it remains an open and free marketplace and that the federal government has an integral role to play in that regard.

Thank you again for inviting Public Knowledge to testify before the Committee. I look forward to your questions.

Mr. GOODLATTE. I will now recognize myself to begin questions.

Let me ask each of you, how do you anticipate the Open Internet Order of the FCC affecting the ability of startup companies that you advise to raise capital—I guess we are directing this to you, Mr. Downes—and have you already seen any effect?

Mr. DOWNES. I have not seen any effect yet. Of course the rules are very new and there is already, as you know, two legal challenges as well as discussions in Congress about potentially disapproving of the order. But in general I think it's quite accurate

to say that the ability of my clients, particularly in the hardware business, to raise capital will be affected by these orders. The problem, of course, is there is a great deal of uncertainty. There was a lot of—the rules themselves are fairly vague, but of course all the exceptions and exemptions I mentioned in my opening statement make it very difficult to tell what is and isn't allowed as far as a network management practice, techniques for optimizing certain kinds of content or certain kinds of media. We don't know if in the future if I invent some new network management technique—and of course they're being invented all the time—it would be much more difficult for me to raise capital, or for my clients to raise capital, to pursue those kind of techniques. I think it's safe to say particularly early-stage investors will want—the way they currently ask for patent stuff, they'll ask for approval from the FCC.

Mr. GOODLATTE. Is it fair to say that while there's always risk in investing in a business—particularly a new business—that with antitrust laws you know the rules of the road and you can consult an attorney, you can take into account what you think those rules are as you move forward; but with FCC regulation, you can look at a set of regulations, begin down that path, and while you are substantially invested in this new technology, this new idea, suddenly those regulations can be changed and you're in a situation where you are no longer a profitable investment?

Mr. DOWNES. Yes. I think that's absolutely correct, Mr. Chairman. And it is also, I think, worth mentioning that the way the FCC implemented the enforcement provisions of its order, very, very broad. Any party has standing to bring a complaint, formal complaint before the FCC about any practice that it believes may or may not violate the net neutrality rules, even non-customers. And it's very difficult, of course, for anyone to know. You know, if the Internet goes slow one day, you don't know if that means somebody is doing a net neutrality violation or if it's slow because something is broken. But under the enforcement provisions of the order, the FCC will file essentially a full legal case, with discovery and everything that goes with it, for any time a formal complaint is filed. And that, of course, is potentially disastrous.

Mr. GOODLATTE. And the ability to raise capital as well as the ability to incentivize the development of new technologies would be affected the same way by the uncertainty created by FCC regulations.

Mr. DOWNES. Yes, I believe that is so.

Mr. GOODLATTE. Let me turn to Mr. Glass. Would you say that you are able to be more flexible and customer oriented than your competitors in your capacity as a small ISP? And if you agree with that statement, will the FCC regulations make it harder for you to remain as flexible and customer oriented?

Mr. GLASS. Mr. Chairman, let's see; as Mr. Downes said, we do not know exactly how the FCC regulations are going to be enforced. It may be at the whims of these commissioners or at some future sitting commissioners that may have different opinions. They are vague enough that we're not exactly sure. So I can't tell you exactly how they might affect our ability to provide innovative services, but we do provide innovative services now that are unique.

For example, we have doctors on our network, some of whom live fairly far out of town; and what we do, when someone goes into the emergency room and they get a CAT scan or an MRI, we go ahead and we prioritize the traffic so that that doctor can immediately—or as least as fast as possible—view the CAT scan and determine what's wrong, give an opinion to the hospital, dash to the hospital if he needs to do so. That sort of priority could arguably be in violation of the FCC's rules. We don't know, but they presumptively discriminate against that prioritization. So we really don't know where things are going, but we are very concerned.

Mr. GOODLATTE. Ms. Sohn, I appreciate your attention to antitrust laws, but I have a concern about your suggestion that antitrust laws and FCC regulations will work well together in this regard. My reading of the Trinko decision is different than yours. Quite frankly, my understanding of that decision is that if you have an industry that is regulated like the cable industry is regulated, like the telephone industry is regulated, then the Supreme Court said that in the Trinko case that you look less to antitrust laws.

But here the point, is that the FCC is not regulating the Internet now and should not be, and therefore the vitality of our antitrust laws would be stronger and more effective if we do not have additional FCC regulation of the Internet, which I am very concerned is simply kicking the door open for the FCC to regulate this incredibly innovative development in our society and in our economy that I think has grown tremendously and become such a huge part of our economy because it has not become heavily regulated.

Do you want to respond to that?

Ms. SOHN. Sure. Network neutrality it is not regulation of the Internet, it is regulation of the companies that provide the on-ramps to the Internet—telephone and cable companies. And the FCC does regulate them, and that's why I'm very concerned that the Trinko decision really guts antitrust law, and that's why former Chairman Sensenbrenner introduced that law in 2006.

Mr. GOODLATTE. Sure. But that law was designed to tweak our antitrust laws to make them more effective. And I would freely acknowledge that we need to look at what we need to do with our antitrust laws to make them effective in addressing what's going on on the Internet, but not turn this over to a regulatory process that is very different than antitrust, which, as we just discussed with Mr. Downes, creates a lot more certainty in terms of investment, in terms of developing new technologies, than having the uncertainty of ever-expanding regulatory powers for the FCC, which I think, as I stated at the outset, are in violation of Congress' intent to begin with.

Ms. SOHN. Look, I share your concern. I'm not for big FCC regulating everything, regulating the Internet. My organization, probably to your dismay, brought the case that struck down the FCC's authority to implement the broadcast flags, so I share those concerns. But the problem is even if—let's set the Trinko case aside—and I would point you to testimony that Howard Shelansky of the FTC did about the effect of the Trinko case on antitrust enforcement in this area. And Howard Shelansky is no fan of network neutrality.

But setting that aside, there are places that are of concern to consumers and concern to edge companies, like Facebook and Twitter and Netflix and Google that just won't be touched by antitrust law. For example, let's say Verizon or Comcast wants Google to pay for faster service or better quality of service, that's not something necessarily that is going to be covered by antitrust law. It's not as easy as a situation where AT&T blocked Skype, where you know that AT&T has a competitive interest in disfavoring VoIP. So there can be instances of discrimination that the FCC rules cover that antitrust law just does not.

Mr. GOODLATTE. Mr. Downes, would you care to respond, or Mr. Glass?

Mr. DOWNES. Well, Mr. Chairman, it is possible that, of course, the broadband provider may ask a company to pay more for more service.That's sort of the nature of competitive industries. It isn't necessarily a violation of net neutrality in principle, and it's certainly not necessarily anything that would be considered anticompetitive or demonstrable consumer harm. That's the standard for antitrust. I think that's a good standard.

And the problem, as I said, with the FCC is that they didn't give us any standard at all. They said we reject that as the standard by which we're going to enforce the antidiscrimination rule, but we don't know what standard they're going to apply instead. They just don't want people to be picking winners and losers on the Internet. But I don't want to leave that to the discretion of the FCC.

Mr. GOODLATTE. Thank you.

Mr. Glass.

Mr. GLASS. Yes. I would really like—it would be really wonderful for me, because I do experience a lot of anticompetitive tactics, especially at the hands of the local incumbent—local exchange carrier to have some recourse under antitrust law. Right now, I am forced to operate as if I don't. And actually, because of that, the best thing that I can ask the government to do is enable competition and at least don't keeping me from competing. I would like to see the antitrust law fixed, however.

Mr. GOODLATTE. Thank you.

The gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman.

I am in the process, lady and gentlemen, of separating out three considerations: One, the concept of net neutrality; two, the role of the Federal Communications Commission; and three, antitrust law. And so I have come to this hearing with the view that the FCC has probably not exercised its fullest authority in this area before this is all over.

Contrary to those who think the FCC has exceeded its authority and it's not what Congress intended, I think that a case could be made for the FCC becoming stronger. So let me question you in this respect: We all agree on the validity and significance of net neutrality as a telecommunications concept; is that true? Yes. Blank. Blank.

Okay. Do you have reservations about net neutrality? Do you think it's dangerous, or are you worried about where it's going, or what?

Mr. DOWNES. Well, as I said in my statement, Mr. Conyers, I am not against net neutrality. I am in favor of the Open Internet, I've been a beneficiary of the Open Internet. My concern is principally with the idea that the FCC, as a regulatory body, is the one to decide what it actually means and to enforce it.

Mr. CONYERS. Well, I'm not talking about the FCC. That's number two on my list. I'll get to that. But you seem reluctant to just come out and say that you are for net neutrality.

Mr. DOWNES. No, I've said it. I have written that I am in favor of net neutrality in principle.

Mr. CONYERS. Fine. But I've had to kind of tease it out of you.

What about you, can I get a straight, okay, yes, I'm for it answer?

Mr. GLASS. Mr. Conyers, I would love to be able to give that sort of a response. The problem is even if you look at Wikipedia, there are three or four definitions of net neutrality under that one heading.

Mr. CONYERS. Well, you take the one that you want. Would you like net neutrality as you would define it?

Mr. GLASS. I would like to see net neutrality if it means freedom from anticompetitive tactics. I would not like to see it if it means onerous regulation or micromanagement of innovative companies that are trying to do things.

Mr. CONYERS. Well, I'm talking about the concept itself, I'm not talking about who's running it and how it's being managed. I don't mean to put words in your mouth, for goodness sake, heaven forbid, but from you two witnesses I seem to sense that there is some hesitation about just coming out and saying net neutrality is a good thing and I'm glad it's here.

I mean, you start telling me about the FCC and who's regulating, I'm just asking you about net—everybody isn't for net neutrality. And I suspect that—I'm not a psychiatrist, but deep down do you have some reservations about net neutrality? You can say yes if you want to.

Mr. GLASS. I think I do have reservations——

Mr. CONYERS. All right. Very good. Now that's what I'm trying to get at.

Now Professor Downes, deep down, don't you have some reservations about net neutrality?

Mr. DOWNES. No. Look, if net neutrality is a political term, yes; if it's an engineering term, no.

Mr. CONYERS. Well, let's see. Okay. Now let me ask the gentlelady witness, where do you come out on this net neutrality?

Ms. SOHN. I am a stalwart supporter of net neutrality. My organization does not think that the FCC's rules went far enough, although we are willing to live with them. They are rules of the road. We believe, as the Commission does, that the companies that provide the on-ramps to the Internet—they are either a monopoly or duopoly in 90 percent of this country—should not be able to pick winners and losers.

Mr. CONYERS. Well, now let me raise this, since my time is just about gone—you fellows did a good job on making me work so hard to get a yes or no answer.

But the last question, Mr. Chairman, if I might, on the question of antitrust, do all of you agree with me that antitrust is a very difficult thing to prosecute? There are certain standards and levels. And antitrust in the Department of Justice has been going down for decades. We don't get much of that anymore. Does that statement ring positive with you?

Mr. DOWNES. Well, I don't think if you asked companies like Microsoft and Intel if they think antitrust has gone down, they would say no.

Mr. CONYERS. Yeah, but I'm asking you.

Mr. DOWNES. I think, certainly in terms of the technology industry, antitrust has been applied more than it had been before, and often I think with dangerous consequences.

Mr. CONYERS. Well, there wasn't any industry before.

What do you say, sir?

Mr. GLASS. From the point of view of a small business person, I don't know if I will ever have recourse to antitrust, but I would love to be able to avail myself of such remedies.

Mr. CONYERS. Yes, ma'am.

Ms. SOHN. Well, I agree with you 100 percent. And particularly when it comes to regulated industries like broadband Internet access providers, the Trinko and Credit Suisse cases have completely eviscerated antitrust enforcement.

Mr. CONYERS. Thank you, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

The Chair recognizes the gentleman from Pennsylvania, Mr. Marino.

Mr. MARINO. Mr. Chairman, I have someone that I have to meet here shortly. Could I reserve my time and when I get back, if I have questions, ask them?

Mr. GOODLATTE. Absolutely. We will do that.

And now the Chair turns to the gentlewoman from California for her questions.

Ms. CHU. Thank you, Mr. Chairman.

Well, some would suggest that current antitrust law is sufficient to protect consumers with regard to access to broadband. Ms. Sohn, you seem to imply that both the Department of Justice and the FCC have a role to play in protecting net neutrality.

If the FCC were stripped of its ability to enforce net neutrality principles, would the Department of Justice have the ability to prevent broadband providers from discriminating among Internet content?

Ms. SOHN. Within the context of a merger like Comcast, yes. And I think the Justice Department did an outstanding job in doing that. However, if it comes to plain old antitrust enforcement, that kind of enforcement has been severely limited by Supreme Court decisions in the Trinko case and the Credit Suisse case. So I think it would be very difficult without some legislation. And I would encourage this Subcommittee to think about it.

And particularly if you're concerned about the competition in the application space between search engines or between social networks, there is nothing in antitrust law that would allow you to move forward on that either. So I would encourage this Sub-

committee to think about how do we repair the damage done by the Supreme Court in the Trinko and Credit Suisse cases.

Ms. CHU. And why is it important to have the FCC involved?

Ms. SOHN. Because the FCC, first of all, in light of those Supreme Court cases, there is very little that an antitrust authority can do when it comes to regulated companies like broadband Internet access providers. And secondly, there are activities that broadband Internet access providers can do that discriminate, that hurt an Open Internet, that do not rise to an antitrust violation. So there are gaps there that the FCC, with its public interest mandate, can fill.

Ms. CHU. Let me ask about the authority of the FCC. There has been significant debate about the Commission's authority to regulate broadband, and in particular Verizon has appealed the Commission's Open Internet Order, alleging that the FCC has acted outside the bonds of its statutory authority. Do you believe the FCC does have the authority to develop net neutrality rules?

Ms. SOHN. Well, we would have preferred that the FCC reclassified broadband Internet access as a telecommunications service, just as Justice Scalia suggested in the Brand X case. Unfortunately, they did not do that. The FCC believes that it has threaded the needle that the D.C. Circuit gave it, the hole that the D.C. Circuit gave it in the Comcast decision, and the court will decide that. Again, we would have preferred that they had gone to Title 2. They decided to go a different way, and the courts will decide.

Ms. CHU. I have to admit that this all seems academic to me because the FCC can clearly regulate this area if they decide to reclassify broadband under the Telecommunications Act. In your view, why has the Commission held off on reclassifying broadband?

Ms. SOHN. I think it's just fear. It's fear of the political blowback that would have happened. Yes, it would have been a controversial decision, but it would have been the most legally sustainable. It's unfortunate. I think the FCC's general counsel was quite correct that not reclassifying not only would have affected net neutrality, but would affect universal service, would affect privacy, would affect any number of important consumer protections that the FCC might undertake, but I think it's all about politics.

Ms. CHU. Thank you. I yield back.

Mr. GOODLATTE. I thank the gentlewoman.

The gentlewoman from Florida, Ms. Adams, is recognized.

Mrs. ADAMS. Thank you, Mr. Chairman.

Commissioner McDowell's dissent that said that reasonable standards set out in the Open Internet Order is one of the most subjective and litigated standards in the legal system, do you agree with that statement?

Ms. SOHN. Could you repeat that? I didn't quite understand that.

Mrs. ADAMS. The observation in Commissioner McDowell's dissent that the reasonable standard set out in the Open Internet Order is one of the most subjective and litigated standards in our legal system?

Ms. SOHN. That is absolutely correct, because under Title 2 of the Communications Act—again, the place where I would have preferred the FCC to go—what is prohibited is unjust and unreasonable discrimination. So the good thing about, had they decided to

go there, is that you have years and years of precedent. Now they have set this new standard, "reasonable network management," which I don't think is as onerous as my colleagues but, however, is going to have to undergo a whole new set of adjudications.

So yes, I agree with Commissioner McDowell, but perhaps we disagree that that would have been the better way to go because there is precedent, and because telecommunications providers know how to behave under that precedent. And in fact, there are over 800 telecommunication providers who choose to be regulated under Title 2. And wireless telephone service—not broadband service, is also regulated under Title 2. So it's something we know.

Mrs. ADAMS. So, would you agree that a standard that determines a behavior's reasonableness by a majority vote of FCC commissioners, is harder to predict than either a bright-line rule or a rule of reason constrained by over a century of antitrust law?

Ms. SOHN. Well, I mean, that's an interesting question. But as I said before, antitrust law doesn't really apply here because of Supreme Court precedent. So it's hard for me to say which is better and which is not. But let me say something about reasonable——

Mrs. ADAMS. Let me ask you something. Let's get a little bit clearer. Would you rather have something under an antitrust law that has been century tested, or a reasonableness law that is subject to the five—I think it was five—commissioners' discretion?

Ms. SOHN. Well, I would say the reasonable standard in Telecom was also time tested. It's also 70 years old. So I guess to me it's a wash.

Mrs. ADAMS. I'm asking you, would you rather have one or the another?

Ms. SOHN. I think you have to have both. It's a false choice, you cannot choose. You have to have both.

Mrs. ADAMS. So you think that the antitrust law, if not amended to quell your concerns, would be a better route than—or the reasonableness law would be a better route than the antitrust law?

Ms. SOHN. No. The problem is that even if the antitrust law is vigorously enforced, there are still gaps that it doesn't reach when it comes to preserving an Open Internet. The gap where, for example, an Internet service provider wants to charge a Facebook or a Google for speedier service, okay; not because it has its own search engine, but just because, because it wants the money, that isn't really covered by antitrust law. Okay. And that's something that can come under the FCC's public interest standard.

So the problem is the gap, and that's why I can't—it's not fair for me to say I like one better than the other because you have to have both.

Mrs. ADAMS. Mr. Glass, you look like you would like to answer that.

Mr. GLASS. Well, I guess what I'm concerned about is there are five commissioners on the FCC. The appointments are usually political and partisan. The organization is far more politically driven than it should be, and this is something that we need to fix. I honestly believe that the FCC has structural problems that Congress should eventually address.

But as it stands right now, it really has been capricious. And I really do believe the definition of "reasonable" is going to float, de-

pending on who is sitting on the Commission at the moment. It's very difficult to conduct business in an industry where you have that sort of uncertainty.

Mrs. ADAMS. Mr. Downes, would you like to comment.

Mr. DOWNES. Yeah. I mean, I think it's worth noting that what they did end up with in the end was not as strict and not as onerous as what they started with, which was a nondiscrimination rule. And I think what's interesting is in the year and couple months' process by which the FCC was taking comments and having testimony on the net neutrality proceeding, I think one of the things they realized was there are a lot of discriminatory practices in the network's design, some of them very recent, some of them there to optimize certain kinds of content or certain kinds of media or certain kinds of services. And that those practices are not harmful to consumers, they were not intended to be anticompetitive, and in fact they're necessary to have an Internet today that looks like what it does, not what it looked like back in 1996.

So I'm actually pleased that the FCC stepped back from the brink in terms of how far it went with the anti-discrimination rule. Obviously, I would have preferred them not to have any rule at all, but the one they had is not as bad as what they started with.

Mrs. ADAMS. Thank you. I yield back my time.

Mr. GOODLATTE. I thank the gentlewoman.

The gentlewoman from California, Ms. Sánchez, is recognized.

Ms. SÁNCHEZ. Thank you, Mr. Chairman.

Mr. Glass, I would like to start with you.

In your written testimony you state that Internet service providers have never censored third-party content. So I want to ask you a very simple yes-or-no question. Are you familiar with AT&T's 2007 admission that they did censor part of a 2007 Pearl Jam concert that was critical of then-President George W. Bush? Are you familiar with that?

Mr. GLASS. Yes, I am. However, they were the publishers of the content, and therefore they had a First Amendment right to edit it.

Ms. SÁNCHEZ. They were also the Internet service provider, the ISP; correct or not correct?

Mr. GLASS. As far as I know, you didn't need to use just their service in order to access the content. So I'm not sure if they qualify as the ISP in the same sense.

Ms. SÁNCHEZ. Well, don't you agree that that type of precedent allows for the possibility that an ISP could censor content?

Mr. GLASS. There is always that possibility, but as an ISP who has worked my whole life to give people access, I amfervently in favor of not doing so.

Ms. SÁNCHEZ. I just was asking about whether or not the possibility existed there. And I think, if I'm not mistaken, you answered yes, that that possibility does exist.

So without net neutrality, what is to stop a rival ISP from blocking access to Web sites, for example, promoting LARIAT service, in effect blocking potential customers from knowing that there are alternative services?

Mr. GLASS. The market has generally taken care of that. We have more than 10 facilities based and even more nonfacilities-

based providers in our area. Customers are easily outraged by such tactics, and they will switch.

Ms. SÁNCHEZ. That is my next question. In your written testimony, you argued that consumers will "move quickly to competitors if they dared to try censoring content." However, as the FCC's national broadband plan notes, 13 percent of Americans have only one broadband access provider and 78 percent of Americans have only two broadband options.

So what would you say to the citizens of both of those groups who have very limited options with regard to who their providers are going to be, that hey, if you are outraged at the censorship, if that occurs from your Internet service provider, and you don't have another provider to go to, what is the recourse? And even maybe where there are two providers that are present, what if both are engaging in that activity, what is the recourse there?

Mr. GLASS. Well, I'm not sure where that figure came from because, again, wireless ISPs reach 70 percent of U.S. Homes and businesses right now, and they are continuing to expand.

Ms. SÁNCHEZ. That is businesses. That is not necessarily individuals.

Mr. GLASS. Homes and businesses. But I am hoping we will certainly work to resolve that problem.

Also, I have here, and we may want to enter it into the record, a white paper from the FCC which was published in December 2010 where they surveyed customers, and two-thirds of them thought it would be easy to switch providers if they wanted to.

Ms. SÁNCHEZ. But those two-thirds may be under the mistaken impression that they have more than one provider available in their area, and what if they don't?

Mr. GLASS. Actually, Ms. Sánchez, I would be inclined to think that it is the reverse. What we find is that most people don't know that wireless ISPs like myself are an option, and we are working to correct that by advertising as hard as we can. Many people do not realize that we do offer a real alternative, and will offer more of one as time goes by.

Ms. SÁNCHEZ. Ms. Sohn, do you agree with what Mr. Glass has to say about censorship and recourse for consumers?

Ms. SOHN. AT&T engaged in blatant censorship when they wouldn't allow Sling Media to be on their platform, even though they allowed MLB streaming video. That was censorship as well.

I am not a First Amendment law expert, but I can tell you I don't know of any case, Supreme Court or otherwise, that says that a telecommunications provider, like AT&T, has absolute First Amendment rights that don't get balanced against the First Amendment rights of people like you and I.

Let me say something about WISPs because I love them. I love Brett's company. I think they are terrific. But by nature, they are niche players. They are enterprise oriented, and they operate mostly where there aren't spectrum congestion problems. In many places they serve as hot spots. And if you look at Mr. Glass's own Web site, it shows you the guaranteed downstream capacity. And for residential areas, it is 256 K, 384 K, 384 K, 512 K, 768 K. That doesn't even meet the definition of broadband that the FCC has put out. So I admire his service. I would love to see him compete and

compete and compete; but to say that they measure up to a Comcast or to an AT&T or even a broadband wireless service is just not the case.

Ms. SÁNCHEZ. Thank you for your answer.

Mr. Chairman, I will submit my additional questions in writing in the interest of time.* I yield back.

Mr. GOODLATTE. I thank the gentlewoman.

I am now pleased to recognize the gentleman from California, Mr. Issa.

Mr. ISSA. Mr. Glass, sometimes being around here for awhile actually has a benefit besides sitting on the top row. Wasn't it roughly 8 years ago that the world gold standard for high bandwidth was 256, set by Korea when they came out with universal 256 broadband? So how many years are you behind the leading edge of broadband typically? When will you be at T1 speeds in your rollout?

Mr. GLASS. Mr. Issa, we are not behind T1 speeds now. The only reason why we offer lower tiers, and by the way, the FCC standard for broadband until recently was 200 K, meaning that every one of our services met the old standard.

Mr. ISSA. Thank you.

Mr. GLASS. They moved goalposts. In any case, we can do far more. However, due to anticompetitive behaviors relative to special access, in other words the way we get our bandwidth from the Internet, our bandwidth is very, very expensive. The reasons you see those rates on our page going down to those levels is simply the bandwidth is so expensive that people don't want to pay more to get more. We would love to give them cheaper broadband, and we are working on it. But unfortunately right now, due to those anticompetitive tactics, that is what we can offer for that price.

Mr. ISSA. Let me go through a line of questioning.

Mr. Glass, today with the bandwidth you have available, if I have a small- to medium-sized business and no other access and I wanted to run VoIP enterprise system at my business, you would by definition, I assume, be prepared to just treat me like any other bandwidth and interrupt me all the time and have me have voice go up and down; or would you give me assured service and priority so that my voice traffic was reliable and predictable and quality?

Mr. GLASS. Actually, this is one thing, Mr. Issa, that we do differently from other ISPs. Other ISPs don't give you a guaranteed minimum speed on your connection. Our company does that for every customer, whether it is residential or business. And we can go to quite high speeds as long as the customer is willing to purchase the bandwidth.

I have right here——

Mr. ISSA. Okay, so you don't have a bandwidth limitation as earlier was said off of that sheet. That is some sort of a misunderstanding? You can deliver high bandwidth, assured service, and you do?

Mr. GLASS. Absolutely.

Mr. ISSA. Ms. Sohn, going back to you, with the FCC sticking in the middle of something that has been growing virtually exponen-

*The material referenced was not submitted to the witness.

tially, providing services such as hundreds or thousands of simultaneous VoIP connections, something that wasn't even thought of outside of a Cisco in your building system a few years ago, what is it that the FCC brings incrementally to this process in your opinion? What is that they are going to do better than what has been happening the last decade?

Ms. SOHN. They are going to provide clear rules of the road to ensure that consumers are protected, that they can access any Web site, any application, any content they want. They will be bring certainty, and not just certainty for consumers.

Mr. ISSA. Okay, I will assume that is exactly what they are going to provide. Are they going to guarantee me that I can take all of the bandwidth available at the maximum speed, that it is given to me by the carriers? In other words, if I have 15 MIP download, they are going to guarantee that I can take all 15 at all times; right?

Ms. SOHN. No, I don't think so.

Mr. ISSA. Okay, so right now—and I don't want to sound like O'Reilly, but let me be a little bit here.

Ms. SOHN. Be my guest. You are doing a great job.

Mr. ISSA. Right now, if everybody wants to take the maximum speed, of course, the system crashes or it slows down. So assured bandwidth, with some sort of metering or prioritizing, in your opinion, wouldn't you say that is in the interest of the consumer? In other words, if I need my voice traffic to actually keep going, even while somebody else is trying to download 10 movies simultaneously, don't I have an interest; and how is the FCC going to do a better job than what was already in place?

Ms. SOHN. First of all, what the FCC is doing is keeping the status quo in place. And I think that is really, really important here when people talk about the FCC is imposing net neutrality.

Mr. ISSA. Okay, I will take your answer as the status quo.

Mr. Downes, since I only have a few moments left, if they are keeping the status quo and the growth has been exponential and it has been done throughout the FCC, how am I from the dais to understand what the benefit is to this grab by the FCC during a recess?

Mr. DOWNES. Frankly, Mr. Issa, I see no benefit to what the FCC is doing. I see only harm, and the harm is the potential for them to slow down the process by which these things will continue to improve. And new services and new network management engineering will be introduced into the network over time. The only thing that is going to happen is that will slow down or worse.

Mr. ISSA. Thank you.

Thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. It is now my pleasure—this is a California-centric thing here. This is the third woman from California I am pleased to recognize.

Mr. ISSA. We are going to give you a lot more. This is important to California.

Mr. GOODLATTE. It sure is. The rest of the country, too. We are glad to hear from Californians, including the gentlewoman from Silicon Valley, Ms. Lofgren.

Ms. LOFGREN. Thank you. Before I ask my questions, I ask unanimous consent to make some testimony from Consumers Union a part of the record.

Mr. GOODLATTE. Without objection.

[The information referred to follows:]

Consumers Union
Nonprofit Publisher of Consumer Reports

Statement of Parul P. Desai
Policy Counsel
Consumers Union
Regarding
"Ensuring Competition on the Internet: Net Neutrality and Antitrust"
in the
United States House of Representatives
Committee on the Judiciary
The Subcommittee on Intellectual Property, Competition, and the Internet

Consumers Union, the nonprofit publisher of *Consumer Reports*® magazine, respectfully submits this written statement for the record. For 75 years, the mission of Consumers Union has been to work for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves. Consumers Union has long been a supporter and advocate of network neutrality, which ensures the Internet remains an open medium where all users – both active and passive users – can access and market the lawful content and services of their choice, without the fear of censorship or discrimination.

Introduction

The benefits of the Internet have become apparent, and all stakeholders agree upon the basic principle of an open Internet or "network neutrality." However, the debate ensues over the best and most reasonable means to ensure that all Americans can continue to reap the benefits of an open Internet. At its core, the debate over an open Internet is a balancing act between the interests of Internet users (which include entrepreneurs, small businesses, and innovators) and the interests of the Internet Access Service Providers (ISPs). The net neutrality rules adopted by the Federal Communications Commission (FCC) present a reasonable path forward for ensuring that balance.

History has shown that today's concerns over network discrimination are not unique. For years, firms with market power have used their dominance to censor or discriminate against services or products they did not approve. For example, in the 1960's the Bell companies prohibited "foreign attachments" to their networks.[1] This meant that consumers could only use telephones and other phone equipment approved or manufactured by the phone company. As a result, the Bells were essentially able to discriminate against third party manufacturers by requiring the use of Bell equipment on the Bells' network.

Today, the ISP market similarly lends itself to use its dominance to discriminate against certain types of uses. Proper oversight and net neutrality rules will promote competition, facilitate innovation, and ensure competitive and nondiscriminatory access to the Internet.

[1] *See In The Matter of Use of the Carterfone Device in Message Toll Telephone Service*, 13 F.C.C.2d 420 (1968).

The ISP Marketplace is not Competitive

The ISP market has increasingly become concentrated. According to the FCC's data, 96% of the population has access to only two wireline ISPs.[2] That is, most consumers either have to choose between the phone company and the cable provider as their ISP. Unfortunately, competition in the wireline ISP marketplace is not increasing and instead is quickly moving to a monopoly in most markets; that is, only one single, monopoly provider will be able to provide the high-speeds that Internet users are demanding for activities like gaming and video streaming.[3] As much as 85% of the population will have access to only one ISP - the local cable monopoly - that will be able to offer very high download speeds.[4]

It is evident that ISPs control already considerable market power in most parts of the country and will soon be able to exercise monopoly control in the majority of the country. As a result, it is easy for these ISPs to exercise market power to discriminate against or interfere with the ability of consumers to access certain content or services, especially competing services (such as voice and video), or even censor speech that the ISP may not agree with.

Some will suggest that wireless Internet access will create more competition to the duopoly/monopoly wireline market. However, the prospect of robust wireless Internet access does not in and of itself create a competitor in the market. This is especially true when much of the wireless industry is captured by dominant wireline companies and two wireless carriers – AT&T Wireless and Verizon Wireless together own a majority of the spectrum.

Moreover, competitors to the dominant wireless carriers have long argued they face anti-competitive practices and other obstacles from truly competing. Competitors have alleged numerous difficulties in striking much needed data roaming and "special access" agreements with the dominant wireless and wireline carriers. Also, competitors are unable to obtain popular and sophisticated devices because of exclusive handset agreements and lack of interoperability of devices among wireless networks. These impediments make it difficult for competitors to attract consumers away from the dominant wireless providers.

Consumers also face obstacles if they wish to switch to or among wireless carriers. Most carriers do not yet offer speeds comparable to wireline speeds. Consumers are faced with high early termination fees if they wish to switch carriers before their contract is up. Consumers must also purchase a new device when they switch due to a lack of interoperability of devices among the wireless networks.

ISPs today face little to no competition in the offering of broadband Internet access service. They have the ability to use their dominance to impede competition in the free market of goods and services. Basic net neutrality rules ensure the Internet allows entrepreneurs, small businesses, and

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[2] *See* Federal Communications Commission, *Connecting America: The National Broadband Plan*, 37 (2010), http://www.broadband.gov/download-plan/.
[3] *See The National Broadband Plan* 42; Susan P. Crawford, *The Looming Cable Monopoly*, 29 Yale L. & Pol'y Rev. 34 (2010).
[4] *See The National Broadband Plan* 42; *The Looming Cable Monopoly*.

innovators with new ideas to enter the open and free marketplace where ideas, products, and services will succeed or fail on quality and merits.

Net Neutrality Promotes Competition and Innovation

History has shown that entities with dominant market power will use their position to discriminate and impede access. The prohibition against discrimination in the communications industry goes back almost a century and has been codified by the Communications Act. This principle also had a basis in the antitrust action taken under the Sherman Act to break up AT&T's telecommunications monopoly and prohibited the divested companies from engaging in discriminatory behavior.

Net neutrality protections will ensure that all Internet users have nondiscriminatory and unfettered access to the Internet. Nondiscriminatory access to the Internet has enabled many with little capital to create new companies, reach new markets, and launch innovative new products and services. It has allowed for a forum in which they can compete in a free and open market. The economic value of the Internet could be jeopardized if just a few ISPs were able to control the flow of what can be accessible on the Internet.

It is inevitable that abuse of market power in the ISP market will affect competition and innovation in the markets that depend on it and it will affect the ability of businesses to compete in the free marketplace. Indeed, the FCC recently provided numerous examples of instances in which ISPs either degraded or blocked Internet traffic.[5] Despite the potential for abuse of market power, ISPs have argued that net neutrality rules will hurt jobs and deter build-out and investment in the infrastructure. The facts and reality indicate that these are hollow threats.

ISPs have argued net neutrality rules will prevent them from developing models that will earn them profits to use towards investments in deployment and infrastructure. However, even in the recent difficult economic times, ISPs have been earning healthy profits. For example, in 2009, Comcast and AT&T earned 10% in profits. Only Exxon Mobile did slightly better in 2009 with 10.21% in profits; even Walmart only earned 3.3% in profits. The reality is decisions in investment and deployment are not dictated simply by net neutrality rules. Investment also depends on factors such as demand and supply costs; competition; and overall confidence in the economy.

ISPs have suggested also that network neutrality rules will affect jobs. However, while earning billions of dollars in profits, some ISPs are still shedding their workforce. From 2007-2009, AT&T reported $36.5 billion in profit, yet reduced its workforce by 20,500 employees during that same period of time.[6] Similarly, from 2007-2009, Verizon reported a profit of $15.6 billion, but has 19,073 fewer employees than it did in 2006.[7]

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[5] *See In the Matter of Preserving the Open Internet*, 25 FCCRcd 17905, ¶¶35-36 (released December 23, 2010).

[6] *See* Media and Democracy Coalition, *FCC Must Protect Entrepreneurs from Internet Service Providers' Unfair Practices* (2010) at http://www.media-democracy.net/node/668.

[7] *See id.*

No one argues that the Internet is not vital to our economy – both on the supply and demand side. ISPs as suppliers must earn revenue to deploy and invest in their networks, and it is evident ISPs are earning healthy profits. However, the Internet is only economically valuable if other businesses have unfettered access to the Internet to innovate and sell their products and services in a free and open marketplace. With a low barrier to entry, the Internet allows small businesses and innovators with new ideas to enter the open and free marketplace where ideas will succeed or fail on the merits.

The FCC's Net Neutrality Rules

In December 2010, the FCC adopted baseline net neutrality protections. These rules require wireline and wireless ISPs to disclose network management practices, performance, and commercial terms to both consumers and content/application developers. They prohibit wireline ISPs from blocking lawful content, applications, services, and non-harmful devices, subject to reasonable network management. Wireless ISPs are prohibited from blocking lawful websites and competing voice and video telephony services, subject to reasonable network management. Finally, the rules prohibit wireline (not wireless) ISPs from engaging in unreasonable discrimination.

These protections fill the vacuum that was left by the *Comcast v. FCC* case,[8] which essentially left the ISP market to conduct business with no oversight. The FCC appropriately used its Title I authority to adopt these baseline protections to ensure that ISPs could not use their dominance to impede access. Indeed, even the Supreme Court assumed, when affirming the FCC's decision to classify ISPs as information providers and not telecommunications providers, the FCC would still have Title I authority over ISPs.[9]

The Judiciary Committee's role is also critical to the future of the development of the Internet economy. The increasing market power of ISPs and their ability to engage in anti-competitive practices are essential to favoring net neutrality rules. Net neutrality like rules have played a crucial and historical role in promoting an efficient and competitive communications market. In fact, the Internet has become an engine of innovation and economic growth because of prior nondiscrimination rules that ensured that communications network owners could not use their market power to exclude competitors.

Conclusion

Oversight is needed to ensure that market power is not used to stifle innovation and competition. The government's role does not have to be intrusive or complicated. Indeed, the FCC's rules are a simple ban on unreasonable behavior, provide basic protections for Internet users, and let the free market work. Similarly, it is also the appropriate role of this Committee to protect competition and consumer choice against market power.

[8] 600 F.3d 642 (D.C. Cir. 2010).

[9] *See National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005) ("Information-service providers, by contrast, are not subject to mandatory common-carrier regulation under Title II, though the Commission has jurisdiction to impose additional regulatory obligations under its Title I ancillary jurisdiction to regulate interstate and foreign communications…)."

Ms. LOFGREN. I am glad we are having this hearing. As we have listened to the testimony, I think it is important to recall that something like 96 percent of Americans have a choice of only two wire-line ISPs. If that were not the case, we probably would have a very different set of circumstances that face us. And when we talk about true broadband Internet, really fast enough to allow

Americans to enjoy next-generation applications such as high-quality video, the market for true broadband is really even smaller for most Americans.

Most of us have no alternative but our cable company which, of course, is facing competition for content on the Internet which raises all kinds of other potential concerns.

Now, Ms. Sohn, thank you so much for being here today. You have been a witness many times before the Judiciary Committee. You have described in your testimony the concern about the monopolies and duopolies. I am wondering, can you give us a comparison on what we are facing here with, say, another First World area, say Europe; do they have greater competition there?

Ms. SOHN. Yes. In almost every international comparison that you see, the U.S. is 15th, 25th as far as speed and value is concerned. That is because we took our regulatory system that we had in the 1990's and the early aughts and we got rid of it when the FCC reclassified broadband Internet access as an information service instead of telecommunication service. And so those countries that are beating us—and it is not just countries in Europe, it is countries in Asia, it is even countries like Iceland and some of the Nordic countries as well—they either require dominant telecommunications providers to open up their networks so competitors can use them, or they heavily subsidize their system. The government does that.

I am not necessarily a big fan of the second one since I am a taxpayer, but I am a huge fan of the first one. If we were to go back to Title 2, we could go there. And I think it would be a great boon to American consumers because prices would go down and choices would go up. I remember the narrow band world, dial-up world. I am old enough to remember that.

Ms. LOFGREN. Me too.

Ms. SOHN. In that era, American consumers had a choice of 13 Internet providers; 13. And now you are lucky if you have two. Even here in D.C., I only have a choice of three.

Ms. LOFGREN. I am still waiting for Verizon FIOS to hit my street.

Ms. SOHN. It is wonderful.

Ms. LOFGREN. Maybe that is an invitation if anyone from Verizon is listening. Now, the competition in other countries that have true broadband, how did they get it?

Ms. SOHN. The regulatory scheme is different. We decided here that we are going to let the free market flourish, and what happened is competition has sunk to where it is right now where you have monopolies and duopolies.

Ms. LOFGREN. I think it's even been discussed here today that some of the issues are not amenable to antitrust remedies, and I think somebody said you might be able to charge Google, for example, a special fee for traveling on your network. Frankly, Google could afford it. But I'm more worried about not the Googles who are sitting financially very happily, but the guy in the garage who doesn't have that, and that we would have the ability really to stifle innovation without some guarantee of access.

Ms. SOHN. That is absolutely right. Chairman Goodlatte talked about what kind of investment would there be under net neutrality

rules. I think investment, where you are from, Congresswoman Lofgren, would be enormous. Investment in the next Twitter, the next NetFlix, the next Facebook, that is who we really care about here. You are right, Google can take care of itself. But imagine if 10 years ago Larry Page and Sergey Brin had gone to a venture capitalist and said, I would like you to fund this new crazy search engine idea I have; but, you know, AT&T/Verizon are asking me to pay for transport. The VC would say, See you later, I will invest in something else.

So it is really the next great innovation, like the ones that were used in Egypt to stir democracy. That is what I am really concerned about.

Ms. LOFGREN. I would just note that it is necessary, especially with the growth of video on the network, there is going to be some crunch time here as we catch up. But my understanding is that the rule does not forbid reasonable network management or nondiscriminatory pro-competitive management of the resources. I guess what I am hearing is that is not as well defined as it needs to be. It may be correct. We may need to have some closer definition so everybody knows what that means. If that is the take-away from this hearing, I think we will have achieved something.

Mr. GOODLATTE. I thank the gentlewoman.

Ms. LOFGREN. I thank the Chairman for yielding.

Mr. GOODLATTE. The gentleman from New York, Mr. Reed is recognized.

Mr. REED. Thank you, Mr. Chairman, and to each and every one of the witnesses here today.

Being relatively new to this body and to this Committee, I will say that I have a preference for witnesses that come from the front line, the people that are out there day in and day out—not to mean any disrespect to the think tanks and the academic world, we listen to them and enjoy their information—but I would like to have a conversation from you, Mr. Glass, because you are out there.

Since I am on the other side of the coast from California to New York, but rural New York, western New York, in your testimony you provided to us it talks about—I think there's a clause here, "Unfortunately, I am here to tell you today that the net neutrality rules enacted by the FCC will put wireless ISPs' efforts to provide competitive broadband and to deploy it to the rural and urban areas that do not have access or competition at risk."

I want to clearly understand what brings you to that conclusion. Can you summarize that for me?

Mr. GLASS. Well, Mr. Reed, there are several reasons why it would cause problems for us. First, it would discourage investment. Even when the notice of proposed rulemaking came out way before the rules were issued, we had investors who were very concerned. One fellow actually, very dramatically, clapped me on the back and said: The Feds are here. Small businesses like you aren't going to be able to play anymore. Why don't you go sell your business instead of asking for capital from me?

The second problem is the uncertainty of what we were allowed to do and what we can't do. We don't have freedom to innovate anymore without asking permission.

The third thing is the potential for censure by the FCC and serious penalties, if someone who isn't even our customer comes along and complains, and we have to either defend ourselves and buy expensive lawyer time or potentially be fined.

Mr. REED. Well, as a lawyer, I can understand that bill and that concern. And I always go after the frivolous lawyers because they give us all a bad name. And the defense cost, being a small business developer myself, that is a risk of business. So I appreciate that firsthand information.

Mr. Downes, in your testimony you indicated something about the risk of unintended consequences on this report ordered out of the FCC are high. What are those unintended consequences? Can you articulate those for me?

Mr. DOWNES. Well, it is difficult to articulate unintended consequences, but we essentially have a lot of history, not just with the FCC and not just with the Federal Government, State governments as well, who passed laws trying to regulate certain problems, sometimes very specific problems—say child pornography or indecent speech or other kinds of identify theft or spam and so on—where the legislation, because the process of legislating is relatively slow to the speed with which things change in terms of technology, and especially the Internet, by the time the legislation is passed, even with the best of intentions, it winds up certainly not solving the problem it intended to solve, and in fact opening up the door for unintended types of uses where regulatory agencies or local prosecutors would use that law to prosecute or try to interfere with behavior that they don't like, but which was not actually what the law was intending.

So my concern, particularly with this rule, is again that because the FCC has said these are the only exceptions that we are going to allow to the neutrality principle, these are the only network engineering practices that we think are acceptable, even though they're inconsistent, that the unintended consequence here will be a slowdown in the innovation of new techniques that we desperately need to keep the growth that we have.

Mr. REED. Thank you very much.

Ms. Sohn, do you see any unintended consequences on the horizon? I understand unintended consequence are hard to identify and articulate, but we have been regulating many industries for long periods of time. Do you see any similar situations where the unintended consequences could flow out of these types of actions?

Ms. SOHN. Well, look, you can always have unintended consequences. But I do think my fellow panelists are exaggerating, and let me tell you why. First of all, both of them say there have been hardly any documented instances of discrimination, so what is the problem? If that is the case, then you will not have hundreds of complaints.

My organization was one of the organizations that brought the complaint against Comcast for throttling back BitTorrent. That took an awful lot of work, okay, and the FCC rules say you have to make a prima facie case. So even if you give standing to everybody, not everybody has the expertise. And I can say in my organization, they don't have the resources to represent everybody. So I

think that unintended consequence is a little overwrought because it is really, really hard to bring a legitimate complaint.

And would you rather have class action suits? Would you rather have the States take care of it? I mean, class action suits were brought against Comcast in California and in Florida. So in some ways this process is even better

Mr. REED. I am a States' rights guy, so I would tread lightly there because the Federal Government, in my opinion, should be a limited Federal Government. So I would defer to the States.

Mr. Chairman, my time has expired so I will yield back.

Mr. GOODLATTE. I thank the gentleman. Now I proceed to recognize another Californian, the gentleman from Los Angeles, Mr. Berman.

Mr. BERMAN. Thank you, Mr. Chairman. It is good to be here. On medical malpractice, I am a States' rights guy.

We need to be on this whole subject, I think we need to be careful; at least my view is net neutrality means neutral as in anti-discriminatory and not necessarily a totally open net. If the FCC is going to regulate, there needs to be allowances for reasonable network management to stem the flow of infringing works, child pornography, unlawful content not in the American sense of unlawful, not in the Mubarak sense of unlawful. And why do I say that? Because I really think, ultimately, without the incentives for legitimate content, the Internet is never going to reach its full potential, which I think is a goal of the FCC, and it is therefore critical that policy makes it clear that steps can be taken to protect content from being stolen and that the existing rules do not prohibit ISPs from taking reasonable steps to do so.

I would like to ask one question. Ms. Sohn, how the heck are you?

Ms. SOHN. I am shocked you are asking me that question.

Mr. BERMAN. I thought you were going to say, Why don't you go back to Foreign Affairs?

In your testimony, you cite to the Comcast decision as one which illustrates a claim for why a provider may block access, and I will quote you here: Both providers deny wrongdoing and claim that these practices were designed to handle congestion, but in neither case did providers disclose their traffic management practices to subscribers. It is ironic that providers which publicly proclaim they have no intention of ever actually blocking or degrading content routinely include statements in their terms of service that would allow them to engage in precisely these practices and without prior notice to consumers.

I would like to get a little better handle on what concern you are expressing. Do you disagree there may be an appropriate situation in which access is denied or blocked and is the issue notices to subscribers? From your testimony, there is an acknowledgement that subscribers were informed in their terms of service, so is it something else that you are seeking here?

Ms. SOHN. So both former E&C Chairman Waxman and the FCC, I think wisely, decided to take matters of network management—that is, making the network flow properly—they took copyright infringement and pornography enforcement out of that standard, and I think that was the right choice. But what the FCC did

do, and I agreed with this, it said there should be nothing in the net neutrality rules that prevents Internet service providers from taking reasonable measures to protect against copyright infringement. And it also says that nothing in the net neutrality rules should prevent the enforcement of intellectual property laws.

So the point there is ISPs, if they engage in reasonable measures to enforce copyright, would be well within the net neutrality rules. And as I understand it today, content providers and ISPs are talking about what those reasonable measures should be.

So it is not network management in my mind, because that is about making sure that there is no congestion, but nothing in the FCC's rule would prohibit something like that happening. I am not a fan of blocking. I am certainly not a fan of ISPs throwing customers off the network, although they do have that ability to do that under the Digital Millennium Copyright Act if they are adjudged to be infringers, but I am not concerned that the network neutrality rules would prohibit reasonable measures to ensure that copyright.

Mr. BERMAN. So you are telling me that if my concern about net neutrality rules is that it will be interpreted to essentially prohibit ISPs from getting involved in efforts, reasonable steps to stop infringing material, I shouldn't be concerned because you are not seeking that?

Ms. SOHN. It is right there in the order. I don't want to be boastful, but I helped to negotiate that language. I guess I am being boastful. No, you should not worry.

Mr. BERMAN. That is the kind of thing that you can boast about any time for my purposes. Thank you.

I yield back.

Mr. GOODLATTE. The gentleman from Pennsylvania, Mr. Marino is recognized for 25 minutes.

Mr. MARINO. I guess I am going to pose this question to all three of you; but, Ms. Sohn, I will start with you. If the FCC gets involved here, would you agree with me that it needs an entirely additional level of administration?

Ms. SOHN. Well, I might agree that it could probably use one or two more administrative law judges to the extent there may be more adjudication. But the point I want to make, there is also this body called the Broadband Internet Technology Advisory Group, and I sit on its board along with Verizon, AT&T, Comcast, Google and others. That is going to be a place, a nongovernmental, multistakeholder forum where ISPs and others can go to get predeterminations as to whether something is reasonable network management.

I think that is going to take the load off the FCC from having to have layers and layers of new bureaucracy. They will still have to have some.

Mr. MARINO. If it is going to take the load off, then why have the FCC—and we are in a position here in this country where spending is out of control. Government is way too big, and we are talking about creating another administrative branch, even if it is a branch of the FCC, to come in and regulate.

Now, in my research concerning the FCC, it has been having a tough time regulating television and other matters. I see this as,

in addition to an impingement of perhaps constitutional rights violations, free speech, we have an entirely new, additional branch of government that we have to pay and it is something that we can't afford at this point.

Ms. SOHN. Well, look, the BITAG cannot enforce rules. It is not a government entity. It is a multi-stakeholder group that's only purpose is to tell ISPs whether, according to good engineering technique, or common engineering technique, something is reasonable network management or not. You still need a government agency to enforce rules of the road.

So you need both. I don't disagree with you. We don't want to bloat government bigger than it is already; however, they may need to shift some resources. They only have one or two administrative law judges, which is crazy. They have adjudications in other places. So they will need to add a few people, but I don't see it becoming more bloated.

Mr. MARINO. I have heard that before with the Federal Government. Let's start out with 2, and a year later it is 222. If we are going to hire more administrative law judges, I would be forced to argue there are other areas where we need administrative law judges, you and I disagree on that. Mr. Glass and then Mr. Downes, would you care to respond?

Mr. GLASS. Mr. Marino, I have actually expressed this in writings earlier that I made online. One of my concerns is that the push for network neutrality regulations at the FCC has diverted it from other pursuits which are more important. The FCC, after it published the national broadband plan, laid out a calendar that said certain things are going to be done in 2010. And because it was spending so much time and energy and money on addressing net neutrality, there were goals that it set for the third quarter of 2010 that it has not yet gotten to. So I am very concerned that it wasted a lot of the Commission's resources.

Mr. DOWNES. I certainly agree with that, particularly in terms of spectrum reform, which is another matter altogether. I think it is important to understand that the FCC has been out of the business of regulating the Internet in any respect since 1996. One of the things that is clear from the proceedings of the last year is that the FCC, and I don't mean any disrespect to the very hardworking staff over there, but they just don't understand technologically what happened in that intervening period. If they are going to start enforcing reasonable network managing practices, the engineering expertise will have to come up significantly from where it is.

I agree with Ms. Sohn that BITAG has great potential to assist them if they listen to the recommendations of BITAG. But in order for them to actually enforce these provisions, they are going to have to do things we don't necessarily like, which is look very closely at a lot of Internet traffic to see if in fact discrimination is happening, or if the speed is happening because the speed is happening.

Mr. MARINO. Just quickly, Mr. Downes, first, I want you to address the constitutionality or lack thereof, particularly pertaining to free speech, how do you see FCC, if it does have control and authority, drawing that line between the two?

Mr. DOWNES. The Report and Order sort of hedges its bets and contradicts itself in some sense, because the FCC does recognize under the Constitution and section 230 of the Communications Act, Internet service providers have the ability to shape content in many meaningful ways. So they haven't outright said they are going to stop that practice. But on the other hand, they said we don't see ISPs as typically being speakers. And at the same time, they recognize that under the Constitution and 230, they do have certain rights.

Mr. GLASS. Mr. Marino, I don't believe it is a First Amendment issue. There may be some Fifth Amendment issues, I think, possibly here, in that if conforming to these rules cripples our network, it may be considered regulatory taking.

Ms. SOHN. I am not sure what kind of speech a broadband Internet access provider actually is engaging in.

Mr. MARINO. That is my point.

Ms. SOHN. Well, no court that I know of has ever said that the owner of the infrastructure has an absolute First Amendment right. And to the extent that the courts have addressed it, it always has been balanced against the rights of the public to receive information. The classic case is the Turner case. It is an old case, but it still is the leading precedent in this area which said that cable operators had to carry over-the-air broadcast stations because the public had the right to see free over-the-air broadcast TV.

Mr. MARINO. Don't you see an onslaught of additional litigation?

Ms. SOHN. There already is.

Mr. MARINO. I mean more?

Ms. SOHN. Look, if Verizon and Metro PCS want to drop their lawsuit against the FCC, I would be all for it.

Mr. MARINO. That is an issue not before us, but that is my concern of, again, the additional litigation involved here plus the fact that the cost, that it is going to be to the American taxpayers.

Mr. GOODLATTE. If the gentleman would yield, the issue in that lawsuit is the very topic of the discussion here today being approached from a different vantage point, and that is, is the FCC under the laws passed by Congress entitled to do what they are trying to do?

It is now my pleasure to yield to the fourth woman from California, Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman.

Before I begin my questions, I ask unanimous consent to submit for the record the Department of Justice's competitive impact statement prepared by the agency's antitrust division in connection to the Comcast-NBC merger approval.

Mr. GOODLATTE. Without objection.

[The information referred to follows:]

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,
STATE OF CALIFORNIA,
STATE OF FLORIDA,
STATE OF MISSOURI,
STATE OF TEXAS, and
STATE OF WASHINGTON,

Plaintiffs,

v.

COMCAST CORP.,
GENERAL ELECTRIC CO., and
NBC UNIVERSAL, INC.,

Defendants.

Case: 1:11-cv-00106
Assigned To : Leon, Richard J.
Assign. Date : 1/18/2011
Description: Antitrust

COMPETITIVE IMPACT STATEMENT

The United States of America ("United States"), acting under the direction of the Attorney General of the United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA" or "Tunney Act"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment (attached hereto as Exhibit A) submitted for entry in this civil antitrust proceeding.

I. NATURE AND PURPOSE OF THE PROCEEDING

On December 3, 2009, Comcast Corporation ("Comcast"), General Electric Company ("GE"), NBC Universal, Inc. ("NBCU"), and Navy, LLC ("Newco"), announced plans to form a new Joint Venture ("JV") to which Comcast and GE will contribute broadcast and cable network assets. As a result of the transaction, Comcast – the nation's largest cable company – will have majority control of a JV holding highly valued video programming needed by Comcast's video distribution rivals to compete effectively.

The United States filed a civil antitrust Complaint on January 18, 2011, seeking to enjoin the proposed transaction because its likely effect would be to lessen competition substantially in the market for timely distribution of professional, full-length video programming to residential customers ("video programming distribution") in major portions of the United States in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. The transaction would allow Comcast to disadvantage its traditional competitors (direct broadcast satellite ("DBS") and telephone companies ("telcos") that provide video services), as well as competing emerging online video distributors ("OVDs"). This loss of current and future competition likely would result in lower-quality services, fewer choices, and higher prices for consumers, as well as reduced investment and less innovation in this dynamic industry.

On January 18, 2011, the Federal Communications Commission ("FCC") adopted a Memorandum Opinion and Order relating to the foregoing transaction.[1] The FCC's Order approved the transaction subject to certain conditions.

Under the proposed Final Judgment filed by the United States Department of Justice simultaneously with this Competitive Impact Statement and explained more fully below, Defendants will be required, among other things, to license the JV's programming to Comcast's emerging OVD competitors in certain circumstances. When Defendants and OVDs cannot reach agreement on the terms and conditions of the license, the aggrieved OVD may apply to the Department for permission to submit its dispute to commercial arbitration under the proposed Final Judgment. The FCC Order contains a similar provision. For so long as commercial arbitration is available for the resolution of such disputes in a timely manner under the FCC's

[1] Memorandum Opinion and Order, *In re Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees*, FCC MB Docket No. 10-56 (adopted Jan. 18, 2011). Under the Communications Act, the FCC has jurisdiction to determine whether mergers involving the transfer of a telecommunications license are in the "public interest, convenience, and necessity." 47 U.S.C. § 310(d).

rules and orders, the Department will ordinarily defer to the FCC's commercial arbitration process to resolve such disputes. However, the Department reserves the right, in its sole discretion, to permit arbitration under the proposed Final Judgment to advance the Final Judgment's competitive objectives. In addition, the Department may seek relief from the Court to address violations of any provisions of the proposed Final Judgment. The proposed Final Judgment also contains provisions to prevent Defendants from interfering with an OVD's ability to obtain content or deliver its services over the Internet.

The proposed Final Judgment will provide a prompt, certain, and effective remedy for consumers by diminishing Comcast's ability to use the JV's programming to harm competition. The United States and Defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment, and to punish and remedy violations thereof.

II. DESCRIPTION OF EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. Defendants, the Proposed Transaction, and the Department's Investigation

1. Comcast

Comcast is a Pennsylvania corporation headquartered in Philadelphia, Pennsylvania. It is the largest cable company in the nation, with approximately 23 million video subscribers. Comcast is also the largest Internet service provider ("ISP"), with over 16 million subscribers. Comcast also wholly owns national cable programming networks, including E! Entertainment, G4, Golf, Style, and Versus, and has partial ownership interests in Current Media, MLB Network, NHL Network, PBS KIDS Sprout, Retirement Living Television, and TV One. In

addition, Comcast has controlling and partial interests in regional sports networks ("RSNs").[2] Comcast also owns digital properties such as DailyCandy.com, Fandango.com, and Fancast, its online video website. In 2009, Comcast reported total revenues of $36 billion. Over 94 percent of Comcast's revenues, or $34 billion, were derived from its cable business, including $19 billion from video services, $8 billion from high-speed Internet services, and $1.4 billion from local advertising on Comcast's cable systems. In contrast, Comcast's cable programming networks earned only about $1.5 billion in revenues from advertising and fees collected from video programming distributors.

2. GE and NBCU

GE is a New York corporation with its principal place of business in Fairfield, Connecticut. GE is a global infrastructure, finance, and media company. GE owns 88 percent of NBCU, a Delaware corporation, headquartered in New York, New York. NBCU is principally involved in the production, packaging, and marketing of news, sports, and entertainment programming.

NBCU wholly owns the NBC and Telemundo broadcast networks, as well as ten local NBC owned and operated television stations ("O&Os"), 16 Telemundo O&Os, and one independent Spanish language television station. In addition, NBCU wholly owns national cable programming networks – Bravo, Chiller, CNBC, CNBC World, MSNBC, mun2, Oxygen, Sleuth, SyFy, and USA Network – and partially owns A&E Television Networks (including the Biography, History, and Lifetime cable networks), The Weather Channel, and ShopNBC.

NBCU also owns Universal Pictures, Focus Films, and Universal Studios, which produce films for theatrical and digital video disk ("DVD") release, as well as content for NBCU's and

[2] Comcast owns Comcast SportsNet ("CSN") Bay Area, CSN California, CSN Mid-Atlantic, CSN New England, CSN Northwest, CSN Philadelphia, CSN Southeast, and CSN Southwest, and holds partial ownership interests in CSN Chicago, SportsNet New York, and The Mtn.

other companies' broadcast and cable programming networks. NBCU produces approximately three-quarters of the original primetime programming shown on the NBC broadcast network and the USA cable network, NBCU's two highest-rated networks. In addition to its programming assets, NBCU owns several theme parks and digital assets, such as iVillage.com. In 2009, NBCU had total revenues of $15.4 billion.

NBCU also is a founding partner and 32 percent owner of Hulu, LLC, currently one of the most successful OVDs. Hulu is a joint venture between NBCU, News Corp., The Walt Disney Company, and a private equity investor. Each of the media partners has representation on the Hulu Board, possesses management rights, and licenses content for Hulu to deliver over the Internet.

3. The Proposed Transaction

On December 3, 2009, Comcast, GE, NBCU, and Newco, entered into a Master Agreement ("Agreement"), whereby Comcast agreed to pay $6.5 billion in cash to GE, and Comcast and GE each agreed to contribute certain assets to the JV. Specifically, GE agreed to contribute all of the assets of NBCU, including its interest in Hulu, and the 12 percent interest in NBCU that GE does not own but has agreed to purchase from Vivendi SA. Comcast agreed to contribute all its cable programming assets, including its national programming networks, its RSNs, and some digital properties, but not its cable systems or its Internet video service, Fancast. As a result of the content contributions and cash payment by Comcast, Comcast will own 51 percent of the JV, and GE will retain a 49 percent interest. The JV will be managed by a separate Board of Directors consisting initially of three Comcast-designated directors and two GE-designated directors. Board decisions will be made by majority vote.

The Agreement precludes Comcast from transferring its interest in the JV for a four-year period, and prohibits GE from transferring its interest for three and one-half years. Thereafter, either party may sell its respective interest in the JV, subject to Comcast's right to purchase at fair market value any interest that GE proposes to sell. Additionally, three and one-half years after closing, GE will have the right to require the JV to redeem 50 percent of GE's interest and, after seven years, GE will have the right to require the JV to redeem all of its remaining interest. If GE elects to exercise its first right of redemption, Comcast will have the contemporaneous right to purchase the remainder of GE's ownership interest once a purchase price is determined. If GE does not exercise its first redemption right, Comcast will have the right to buy 50 percent of GE's initial ownership interest five years after closing and all of GE's remaining ownership interest eight years after closing. It is expected that Comcast ultimately will own 100 percent of the JV.

4. The Department's Investigation

The Department opened an investigation soon after the JV was announced and conducted a thorough and comprehensive review of the video programming distribution industry and the potential implications of the transaction. The Department interviewed more than 125 companies and individuals involved in the industry, obtained testimony from Defendants' officers, required Defendants to provide the Department with responses to numerous questions, reviewed over one million business documents from Defendants' officers and employees, obtained and reviewed tens of thousands of third-party documents, obtained and extensively analyzed large volumes of industry financial and economic data, consulted with industry and economic experts, organized product demonstrations, and conducted independent industry research. The Department also consulted extensively with the FCC to ensure that the agencies conducted their reviews in a

coordinated and complementary fashion and created remedies that were both comprehensive and consistent.

B. The Video Programming Industry

NBCU and Comcast are participants in the video programming industry, in which content is produced and distributed to viewers through their television sets or, increasingly, through Internet-connected devices. Historically, the video programming industry has had three different levels: content production, content aggregation or networks, and distribution.

1. Content Production

Television production studios produce television shows and coordinate how, when, and where their content is licensed in order to maximize revenues. They usually license to broadcast and cable networks the right to show a program first (*i.e.*, the first-run rights). Content producers also license their content for subsequent "windows" such as syndication (*e.g.*, licensing series to broadcast and cable networks after the first run of the programming), as well as for DVD distribution, video on demand ("VOD"), and pay per view ("PPV") services. For example, the television show *House* is produced by NBCU, licensed for its first run on the FOX broadcast network and then rerun on the USA Network, a cable network owned by NBCU. These content licenses often include ancillary rights such as the right to offer some programming on demand.

Historically, first-run licenses were reserved for one of the four major broadcast networks (ABC, CBS, NBC, and FOX), followed by broadcast syndication and, ultimately, cable syndication. Over the past several years, however, content owners have begun to license their content for first run on cable networks and distribution over the Internet on either a catch-up (*e.g.*, next day) or syndicated (*e.g.*, next season) basis.

In addition to producing content for television and cable networks, NBCU produces and distributes first-run movies through Universal Pictures, Universal Studios, and Focus Films. Typically, producers distribute movies to theaters before releasing them on DVD, then license them to VOD/PPV providers, then to premium cable channels (*e.g.*, Home Box Office ("HBO")), then to regular cable channels, and finally to broadcast networks. As with television distribution, studios have experimented with different windows for film distribution over the past several years.

2. Programming Networks

Networks aggregate content to provide a 24-hour service that is attractive to consumers. The most popular networks, by far, are the four broadcast networks.[3] However, cable networks have grown in popularity and number, and at the end of 2009 there were an estimated 600 national, plus another 100 regional, cable programming networks.

a. Broadcast Networks

Owners of broadcast network programming or broadcasters like NBCU license their broadcast networks either to third-party television stations affiliated with that network ("network affiliates"), or to their owned and operated television stations ("O&Os"). The network affiliates and O&Os distribute the broadcast network feeds over the air ("OTA") to the public and also retransmit them to video programming distributors, such as cable companies and DBS providers, which in turn distribute the feeds to their subscribers.

Under the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"), Pub. L. No. 102-385, 106 Stat. 1460 (1992), broadcast television stations, whether

[3] The four largest broadcast networks attract 8 to 12 million viewers each, whereas the most popular cable networks typically attract approximately 2 million viewers each. SNL Kagan, *Economics of Basic Cable Networks* 43 (2009); The Nielsen Company, *Snapshot of Television Use in the U.S.* 2 (Sept. 2010), http://blog.nielsen.com/nielsenwire/wp-content/uploads/2010/09/Nielsen-State-of-TV-09232010.pdf.

network affiliates or O&Os, may elect to obtain "retransmission consent" from a programming distributor, in which case a distributor negotiates with a station for the right to carry the station's programming for agreed-upon terms. Alternatively, stations may elect "must carry" status and demand carriage but without compensation. Stations affiliated with the four major broadcast networks and the networks' O&Os have elected retransmission consent. Historically, these stations negotiated for non-monetary compensation (*e.g.*, carriage of new cable channels owned by the broadcaster) in exchange for retransmission consent. Today, most broadcast stations seek retransmission consent fees based on the number of subscribers to the cable, DBS, or telco service distributing their content.[4] Less popular broadcast networks generally elect must carry status, although recently they also have begun to negotiate retransmission payments. Despite these retransmission payments, broadcast stations earn the majority of their revenues from local advertising sales. The broadcast networks earn most of their revenues from national advertising sales.

b. Cable Networks

Popular cable networks include ESPN, USA, MTV, CNN, and Bravo. Cable networks typically derive roughly one half of their revenues from licensing fees paid by video programming distributors and the other half from advertising fees. Generally, a distributor pays an owner of cable networks a monthly per-subscriber fee that may vary based upon the number of subscribers served by the distributor, the programming packages in which the program is included, the percentage of the distributor's subscribers receiving the programming, and other factors. Typically, the popularity or ratings of a network's programming affects the ability of a

[4] In the past, NBCU negotiated the retransmission rights only for its O&Os, but recently it has made efforts to obtain the rights from its network affiliates to negotiate retransmission consent agreements on their behalf. NBCU also may seek to renegotiate its agreements with its affiliates to obtain a share of any retransmission consent fees the affiliates are able to command.

content owner to negotiate higher license fees. In addition to the right to carry the network, a distributor of the cable network often receives two to three minutes of advertising time per hour on the network for sale to local businesses (*e.g.*, car dealers). A distributor also may receive marketing payments or discounts to encourage wider distribution of the programming. In the case of a completely new cable network, a programmer may pay a distributor to carry the network or offer other discounts.

3. Video Programming Distribution

Video programming distributors acquire the rights to transmit professional (as opposed to user-generated videos such as those typically seen on YouTube), full-length (as opposed to clips) broadcast and cable programming networks or individual programs or movies, aggregate the content, and distribute it to their subscribers or users. This content includes live programming, sports, and general entertainment programming from a variety of broadcast and cable networks and from movie studios, and can be viewed either on demand or as scheduled in a broadcast or cable network's linear stream. Video programming distributors offer various packages of content (*e.g.*, basic, expanded basic, digital) with different quality levels (*e.g.*, standard definition, HD, 3D), and employ different business models (*e.g.*, ad-supported, subscription).

a. Multichannel Video Programming Distributors

Traditional video programming distributors include incumbent cable companies, DBS providers, cable overbuilders, also known as broadband service providers ("BSPs," such as RCN), and telcos. These distributors are referred to as multichannel video programming distributors ("MVPDs"), and typically offer hundreds of channels of professional video programming to residential customers for a fee.

b. Online Video Programming Distributors

OVDs are relatively recent entrants into the video programming distribution market. They deliver a variety of on-demand professional, full-length video programming over the Internet, whether streamed to Internet-connected televisions or other devices, or downloaded for later viewing. Hulu, Netflix, Amazon, and Apple are examples of OVDs, although the content delivered and business model used varies greatly among them.

Unlike MVPDs, OVDs do not own distribution facilities and are dependent upon ISPs for the delivery of their content to viewers. Therefore, the future growth of OVDs depends, in part, on how quickly ISPs expand and upgrade their broadband facilities and the preservation of their incentives to innovate and invest.[5] The higher the bandwidth available from the ISP, the greater the speed and the better the quality of the picture delivered to an OVD's users.

ISPs' management and pricing of broadband services may also affect OVDs. In particular, OVDs would be harmed competitively if ISPs that are also MVPDs (*e.g.*, cable companies, telcos) were to impair or delay the delivery of video because OVDs pose a threat to those MVPDs' traditional video programming distribution businesses. Because Comcast is the country's largest ISP, an inherent conflict exists between Comcast's provision of broadband services to its customers, who may use this service to view video programming provided by OVDs, and its desire to continue to sell them MVPD services.

Growth of OVDs also will depend, in part, on their ability to acquire programming from content producers. Some cable companies, such as Comcast and Cablevision Corp., have purchased or launched their own cable networks. This vertical integration of content and distribution was one reason for the passage of Section 19 of the 1992 Cable Act, 47 U.S.C. § 548. Pursuant to the Act, Congress directed the FCC to promulgate rules that place restrictions

[5] *See* discussion *infra* Section II.C.2.b.

on how cable programmers affiliated with a cable company deal with unaffiliated distributors. These "program access rules" were designed to prevent vertically integrated cable companies from refusing to provide popular programming to their competitors. The rules prohibit both the cable company and a cable network owned by it from engaging in unfair acts and practices, including: (1) entering into exclusive agreements to distribute the cable network; (2) selling the cable network to the cable company's competitors on discriminatory terms and conditions; and (3) unduly influencing the cable network in deciding to whom, and on what terms and conditions, to sell its programming.[6] The FCC program access rules do not apply to online distribution or to retransmission of broadcast station content.

C. The Market for Video Programming Distribution in the United States

The relevant product market affected by this transaction is the market for timely distribution of professional, full-length video programming to residential customers ("video programming distribution"). Professionally produced content is video programming that is created or produced by media and entertainment companies using professional equipment, talent, and production crews, and for which those companies hold or maintain distribution and syndication rights. Video programming distribution is characterized by the aggregation of professionally produced content consisting of entire episodes of shows and movies, rather than short clips. The market for video programming distribution includes both MVPDs and OVDs.

1. Traditional Video Programming Distribution

Cable companies first began operating in the 1940s and initially were granted exclusive franchises to serve local communities. Although they now face competition, the incumbent cable companies continue to serve a dominant share of subscribers in most areas. In the mid-

[6] 47 C.F.R. §§ 76.1001-76.1002. The prohibition on exclusivity sunsets in October 2012, unless extended by the FCC pursuant to a rulemaking. *Id.* § 76.1002 (c)(6).

1990s, DirecTV and DISH Network began to offer competing services using small satellite dishes installed on consumers' homes. Around the same time, cable overbuilders began building their own wireline networks in order to compete with the incumbent cable operator and offer video, high-speed Internet, and telephony services – the "triple-play." More recently, Verizon and AT&T entered the market with their own video distribution services, also offering the triple-play. Competition from these video programming distributors encouraged incumbent cable operators across the country to upgrade their systems and offer many more video programming channels, as well as the triple-play. Further innovations have included digital video recorders ("DVRs") that allow consumers to record programming and view it later, and VOD services that enable viewers to watch broadcast or cable network programming or movies on demand at the consumer's convenience for a limited time.

A consumer purchasing video programming distribution services selects from those distributors offering such services directly to that consumer's home. The DBS operators – DirecTV and DISH – can reach almost any consumer who lives in the continental United States and has an unobstructed line of sight to the DBS operators' satellites. However, wireline cable distributors, such as Comcast and Verizon, generally must obtain a franchise from local or state authorities to construct and operate a wireline network in a specific area, and can build lines only to the homes in that area. A consumer cannot purchase video programming distribution services from a wireline distributor operating outside its area because that firm does not have the facilities to reach the consumer's home. Consequently, although the set of video programming distributors able to offer service to individual consumers' residences generally is the same within each local community, that set differs from one local community to another and can even vary within a local community. The markets for video programming distribution therefore are local.

The geographic markets relevant to this transaction are the numerous local markets throughout the United States where Comcast is the incumbent cable operator and where Comcast through the JV will be able to withhold NBCU programming from, or raise programming costs to, Comcast's rival distributors. Comcast service areas cover 50 million U.S. television households or about 45 percent of households nationwide, with nearly half of those households (23 million) subscribing to at least one Comcast service. Competitive effects also may be felt in other areas because Comcast's competitors serve territories outside its cable footprint. If Comcast can disadvantage these rivals, for example by raising their costs, competition will be reduced everywhere these competitors provide service reflecting these higher costs. Thus, the potential anticompetitive effects of the transaction could extend to almost all Americans.

The incumbent cable companies often dominate any particular market and typically hold well over 50 percent market shares within their franchise areas. For example, Comcast has market shares of 64 percent in Philadelphia, 62 percent in Chicago, 60 percent in Miami, and 58 percent in San Francisco (based on MVPD subscribers). Combined, the DBS providers account for approximately 31 percent of video programming subscribers nationwide, although their shares vary and may be lower in any particular local market. Although AT&T and Verizon have had great success and achieved penetration (*i.e.*, the percentage of households to which a provider's service is available that actually buys its service) as high as 40 percent in the selected communities they have entered, they currently have limited expansion plans. Overbuilders serve an even smaller portion of the United States.

2. Competition from OVDs

OVDs are relatively recent entrants into the video programming distribution market. Their services are available to any consumer with high-speed Internet service sufficient to

receive video of an acceptable quality. OVDs have increased substantially the amount of full-length professional content they distribute online. Viewership of video content distributed over the Internet has grown enormously and is expected to continue to grow. The number of adult Internet users who watch full-length television shows online is expected to increase from 41.1 million in 2008 to 72.2 million in 2011.[7] The total number of unique U.S. viewers of video who watch full-length television shows online grew 21 percent from 2008 to 2009.[8] OVD revenues also have increased dramatically. Revenue associated with video content delivered over the Internet to televisions is expected to grow from $2 billion in 2009 to over $17 billion in 2014.[9]

One reason for the dramatic growth of online distribution is the increased consumer interest in on-demand viewing, especially among younger viewers who have grown up with the Internet, and are accustomed to viewing video at a time and on a device of their choosing.[10] In response to competition by OVDs, MVPDs increasingly are offering more on-demand choices.

a. OVD Business Models and Participants

Recognizing the enormous potential of OVDs, dozens of companies are innovating and experimenting with products and services that either distribute online video programming or facilitate such distribution. New developments, products, and models are announced on almost a

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[7] *Reaching Online Video Viewers with Long-Form Content*, eMarketer.com (July 26, 2010), http://www3.emarketer.com/Article.aspx?R=1007830.

[8] *Id.*

[9] Robert Briel, *Faster growth for web-to-TV video*, Broadband TV News (Aug. 17, 2010), http://www.broadbandtvnews.com/2010/08/17/faster-growth-for-web-to-tv-video.

[10] *See* R. Thomas Umstead, *Younger Viewers Watching More TV on the Web*, Multichannel News (Apr. 12, 2010), http://www.multichannel.com/article/451376-Younger_Viewers_Watching_More_Television_On_The_Web.php (survey of more than 1,000 people shows 23 percent under the age of 25 watch most of their television online).

daily basis by companies seeking to satisfy consumer demand. A number of companies are committing significant resources to this industry.

OVDs provide content using a variety of different business models. Some offer content on an ad-supported basis pursuant to which consumers pay nothing. One firm using this model is Hulu, which aggregates primarily current-season broadcast content from NBC, FOX, ABC, and others. Hulu has experienced substantial growth since its launch in 2008, reaching 39 million unique viewers by February 2010.[11]

Netflix has pursued a different business model. It initially offered DVDs delivered by mail and then added unlimited streaming of a limited library of content over the Internet for a monthly subscription fee. Netflix has expanded its online library and introduced an Internet-only subscription service. Netflix content primarily consists of relatively recent movies, older movies, and past-season television shows. Netflix recently announced a deal with premium cable network EPIX for access to more movie content that it will distribute over the Internet.[12] Netflix also has grown substantially in the last several years, from 7.5 million subscribers at the end of 2007 to 16.9 million in the third quarter of 2010.[13]

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[11] Press Release, *comScore Releases February 2010 U.S. Online Video Rankings, Hulu Viewer Engagement Up 120 percent vs. Year Ago to 2.4 Hours of Video per Viewer in February* (Apr. 13, 2010), http://www.comscore.com/Press_Events/Press_Releases/2010/4/comScore_Releases_February_2010_U.S._Online_Video_Rankings.

[12] Netflix, Inc., Q3 10 Management's commentary and financial highlights, at 2 (Oct. 20, 2010), *available at* http://files.shareholder.com/downloads/NFLX/1118542273x0x411049/157a4bc4-4cad-4d7b-9496-b59006d73344/Q310%20Management%27s%20commentary%20and%20financial%20highlights.pdf.

[13] Netflix, Inc., Form 10-K at 32 (Feb. 22, 2010); Press Release, Netflix, Inc. Netflix Announces Q3 2010 Financial Results, at 1 (Oct 20, 2010), *available at* http://files.shareholder.com/downloads/NFLX/1118542273x0x411037/5a757dd5-b423-40d7-bb60-3418356e582e/3Q10_Earnings_Release.pdf.

Apple also is experimenting with different business models for video programming distribution. For several years it has offered content on an electronic sell-through ("EST") basis through its Apple iTunes Store. Customers pay a per-transaction fee to buy television shows and movies and download them onto various electronic devices (*e.g.*, iPod). Apple recently announced a service that allows consumers to rent television content on a per-transaction basis (*e.g.*, $0.99 per show) and view it for a limited time. Other major companies are offering or planning to offer OVD services.[14]

b. The Impact of OVDs

Some of these OVD products and services undoubtedly will be viewed by consumers as closer substitutes for MVPD services than others. The extent to which an OVD service has the potential to become a better substitute for MVPD service will depend on a number of factors, such as the OVD's ability to obtain popular content, its ability to protect the licensed content from piracy, its financial strength, and its technical capabilities to deliver high-quality content. Moreover, as noted previously, OVDs' future competitive significance depends, in part, on robust broadband capacity. Accordingly, the competitive significance of OVDs is fostered by

[14] For example, Google recently launched GoogleTV, a device that enables viewers simultaneously to search the Internet and their MVPD service for content, and to switch back and forth on their televisions between content delivered over the Internet and content delivered by their MVPD. Press Release, Google, *Industry Leaders Announce Open Platform to Bring Web to TV* (May 20, 2010), http://www.google.com/intl/en/press/pressrel/20100520_googletv.html. Walmart recently acquired VUDU, an OVD service, and is making content available for EST and rental to VUDU-enabled devices. Press Release, *Walmart Announces Acquisition of Digital Entertainment Provider, VUDU* (Feb. 22, 2010), http://www.walmartstores.com/pressroom/news/9661.aspx. Amazon is reportedly developing an OVD service that allows Amazon service subscribers to stream television and movie content over the Internet. Nick Wingfield & Sam Schechner, *No Longer Tiny, Netflix Gets Respect and Creates Fear*, Wall St. J. (Dec. 6, 2010), http://online.wsj.com/article/SB10001424052748704493004576001781352962132.html. Sears and Kmart recently announced the launch of an online video store, called Alphaline, which sells and rents movies and television shows. Paul Bond, *Sears, Kmart launch Alphaline online video store*, REUTERS (Dec. 30, 2010), http://www.reuters.com/article/idUSTRE6BT03C20101230.

protecting broadband providers' economic incentives to upgrade and improve their broadband infrastructure, and obtain fair returns on that investment.

Today, some consumers regard OVDs as acceptable substitutes for at least a portion of their traditional video programming distribution services. These consumers buy smaller content packages from traditional distributors, decline to take certain premium channels, or purchase fewer VOD offerings, and instead watch that content online, a practice known as "cord-shaving." A small but growing number of MVPD customers are also "cutting the cable cord" completely in favor of OVDs. These customers may rely on an individual OVD or may view video content from a number of OVDs (*e.g.*, Hulu ad-supported service, Netflix subscription service, Apple EST service) as a replacement for their MVPD service.

When measured by the number of customers who are cord-shaving or cord-cutting, OVDs currently have a *de minimis* share of the video programming distribution market. Their current market share, however, greatly understates their potential competitive significance in this market. Whether viewers buy individual or a combination of OVD services, OVDs are likely to continue to develop into better substitutes for MVPD video services. Evolving consumer demand, improving technology (*e.g.*, higher Internet access speeds, better compression technologies to improve picture quality, improved digital rights management to combat piracy), the increased choice of viewing devices, and advertisers' increasing willingness to place their ads on the Internet likely will make OVDs stronger competitors to MVPDs for an increasing number of viewers.[15]

[15] Historically, OTA distribution of broadcast network content has not served as a significant competitive constraint on MVPDs because of the limited number of channels offered. In addition, OTA distribution likely will not expand in the future because no new broadcast networks are likely to be licensed for distribution. Thus, OTA is unlikely to become a more significant video programming distributor. By contrast, OVDs are expanding rapidly and have the potential to provide increased and more innovative viewing options in the future.

The development of the video programming distribution market – and in particular the success of OVDs – may influence any future analysis of consolidation in this market. Such analysis would follow standard merger evaluation principles and consider not only the role of OVDs, but also factors such as the extent to which the merging firms' offerings are close substitutes and compete directly. In this case, Defendants' own assessments – as reflected in numerous internal documents and their executives' testimony – of the importance of OVDs and their potential to alter dramatically the existing competitive landscape are particularly important to determining the relevant product market.

c. Comcast's and Other MVPDs' Reactions to the Growth of OVDs

Comcast and other MVPDs recognize the threat posed to their video distribution business from the growth of OVDs. Many internal documents reflect Comcast's assessment that OVDs are growing quickly and pose a competitive threat to traditional forms of video programming distribution. In response to this threat, Comcast has taken significant steps to improve the quality of Fancast, its own Internet video service. Among other things, Comcast has attempted to obtain additional – and at times exclusive – content from programmers, and has made Fancast's user interface easier to navigate. Comcast also has increased the quality and quantity of the VOD content it offers as an adjunct to its traditional cable service.

In addition, Comcast has created and implemented an "authentication" system that enables its existing cable subscribers to view some video content over the Internet if the subscriber already pays for and receives the same content from Comcast through its traditional cable service. Internal documents expressly acknowledge that "authentication" is Comcast's and other MVPDs' attempt to counter the perceived threat posed by OVDs.

Comcast's and other MVPDs' reactions to the emergence of OVDs demonstrate that they view OVDs as a future competitive threat and are adjusting their investment decisions today in response to that threat. Because OVDs today affect MVPDs' decisions, they are appropriately treated as participants in the market. Market definition considers future substitution patterns, and the investment decisions of MVPDs are strong evidence of market participants' view of the increased likelihood of consumer substitution between MVPD and OVD services.[16] This effect on investment is significant and could be diminished or even lost altogether if Comcast, through the JV, acquires the ability to delay or deter the development of OVDs.

D. The Anticompetitive Effects of the Proposed Transaction

Antitrust law, including Section 7 of the Clayton Act, protects consumers from anticompetitive conduct, such as firms' acquisition of the ability to raise prices above levels that would prevail in a competitive market. It also ensures that firms do not acquire the ability to stifle innovation. Vertical mergers are those that occur between firms at different stages of the chain of production and distribution. Vertical mergers have the potential to harm competition by changing the merged firm's ability or incentives to deal with upstream or downstream rivals. For example, the merger may give the vertically integrated entity the ability to establish or protect market power in a downstream market by denying or raising the price of an input to downstream rivals that a stand-alone upstream firm otherwise would sell to those downstream firms. The merged firm may find it profitable to forego the benefits of dealing with its rivals in order to hobble them as competitors to its own downstream operations.

[16] *Cf.* U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* § 5.2 (Aug. 19, 2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.html ("However, recent or ongoing changes in market conditions may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance. The Agencies consider reasonably predictable effects or ongoing changes in market conditions when calculating and interpreting market share data.").

A merged firm can more readily harm competition when its rivals offer new products or technologies whose competitive potential is evolving. Nascent competitors may be relatively easy to quash. For example, denying an important input, such as a popular television show, to a nascent competitor with a small customer base is much less costly in terms of foregone revenues than denying that same show to a more established rival with a larger customer base. Even if a vertical merger only delays nascent competition, an increase in the duration of a firm's market power can result in significant competitive harm. The application and enforcement of antitrust law is appropriate in such situations because promoting innovation is one of its important goals.[17] The crucial role of innovation has led at least one noted commentator to argue that restraints on innovation "very likely produce a far greater amount of economic harm than classical restraints on competition," and thus deserve special attention.[18] By quashing or

[17] U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* § 1 (Apr. 1995), *available at* http://www.justice.gov/atr/public/guidelines/0558.htm ("The antitrust laws promote innovation and consumer welfare by prohibiting certain actions that may harm competition with respect to either existing or new ways of serving consumers."); *see also* 19A Phillip E. Areeda et al., *Antitrust Law*, ¶ 1902a (2d ed. 2005) ("Our capitalist economic system places a very strong value on competition, not only to reduce costs but also to innovate new products and processes.").

[18] Herbert Hovenkamp, *Restraints on Innovation*, 29 Cardozo L. Rev. 247, 253-54, 260 (2007) ("[N]o one doubts [the] basic conclusion that innovation and technological progress very likely contribute much more to economic growth than policy pressures that drive investment and output toward the competitive level."); *see also* 4B Phillip E. Areeda et al., *Antitrust Law*, ¶ 407a (3d ed. 2007); Willow A. Sheremata, *Barriers to innovation: a monopoly, network externalities, and the speed of innovation*, 42 Antitrust Bull. 937, 938 (1997) ("'[I]n the long run it is dynamic performance that counts.' The speed of innovation is important to social welfare." (quoting F.M. Scherer & David Ross, Industrial Market Structure & Economic Performance 613 (3d ed. 1990))).

delaying the progress of rivals that attempt to introduce new products and technologies, the merged firm could slow the pace of innovation in the market and thus harm consumers.[19]

1. The Importance of Access to NBCU Content

Generally, programmers want to distribute their content in multiple ways to maximize viewers' exposure to the content and the impact of any advertising revenues. Likewise, distributors must be able to license a sufficient quantity and quality of content to create a compelling video programming service. A distributor also must gain access to a sufficient variety of content from different sources. This "aggregation" of a variety of content is important to a distributor's ability to succeed.

NBCU content is extremely valuable to video programming distributors. NBC is one of the original three broadcast networks and has decades of history and brand name recognition. It carries general interest content that appeals to a wide variety of viewers. Surveys routinely rank the NBC network as one of the top four of all broadcast and cable networks. Similarly, NBCU's USA Network is highly valued and has been rated the top cable network for four of the past five years. Many of NBCU's other networks – Bravo, CNBC, MSNBC, SyFy – also are highly rated and valued by their audiences.

The proposed transaction would give Comcast, through the JV, control of an important portfolio of current and library content. The ratings of each NBCU network are based on the popularity of the particular slate of shows currently on that network and can increase or decrease significantly from one television season to the next based on the gain or loss of hit shows. NBCU also has the ability to switch programming from one network to another, or otherwise make popular content from one network available to another. Through the JV, Comcast would

[19] *See* Sheremata, *supra* note 18, at 944 ("When owners of current technology raise artificial barriers to entry of new technology, opportunities for innovation decline to the detriment of consumers.").

gain the ability to impair emerging OVD competition by withholding or raising the prices of individual NBCU shows, or of linear feeds of one or more NBCU cable or broadcast networks. It is reasonable to examine the competitive impact of withholding NBCU content in the aggregate, rather than analyzing the value of any individual show or network to a competitor, because an aggregate withholding strategy would have the greatest impact on Comcast's downstream rivals.

2. The Proposed Transaction Increases the JV's Incentive and Ability to Harm Competitors

a. Ability and Incentive to Harm Rival MVPDs

If the proposed transaction is approved, Comcast through the JV will gain control of NBCU's content, including a substantial amount of valuable broadcast and cable programming. Competing MVPDs will be forced to obtain licenses for NBCU content from their rival, Comcast. Unlike a stand-alone programmer, Comcast's pricing and distribution decisions will take into account the impact of those decisions on the competitiveness of rival MVPDs. As a result, Comcast will have a strong incentive to disadvantage its competitors by denying them access to valuable programming or raising their licensing fees above what a stand-alone NBCU would have found it profitable to charge.

A stand-alone programmer typically attempts to maximize the combined license fee and advertising revenues from its programming by making its content available in multiple ways. The JV would continue to value widespread distribution of NBCU content, but it also would likely consider how access to that content makes Comcast's MVPD rivals better competitors. This could lead the JV to withhold content altogether or, more likely, to insist on higher fees for the NBCU content from Comcast's MVPD competitors. Whether Comcast's rival MVPDs refuse to purchase the programming or agree to pay the higher fees, Comcast would benefit from

weakening its MVPD rivals. Likewise, high licensing fees charged to other MVPDs and OVDs will also induce customers to switch to (or stay with) Comcast. These higher licensing fees will be reflected either in higher subscriber fees or, in the case of MVPDs building alternative cable distribution infrastructures, a smaller level of investment and, consequently, a smaller coverage area for the MVPD competing with Comcast. In either case, higher licensing fees will reduce pricing pressure on Comcast's MVPD business and increase its ability to raise prices to its subscribers.

By disadvantaging competitors in this manner, Comcast through the JV will cause some of its rivals' customers to seek an alternative MVPD provider. Many of these dissatisfied customers likely will become Comcast subscribers, making it profitable for Comcast and the JV to increase licensing fees above the stand-alone NBCU levels. Those increased fees likely will lead to higher prices for subscribers of other MVPDs and perhaps further migration by those subscribers to Comcast.

Licensing disputes in which a major broadcast network has pulled a network signal from an MVPD have resulted in the MVPD's loss of significant numbers of subscribers to its competitors. Through the formation of the JV, Comcast gains the rights to negotiate on behalf of the seven O&Os that operate in areas where it is the dominant cable company. It also becomes the owner of the NBC network, which may give it leverage to seek the rights to negotiate on behalf of NBCU's NBC network affiliate television stations, or at least the ability to influence affiliate negotiations, for retransmission consent rights in other areas of the United States. Comcast, through the JV, can withhold or raise the price of the NBC network to its rivals, thereby causing customers to shift away from the rival. Other NBCU programming also is

important to consumers, and similar switching behavior could result if the JV were to withhold it from Comcast's rival MVPDs.

Comcast has engaged in such strategies in the past. For example, Comcast has withheld its RSN in Philadelphia in order to discriminate against, and thereby disadvantage, DBS providers against which Comcast competes in that city. The DBS providers' market shares are lower and Comcast's subscription fees are higher in Philadelphia than in comparable markets. This appears to have been a profitable strategy for Comcast because the overall benefit to its cable business of retaining subscribers seems to have outweighed the substantial losses associated with failing to earn licensing fees for the withheld RSN from DBS companies.

Post-transaction, Comcast's rival MVPDs would realize that, unlike the stand-alone NBCU, the JV will set higher licensing fees for NBCU that take into consideration Comcast's business profits. Some MVPDs might find it unprofitable to carry the programming at the prices the JV could command. Other MVPDs might agree to the JV's increased prices for the NBCU content given the likelihood that they would lose a large number of their subscribers if they did not carry the NBCU content.

Lowering the profitability of Comcast's MVPD rivals also would weaken the incentives of some existing and future entrants to build out their systems, especially in areas Comcast currently serves, weakening the competitive constraints faced by Comcast. This weakened state of competition would allow Comcast, in turn, to decrease its investments and innovation to improve its own offerings. Higher subscription fees for Comcast services or decreased investment in improving their quality are less likely to induce customer switching to Comcast's MVPD rivals where those rivals are unable to match its programming or prices. As a result,

Comcast could reinforce and even increase its dominant market share of video programming distribution in all areas of the country in which it operates.

b. Incentive and Ability to Harm OVDs

Comcast, through the JV, also could discriminate against competing OVDs in similar ways, thereby diminishing the competitive threat posed by individual OVDs and impeding the development of OVDs, generally. The JV could charge OVDs higher content fees than the stand-alone NBCU would have charged, or impose different terms for NBCU content than Comcast negotiates for itself. The JV also could withhold NBCU content completely, thereby diminishing OVDs' ability to compete for video programming distribution customers, again to Comcast's benefit. Either situation could delay significantly the development of OVDs as a competitive alternative to traditional video programming distribution services.

Over the last several years, NBCU has been one of the content providers most willing to experiment with different methods of online distribution. It was a driving force behind the creation and success of Hulu, and is now a partner in, and major content contributor to, the recently launched Hulu Plus, a subscription version of Hulu. Prior to the JV announcement, NBCU entered into several contracts with OVDs to distribute its content online through Apple iTunes and Amazon, and on a subscription basis through Netflix. Allowing the JV to proceed removes NBCU content from the control of a company that supported the development of OVDs and places it in the control of a company that views OVDs as a serious competitive threat.

Finally, Comcast, through the JV, would gain control of NBCU's governance rights and 32 percent ownership interest in Hulu, a current and future competitor to Comcast's MVPD services. Hulu has achieved significant success since its launch in early 2008.

Each of the media partners in Hulu, including NBCU, contributes content to Hulu and holds three seats on Hulu's Board of Directors. Significantly, any important or strategic decisions by Hulu require the unanimous approval of all members of the Board. Comcast's acquisition of NBCU's interest in Hulu would give it the ability to hamper Hulu's strategic and competitive development by refusing to agree to major actions by Hulu, or by blocking Hulu's access to NBCU content.

3. How the Formation of the JV Changes Comcast's Incentives and Abilities

Post-transaction, the JV would gain increased bargaining leverage sufficient to negotiate higher prices or withhold NBCU content from Comcast's MVPD competitors. Comcast's rival distributors would have to pay the increased prices or not carry the programming. In either case, the MVPDs likely would be less effective competitors to Comcast, and Comcast would be able to delay or otherwise substantially impede the development of OVDs as alternatives to MVPDs.

All of these activities could have a substantial anticompetitive effect on consumers and the market. Because Comcast would face less competition from other video programming distributors, it would be less constrained in its pricing decisions and have a reduced incentive to innovate. As a result, consumers likely would be forced to pay higher prices to obtain their video content or receive fewer benefits of innovation. They also would have fewer choices in the types of content and providers to which they would have access, and there would be lower levels of investment, less experimentation with new models of delivering content, and less diversity in the types and range of product offerings.

4. Entry Is Unlikely to Reverse the Anticompetitive Effects of the JV

Over the last decade, Comcast and other traditional video distributors benefited from an industry with limited competition and increasing prices,[20] in part because successful entry into the traditional video programming distribution business is difficult and requires an enormous investment to create a distribution infrastructure such as building out wireline facilities or obtaining spectrum and launching satellites. Accordingly, additional entry into wireline or DBS distribution is not likely in the foreseeable future.[21] Telcos have been willing to incur some of the enormous costs to modify their existing telephone infrastructure to distribute video, but only in certain areas, and they have recently indicated that further expansion will be limited for the foreseeable future.[22]

OVDs, therefore, represent the most likely prospect for successful competitive entry into the existing video programming distribution market. However, they face the difficulty of obtaining access to a sufficient amount of content to become viable distribution businesses. In addition, OVDs rely upon the infrastructure of others, including Comcast, to deliver service to their customers. After the JV is formed, Comcast will control some of the most significant

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[20] *See, e.g.*, Report on Cable Industry Prices, *In re Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, 24 F.C.C.R. 259, ¶ 2 & chart 1 (rel. Jan. 16, 2009), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-09-53A1.pdf (data showing price of expanded basic service increased more than three times the consumer price index (CPI) between 1995 and 2008).

[21] Similarly, it is unlikely that an entrant would attempt to provide a traditional MVPD service with wireless technology, particularly given the difficulty in acquiring spectrum and the costs and risks of constructing such a system. *See generally* U.S. Dep't of Justice, *Ex Parte* Submission, *In re Economic Issues in Broadband Competition, A National Broadband Plan for our Future*, FCC GN Docket No. 09-51, at 8-11 (filed Jan. 4, 2010), *available at* http://www.justice.gov/atr/public/comments/253393.htm.

[22] *See, e.g.*, Transcript, *Verizon at Credit Suisse Group Global Media and Communications Conference*, at 11 (Mar. 8, 2010), *available at* http://investor.verizon.com/news/20100308/20100308_transcript.pdf.

content needed by OVDs to successfully position themselves as a replacement for traditional video distribution providers.

5. Any Efficiencies Arising from the Deal Are Negligible or Not Merger-Specific

The Department considers expected efficiencies in determining whether to challenge a vertical merger. The potential anticompetitive harms from a proposed transaction are balanced against the asserted efficiencies of the transaction. The evidence does not show substantial efficiencies from the transaction.

In particular, the JV is unlikely to achieve substantial savings from the elimination of double marginalization. Double marginalization occurs when two independent companies at different points in a product's supply chain each extract a profit margin above marginal cost. Because each firm in the supply chain treats the other firm's price (in lieu of its marginal cost) as a cost of producing the final good, each firm finds it profitable to produce a lower output than the firms would have produced had they accurately accounted for the social cost of producing the output. This ultimately results in a lower output (and a higher price to consumers) than would have occurred if the product had been produced by a combined firm. Despite a higher price, the lower output from double marginalization ultimately results in lower total profits for the entire supply chain.

Vertical mergers often are procompetitive because they enable the merged firm to properly account for costs when determining output and setting a final product price. The combined firm no longer treats the profit of the other firm as part of the cost of production. Because the combined firm faces lower marginal costs, it may find it profitable to expand output and reduce the final product price. Lower marginal costs may result in better service, greater product quality or innovation, or other improvements.

In certain industries, however, including the one at issue here, vertical mergers are far less likely to reduce or eliminate double marginalization. Documents, data, and testimony obtained from Defendants and third parties demonstrate that much, if not all, of any potential double marginalization is reduced, if not completely eliminated, through the course of contract negotiations between programmers and distributors over quantity and penetration discounts, tiering requirements, and other explicit and verifiable conditions.

Other efficiencies claimed by Comcast are not specific to this transaction or not verifiable, or both. It is unlikely that the efficiencies associated with this transaction would be sufficient to undo the competitive harm that otherwise would result from the JV.

III. EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The proposed Final Judgment ensures that Comcast, through the JV, will not impede the development of emerging online video distribution competition by denying access to the JV's content to such competitors. The proposed Final Judgment also contains provisions that protect Comcast's traditional video distribution competitors. The proposed Final Judgment thereby protects consumers by eliminating the likely anticompetitive effects of the proposed transaction.

A. The Proposed Final Judgment Protects Emerging Online Video Competition

1. The Proposed Final Judgment Ensures that OVDs have Access to the JV's Video Programming

The proposed Final Judgment requires the JV to license its broadcast, cable, and film content to OVDs on terms comparable to those in similar licensing arrangements with MVPDs or OVDs. It provides two options through which an OVD will be able to obtain the JV's content.

Under the first option, set forth in Section IV.A of the proposed Final Judgment, the JV must license linear feeds of video programming to any requesting OVD on terms that are economically equivalent to the terms on which the JV licenses that programming to MVPDs.

Subject to some exceptions, the JV must make available to an OVD any channel or bundle of channels, and all quality levels and VOD rights, it provides to any MVPD with more than one million subscribers.

The terms of the JV's license with the OVD need not match precisely any existing license between the JV and the MVPD, but it must reasonably approximate, in the aggregate, an existing licensing agreement. That approximation must account for factors, such as advertising revenues and any technical and economic limitations of the OVD seeking a license.

The first option ensures that the JV will not be able to use its control of content to impede competitive pressure exerted on traditional forms of video programming distribution from OVDs that choose to offer linear channels and associated VOD content. The proposed Final Judgment uses Defendants' own contracts with MVPDs, including MVPDs that do not compete with Comcast, as proxies for the content and terms the JV would be willing to provide to distributors if it did not have the incentive or ability to disadvantage them in order to maintain customers in or drive customers to Comcast's service.

Under the second option, set forth in Section IV.B, the proposed Final Judgment requires the JV to license to an OVD, broadcast, cable, or film content comparable in scope and quality to the content the OVD receives from one of the JV's programming peers. For example, if an OVD receives each episode of five primetime television series from CBS for display in a subscription VOD service within 48 hours of the original airing, the JV must provide the OVD a comparable set of NBC broadcast television programs, as measured by volume and economic value, for display during the same subscription VOD window. The requirement applies to all JV content, even non-NBCU content, in order to ensure that the JV cannot undermine the purposes of the proposed Final Judgment by shifting content from one network to another.

While the first option ensures that Comcast, through the JV, will not disadvantage OVD competitors in relation to MVPDs, the second option ensures that the programming licensed by the JV to OVDs will reflect the licensing trends of its peers as the industry evolves. Because the OVD industry is still developing, the contracts of the JV's peers also provide an appropriate benchmark for determining the terms and conditions under which content should be licensed to OVDs. The programming peers include the owners of the three major non-NBC broadcast networks (CBS, FOX, and ABC), the largest cable network groups (including News Corporation, Time Warner, Inc., Viacom, and The Walt Disney Company), and the six largest production studios (including News Corporation, Viacom, Sony Corporation of America, Time Warner Inc., and The Walt Disney Company).

If an OVD and the JV are unable to reach an agreement for carriage of the JV's programming under either of these options, an OVD may apply to the Department for permission to submit its dispute to commercial arbitration in accordance with Section VII of the proposed Final Judgment. The FCC Order requires the JV to license content on reasonable terms to OVDs and includes an arbitration mechanism for resolution of disputes over access to programming. The FCC is the expert communications industry agency, and the Department worked very closely with the FCC in designing effective relief in this case. For so long as commercial arbitration is available for resolution of disputes in a timely manner under the FCC's rules and orders, the Department will ordinarily defer to the FCC's commercial arbitration process to resolve such disputes. OVDs are nascent competitors, however, and consistent with the Department's competition law enforcement mandate, the Department reserves the right, in its sole discretion, to permit arbitration pursuant to Section VII to advance the competitive objectives of the proposed Final Judgment. Although the Department may seek enforcement of

the Final Judgment through traditional judicial process, the arbitration process will help ensure that OVDs can obtain content from the JV at a competitive price, without involving the Department or the Court in expensive and time-consuming litigation.[23] To support the proposed Final Judgment's requirement that the JV license its programming to OVDs and assist the Department's oversight of this nascent competition, Comcast and NBCU are required, pursuant to Sections IV.M and IV.N, to maintain copies of agreements the JV has with any OVD as well as the identities of any OVD that has requested video programming from the JV.

2. The Proposed Final Judgment Prevents Comcast, through the JV, from Adversely Affecting Hulu

Section IV.D of the proposed Final Judgment requires Defendants to relinquish their voting and other governance rights in Hulu, and Section IV.E prohibits them from receiving confidential or competitively sensitive information concerning Hulu. As noted above, Hulu is one of the most successful OVDs to date. Comcast has an incentive to prevent Hulu from becoming an even more attractive avenue for viewing video programming because Hulu would then exert increased competitive pressure on Comcast's cable business. If the proposed transaction were to be consummated without conditions, Defendants would hold seats on Hulu's Board of Directors and could exercise their voting and other governance rights to compromise strategic and competitive initiatives Hulu may wish to pursue. Requiring Defendants to relinquish their voting and governance rights in Hulu, and barring access to competitively

[23] Under Section VI of the proposed Final Judgment, Defendants are required to license only video programming subject to their management or control or over which Defendants possess the power or authority to negotiate content licenses. NBCU has management rights in The Weather Channel, including the right to negotiate programming contracts on its behalf. NBCU currently is not exercising these rights. However, Section V.F provides that if the JV exercises them or otherwise influences The Weather Channel, this programming will be covered under the requirements of the proposed Final Judgment. Similarly, Section V.E exempts The Weather Channel, TV One, FearNet, the Pittsburgh Cable News Channel, and Hulu from the definitions of "Defendants" and other related terms unless the Defendants gain control over those channels or the ability to negotiate or influence carriage contracts for those channels.

sensitive information, will prevent Comcast, through the JV, from interfering with Hulu's competitive and strategic plans.

At the same time, NBCU should not be permitted to abandon its commitments to provide Hulu video programming under agreements currently in place and deny Hulu customers the value of the JV's content. Therefore, Section IV.G of the proposed Final Judgment requires the JV to continue to supply Hulu with content commensurate with the supply of content provided to Hulu by its other media owners.

3. The Proposed Final Judgment Prohibits Defendants from Discriminating Against, Retaliating Against, or Punishing Video Programmers and OVDs

The proposed Final Judgment protects the development of OVDs by prohibiting Defendants from engaging in certain conduct that would deter video programmers and OVDs from contracting with each other. Section V.A of the proposed Final Judgment prohibits Defendants from discriminating against, retaliating against, or punishing any content provider for providing programming to any OVD. Section V.A also prohibits Defendants from discriminating against, retaliating against, or punishing any OVD for obtaining video programming, for invoking any provisions of the proposed Final Judgment or any FCC rule or order, or for furnishing information to the Department concerning Defendants' compliance with the proposed Final Judgment.

4. The Proposed Final Judgment Prohibits Defendants from Limiting Distribution to OVDs through Restrictive Licensing Practices

The proposed Final Judgment further protects the development of OVDs by preventing Comcast from using its influence either as the nation's largest MVPD or as the licensor, through the JV, of important video programming to enter into agreements containing restrictive contracting terms. Video programming agreements often grant licensees preferred or exclusive

access to the programming content for a particular time period. Such exclusivity provisions can be competitively neutral, but also can have either pro- or anticompetitive purposes or effects. Sections V.B and V.C of the proposed Final Judgment set forth broad prohibitions on restrictive contracting practices, including exclusives, but then delineate a narrowly tailored set of exceptions to those bans. These provisions ensure that Comcast, through the JV, cannot use restrictive contract terms to harm the development of OVDs and, at the same time, preserve the JV's incentives to produce and exploit quality programming.

The video programming distribution industry frequently uses exclusive contract terms that can be procompetitive. For instance, as discussed above, content producers often sequence the release of their content to various distribution platforms, a practice known as "windowing." These windows of exclusivity enable a content producer to maximize the revenues it earns on its content by separating customers based on their willingness to pay and effectively increasing the price charged to the customers that place a higher value on receiving content earlier. Exclusivity also encourages the various distributors, such as cable companies, to promote the content during a distribution window by assuring the distributor that the content will not be available through other distribution channels at a lower price. This ability to price discriminate across types of customers and increase promotion of the content increases the profitability of producing quality programming and encourages the production of more high-quality programming than otherwise would be the case. Exclusivity also may help a new competitor gain entry to a market by encouraging users to try a service they would not otherwise consider. For example, an OVD may desire a limited exclusivity window in order to market its exclusive access to certain programming provided by its service. This unique content makes the service more attractive to consumers and gives them a reason to replace their existing service or try something new.

However, exclusivity restrictions also can serve anticompetitive ends. As a cable company, Comcast has the incentive to seek exclusivity provisions that would prevent content producers from licensing their content to alternative distributors, such as OVDs, for a longer period than the content producer ordinarily would find economically reasonable, in order to hinder OVD development. If Comcast could use exclusivity provisions to prevent the JV's peers from licensing content to OVDs that otherwise would obtain the rights to offer the programming, other provisions of the proposed Final Judgment designed to preserve and foster OVD competition could be effectively nullified.

The proposed Final Judgment strikes a balance by allowing reasonable and customary exclusivity provisions that enhance competition while prohibiting those provisions that, without any offsetting procompetitive benefits, hinder the development of effective competition from OVDs. Section V.B of the proposed Final Judgment prohibits the JV from entering into any agreement containing terms that forbid, limit, or create economic incentives for the licensee to limit distribution of the JV's video programming through OVDs, unless such terms are common and reasonable in the industry. Evidence of what is common and reasonable industry practice includes, among other things, Defendants' contracting practices prior to the date that the JV was announced, as well as practices of the JV's video programming peers. This provision allows the JV to employ those pricing and contractual strategies used by its peers to maximize the value of the content it produces, while limiting Comcast's incentives, through the JV, to craft unusually restrictive contractual terms in the JV's contracts with third parties, the purpose of which is to limit the access of OVDs to content produced by the JV. Section V.C of the proposed Final Judgment prohibits Comcast from entering into or enforcing agreements for carriage of video programming on its cable systems that forbid, limit, or create incentives that limit the provision

of video programming to OVDs. Section V.C establishes three narrow exceptions to this broad prohibition. First, Comcast may obtain a 30-day exclusive from free online display if Comcast pays for the video programming. Second, Comcast may enter into an agreement in which the programmer provides content exclusively to Comcast, and to no other MVPD or OVD, for 14 days or less. Third, Comcast may condition carriage of programming on its cable system on terms which require it to be treated in material parity with other similarly situated MVPDs, except to the extent such terms would be inconsistent with the purpose of the proposed Final Judgment. These provisions are designed to ensure that Comcast, either alone or in conjunction with the JV, cannot use existing or new contracts to dictate the terms of the video programming agreements that the JV's peers are able to offer OVDs, thereby hindering the development of OVDs.

5. The Proposed Final Judgment Prohibits Unreasonable Discrimination in Internet Broadband Access

Section V.G of the proposed Final Judgment requires Comcast to abide by certain restrictions on the operation and management of its Internet facilities. Without these restrictions Comcast would have the ability and the incentive to undermine the effectiveness of the proposed Final Judgment. Comcast is the dominant high-speed ISP in much of its footprint and therefore could disadvantage OVDs in ways that would prevent them from becoming better competitive alternatives to Comcast's video programming distribution services. OVDs are dependent upon ISPs' access networks to deliver video content to their subscribers. Without the protections secured in the proposed Final Judgment, Comcast would have the ability, for instance, to give priority to non-OVD traffic on its network, thus adversely affecting the quality of OVD services that compete with Comcast's own MVPD or OVD services. Comcast also would be able to

favor its own services by not subjecting them to the network management practices imposed on other services.

Section V.G.1 of the proposed Final Judgment prohibits Comcast from unreasonably discriminating in the transmission of lawful traffic over its Internet access service, with the proviso that reasonable network management practices do not constitute unreasonable discrimination. This provision requires Comcast to treat all Internet traffic the same and, in particular, to ensure that OVD traffic is treated no worse than any other traffic on Comcast's Internet access service, including traffic from Comcast and NBCU sites. Similarly, Section V.G.2 prohibits Comcast from excluding their own services from any caps, tiers, metering, or other usage-based billing plans, and requires them to ensure that OVD traffic is counted in the same way as Comcast's traffic, and that billing plans are not used to disadvantage an OVD in favor of Comcast. Many high-speed Internet providers are evaluating usage-based billing plans. These plans may more efficiently apportion infrastructure costs across users, offer lower-cost service to low-volume subscribers, or divert high-volume usage to non-peak hours. However, these plans also have the potential to increase the cost of high-volume services, such as video distribution, that may compete with an MVPD's video services. Section V.G.2 addresses this concern by ensuring that under these plans Comcast must treat other OVD services just as it treats its own Internet-based video services.

Specialized Services are offered to consumers over the same last-mile facilities as Internet access services, but are separate from the public Internet. The potential benefits of Specialized Services include the facilitation of services that might not otherwise be technically or economically feasible on current networks and the development of new and innovative services, such as services that may compete directly with Comcast's own MVPD offerings. If Comcast

were to offer online video services through Specialized Services, however, it could effectively avoid the prohibitions in Sections V.G.1 and V.G.2. Sections V.G.3 and V.G.4 recognize both the potential benefits and the risks of Specialized Services and strike a balance to protect the beneficial development of these services while preventing Comcast from using them anticompetitively to benefit its own content. Section V.G.3 prohibits Comcast from offering Specialized Services that are comprised substantially or entirely of the JV's content. Section V.G.4 requires Comcast to allow any OVD access to a Specialized Service if other OVDs, including Comcast, are being offered access. Together, these two provisions ensure that OVDs will have access to any Specialized Service Comcast may offer that includes comparable services.

Finally, Section V.G.5 ensures that Comcast will maintain its public Internet access service at a level that typically would allow any user on the network to download content from the public Internet at speeds of at least 12 megabits per second in markets where it has deployed DOCSIS 3.0. The requirement to maintain service at this speed may be adjusted by the Court upon a showing that other comparable high-speed Internet access providers offer higher or lower speeds. These speeds are sufficient to ensure that Comcast's Internet access services can support the development of OVDs as well as other services that are potentially competitive with Comcast's own offerings.

In interpreting Section V.G and the terms used therein, the Department will be informed by the FCC's Report and Order, *In re Preserving the Open Internet Broadband Industry Practices*, GN Docket No. 90-191 & WC Docket No. 07-52, adopted December 21, 2010.

B. The Proposed Final Judgment Preserves Traditional Video Competition

A number of FCC orders issued in prior mergers established a commercial arbitration process for resolution of disputes over access to broadcast network programming and regional sports networks. The FCC Order approving this transaction requires the JV to license all of its programming to MVPDs, including its cable networks, and includes an arbitration mechanism that contains several enhancements to its existing commercial arbitration process when licensing disputes between Defendants and other MVPDs arise.[24] The Department believes that these enhancements, combined with the FCC's experience in MVPD arbitration disputes, should protect MVPDs' access to the JV's programming without need of another commercial arbitration mechanism for MVPDs under this proposed Final Judgment.

In addition to the protections contained in the FCC Order, the proposed Final Judgment, in Section V.A, prohibits Defendants from discriminating against, retaliating against, or punishing any MVPD for obtaining video programming, for furnishing any information to the United States about any noncompliance with the proposed Final Judgment, or for invoking the arbitration provisions of the FCC Order. Section V.D also prevents Defendants from requiring or encouraging their local broadcast network affiliates to deny MVPDs the right to carry the local network signals. To aid the enforcement of this prohibition, pursuant to Sections IV.J and IV.K, Comcast and NBCU are required to maintain not only their network affiliate agreements, but also all documents discussing whether any of their affiliates has withheld or threatened to withhold retransmission consent from any MVPD.

[24] For example, the FCC Order allows an MVPD claimant to demand arbitration of programming on a stand-alone basis in certain circumstances. It also allows a claimant whose contract with the JV has expired to continue to carry the JV's programming during the pendency of the dispute, subject to a true-up. The FCC Order also contains further modifications to the arbitration process relating to smaller MVPDs.

C. Term of the Proposed Final Judgment

Section XI of the proposed Final Judgment provides that the Final Judgment will expire seven years from the date of entry unless extended by the Court. The FCC Order also lasts for seven years. The Department believes this time period is long enough to ensure that the JV cannot deny access to Comcast's OVD competitors at a crucial point in their development but otherwise short enough to account for the rapidly evolving nature of the video distribution market.

IV. REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgment has no prima facie effect in any subsequent private lawsuit that may be brought against Defendants.

V. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The Department and Defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the Department has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least 60 days preceding the effective date of the proposed Final Judgment within which any person may submit to the Department written comments regarding the proposed Final Judgment. Any person who wishes to comment should

do so within 60 days of the date of publication of this Competitive Impact Statement in the Federal Register, or the last date of publication in a newspaper of the summary of this Competitive Impact Statement, whichever is later. All comments received during this period will be considered by the Department, which remains free to withdraw its consent to the proposed Final Judgment at any time prior to the Court's entry of judgment. The comments and the response of the Department will be filed with the Court and published in the Federal Register.

Written comments should be submitted to:

Nancy M. Goodman
Chief, Telecommunications and Media Enforcement Section
Antitrust Division
United States Department of Justice
450 Fifth Street, N.W., Suite 7000
Washington, DC 20530

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment.

VI. ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

The United States considered, as an alternative to the proposed Final Judgment, seeking preliminary and permanent injunctions against Defendants' transaction and proceeding to a full trial on the merits. The United States is satisfied, however, that the relief in the proposed Final Judgment will preserve competition for the provision of video programming distribution services in the United States. Thus, the proposed Final Judgment would protect competition as effectively as would any remedy available through litigation, but avoids the time, expense, and uncertainty of a full trial on the merits.

VII. STANDARD OF REVIEW UNDER THE APPA FOR THE PROPOSED FINAL JUDGMENT

The Clayton Act, as amended by the APPA, requires that proposed consent judgments in antitrust cases brought by the United States be subject to a sixty-day comment period, after which the court shall determine whether entry of the proposed Final Judgment "is in the public interest." 15 U.S.C. § 16(e)(1). In making that determination, the court, in accordance with the statute as amended in 2004, is required to consider:

> (A) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration of relief sought, anticipated effects of alternative remedies actually considered, whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and
>
> (B) the impact of entry of such judgment upon competition in the relevant market or markets, upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e)(1)(A), (B). In considering these statutory factors, the court's inquiry is necessarily a limited one as the government is entitled to "broad discretion to settle with the defendant within the reaches of the public interest." *United States v. Microsoft Corp.*, 56 F.3d 1448, 1461 (D.C. Cir. 1995); *see also United States v. InBev N.V./S.A.*, No. 08-1965 (JR), 2009-2 Trade Cas. (CCH) ¶ 76,736, 2009 U.S. Dist. LEXIS 84787, at *3 (D.D.C. Aug. 11, 2009) (noting that the court's review of a consent judgment is limited and only inquires "into whether the government's determination that the proposed remedies will cure the antitrust violations alleged in the complaint was reasonable, and whether the mechanisms to enforce the final judgment are clear and manageable."). *See generally United States v. SBC Comm., Inc.*, 489 F. Supp. 2d 1 (D.D.C. 2007) (assessing public interest standard under the Tunney Act).[25]

[25] The 2004 amendments substituted "shall" for "may" in directing relevant factors for court to consider and amended the list of factors to focus on competitive considerations and to address

As the United States Court of Appeals for the District of Columbia Circuit has held, under the APPA a court considers, among other things, the relationship between the remedy secured and the specific allegations set forth in the government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. *Microsoft*, 56 F.3d at 1458-62. With respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted evaluation of what relief would best serve the public." *United States v. BNS, Inc.*, 858 F.2d 456, 462 (9th Cir. 1988) (citing *United States v. Bechtel Corp.*, 648 F.2d 660, 666 (9th Cir. 1981)); *see also Microsoft*, 56 F.3d at 1460-62; *United States v. Alcoa, Inc.*, 152 F. Supp. 2d 37, 40 (D.D.C. 2001); *InBev*, 2009 U.S. Dist. LEXIS 84787, at *3. Courts have held that:

> [t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is "*within the reaches of the public interest*." More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.

Bechtel, 648 F.2d at 666 (emphasis added) (citations omitted).[26] In determining whether a proposed settlement is in the public interest, a district court "must accord deference to the government's predictions about the efficacy of its remedies, and may not require that the

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potentially ambiguous judgment terms. *Compare* 15 U.S.C. § 16(e) (2004), *with* 15 U.S.C. § 16(e)(1) (2006); *see also SBC Comm.*, 489 F. Supp. 2d at 11 (concluding that the 2004 amendments "effected minimal changes" to Tunney Act review).

[26] *Cf. BNS*, 858 F.2d at 464 (holding that the court's "ultimate authority under the [APPA] is limited to approving or disapproving the consent decree"); *United States v. Gillette Co.*, 406 F. Supp. 713, 716 (D. Mass. 1975) (noting that, in this way, the court is constrained to "look at the overall picture not hypercritically, nor with a microscope, but with an artist's reducing glass"). *See generally Microsoft*, 56 F.3d at 1461 (discussing whether "the remedies [obtained in the decree are] so inconsonant with the allegations charged as to fall outside of the 'reaches of the public interest'").

remedies perfectly match the alleged violations." *SBC Comm.*, 489 F. Supp. 2d at 17; *see also Microsoft*, 56 F.3d at 1461 (noting the need for courts to be "deferential to the government's predictions as to the effect of the proposed remedies"); *United States v. Archer-Daniels-Midland Co.*, 272 F. Supp. 2d 1, 6 (D.D.C. 2003) (noting that the court should grant "due respect to the government's prediction as to the effect of proposed remedies, its perception of the market structure, and its views of the nature of the case").

Courts have greater flexibility in approving proposed consent decrees than in crafting their own decrees following a finding of liability in a litigated matter. "[A] proposed decree must be approved even if it falls short of the remedy the court would impose on its own, as long as it falls within the range of acceptability or is 'within the reaches of public interest.'" *United States v. Am. Tel. & Tel. Co.*, 552 F. Supp. 131, 151 (D.D.C. 1982) (citations omitted) (quoting *United States v. Gillette Co.*, 406 F. Supp. 713, 716 (D. Mass. 1975)), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); *see also United States v. Alcan Aluminum Ltd.*, 605 F. Supp. 619, 622 (W.D. Ky. 1985) (approving the consent decree even though the court might have imposed a greater remedy if the matter had been litigated). To meet this standard, the Department "need only provide a factual basis for concluding that the settlements are reasonably adequate remedies for the alleged harms." *SBC Comm.*, 489 F. Supp. 2d at 17.

Moreover, the court's role under the APPA is limited to reviewing the remedy in relationship to the violations that the United States has alleged in its Complaint, and does not authorize the court to "construct [its] own hypothetical case and then evaluate the decree against that case." *Microsoft*, 56 F.3d at 1459; *see also InBev*, 2009 U.S. Dist. LEXIS 84787, at *20 ("[T]he 'public interest' is not to be measured by comparing the violations alleged in the complaint against those the court believes could have, or even should have, been alleged.").

Because the "court's authority to review the decree depends entirely on the government's exercising its prosecutorial discretion by bringing a case in the first place," it follows that "the court is only authorized to review the decree itself," and not to "effectively redraft the complaint" to inquire into other matters that the United States did not pursue. *Microsoft*, 56 F.3d at 1459-60. As this Court recently confirmed in *SBC Communications*, courts "cannot look beyond the complaint in making the public interest determination unless the complaint is drafted so narrowly as to make a mockery of judicial power." *SBC Comm.*, 489 F. Supp. 2d at 15.

In its 2004 amendments, Congress made clear its intent to preserve the practical benefits of utilizing consent decrees in antitrust enforcement, adding the unambiguous instruction that "[n]othing in this section shall be construed to require the court to conduct an evidentiary hearing or to require the court to permit anyone to intervene." 15 U.S.C. § 16(e)(2). The language wrote into the statute what Congress intended when it enacted the Tunney Act in 1974, as Senator Tunney explained: "[t]he court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process." 119 Cong. Rec. 24,598 (1973) (statement of Senator Tunney). Rather, the procedure for the public interest determination is left to the discretion of the court, with the recognition that the court's "scope of review remains sharply proscribed by precedent and the nature of Tunney Act proceedings." *SBC Comm.*, 489 F. Supp. 2d at 11.[27]

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[27] *See United States v. Enova Corp.*, 107 F. Supp. 2d 10, 17 (D.D.C. 2000) (noting that the "Tunney Act expressly allows the court to make its public interest determination on the basis of the competitive impact statement and response to comments alone"); *United States v. Mid-Am. Dairymen, Inc.*, 1977-1 Trade Cas. (CCH) ¶ 61,508, at 71,980 (W.D. Mo. 1977) ("Absent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances."); S. Rep. No. 93-298, 93d Cong., 1st

VIII. DETERMINATIVE DOCUMENTS

Appendix F to the FCC's Memorandum Opinion and Order, *In re Applications of Comcast Corp., General Electric Co. and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licensees*, FCC MB Docket No. 10-56 (adopted Jan. 18, 2011), was the only determinative document or material within the meaning of the APPA considered by the Department in formulating the proposed Final Judgment. The Department will file a notice and link to this document as soon as it is posted on the FCC's website.

Sess., at 6 (1973) ("Where the public interest can be meaningfully evaluated simply on the basis of briefs and oral arguments, that is the approach that should be utilized.").

Dated: January 18, 2011

Respectfully submitted,

/s/

Yvette F. Tarlov (D.C. Bar #442452)
Attorney
Telecommunications & Media Enforcement
Antitrust Division
U.S. Department of Justice
450 Fifth Street, N.W., Suite 7000
Washington, DC 20530
Telephone: (202) 514-5621
Facsimile: (202) 514-6381
Email: Yvette.Tarlov@usdoj.gov

Ms. WATERS. I have another submission and that is from a group of economists sent to the FCC discussing the importance of net neutrality rules.

Mr. GOODLATTE. Without objection, so ordered.

[The information referred to follows:]

July 7, 2010

The Honorable Julius Genachowski
Chairman
Federal Communications Commission
455 12th Street, SW
Washington D.C. 20554

Dear Chairman Genachowski:

On May 24th you received a letter signed by 74 members of the House of Representatives asking the Federal Communications Commission to refrain from moving forward with network neutrality regulations. The analysis in that letter is based on a misunderstanding of the current state of the Internet and does not accurately reflect the economic impacts of network neutrality. As economists who have researched the impact of network neutrality regulations on the Internet, the economy, and society as a whole, we ask that you consider moving forward with network neutrality regulations.

The letter submitted by the Representatives (as well as much of the analysis on both sides of the debate) does not recognize that the Internet currently operates under a *de facto* network neutrality regime. Most internet service providers do not currently engage in prioritization or price discrimination tactics that would be restricted under the proposed rules. The question therefore is not whether to impose network neutrality on the Internet; but rather it is whether to eliminate it. Ending net neutrality would represent a fundamental change in the way the Internet works. The consequences of such a change are impossible to predict with certainty. The Internet creates a tremendous amount of value for content developers, end-users, Internet Service Providers, businesses, and the workforce.

That letter also does not recognize that the Internet is characterized by market imperfections that network neutrality regulations may help correct. Economists generally agree that markets function best when they are left alone, but the Internet market exhibits failures which justify government intervention. These imperfections include a network effect: additional connections to the network make the Internet more valuable to all end-users and content providers on the network, thereby encouraging more end-users and content providers to join the network. Eliminating network neutrality would make it more expensive for content providers to reach end-users, driving some off the network. Because of network effects the exit of content providers may reduce the value of the Internet to end-users driving some off. This feedback mechanism may reduce the value of the Internet for all parties. Connections to the network allow users to join the network as consumers, but also to take advantage of productive activities such as investment, entrepreneurship and innovation, blurring the distinction between end-users and content providers.

The Internet also suffers from information externalities—positive spillovers that result from the provision of information. The Internet produces billions of dollars of free value for the American public: Information is shared, reused, and reconfigured without fees or penalties. Websites are not compensated when their content is repurposed or passed on—that means fewer subscriptions to paid services, fewer direct page views, and a loss of advertising dollars. If all the individuals who absorbed information were required to pay the content providers, content providers would generate more revenue.

Without network neutrality regulations, Internet Service Providers would be allowed to engage in pricing practices that transfer wealth from content providers to Internet Service Providers. Shifting wealth away from an already under-compensated group may worsen this market failure, disincentivize content provision, and make providing an economically efficient level of information on the Internet even more difficult.

The letter from the Representatives does not recognize that "the Internet" is not just Internet infrastructure, but also includes Internet content. The network neutrality debate is fundamentally about how to divide the value generated by the Internet. The Internet is properly defined as both as the physical infrastructure as well as the content and information moving along that infrastructure. Infrastructure without content is useless, as is content without infrastructure.

Eliminating network neutrality would shift wealth from content developers to Internet Service Providers and risks shrinking the pie for everyone. Internet infrastructure and Internet content are complementary goods, and both must be increased in tandem to maximize the value of the Internet. While it is possible that eliminating network neutrality would increase investment in Internet infrastructure, it would do so at a high price. Elimination may also decrease investment in Internet content, which is already suffering from underinvestment, and may decrease the wealth generated by Internet content. In addition, allowing for tariff-based prioritization schemes create incentives for Internet Service Providers to artificially generate scarcity in capacity in order to support a higher tariff for prioritization. Hence, there is a good chance that investment in Internet infrastructure would be reduced following an elimination of network neutrality.

The Internet is a crucial tool for America's business and workers. The FCC should promulgate regulations designed to maximize the value of the Internet to Americans and maintain the incredibly robust, productive and participatory environment that thrives on a nondiscriminatory Internet.

Sincerely,

Subhajyoti Bandyopadhyay
Associate Professor
Information Systems and Operations Management
Warrington College of Business Administration
University of Florida

J. Scott Holladay
Economics Fellow
Institute for Policy Integrity,
New York University School of Law

Dr. Hsing K. (Kenny) Cheng
American Economics Institutions Fellow
Associate Professor
Warrington College of Business Administration
Department of Information Systems and Operations Management
University of Florida

Joacim Tåg
Research Fellow
Research Institute of Industrial
Economics (IFN)

Ms. WATERS. Thank you very much, Mr. Chairman.

I would like to thank our panelists for being here today. I find this discussion very engaging, and I am particularly interested, since I spent so much time on the Comcast-NBC merger and learned so much about the power of a huge organization with a lot of resources.

And I want to know, and I would like to ask Ms. Sohn, what challenges will exist for online content providers in light of mergers

that will follow the Comcast-NBC merger? How can an ISP like LARIAT, for example, compete against an ISP like Comcast-NBC?

Ms. SOHN. First, Congresswoman Waters, I really want to thank you for the work you did, really bringing the public's attention to that merger, because it was a merger of unprecedented proportions. I was disappointed that nobody—few people in the government, save you and perhaps Mr. Cole and Mr. Frank and the Senate, had the guts to say, How can we even consider this? But, unfortunately, you guys were really sole practitioners in that regard.

So, you know, I don't think Larry can compete. There is no way. I mean, Comcast now has this vertical merger of one of the most popular broadcast networks in the country. And also, it is the biggest Internet service provider and the biggest cable operator. I think the Justice Department did the best it could within the limits that it had. Again, in fear of Trinko, I will say they didn't want to push too far because they were concerned about these precedents that really limit antitrust law.

So the good news about the competitive impact statement that you just submitted for the record is that it says that online video distributors, what I call OVDs, are competitors. They are part of the market, and that big ISPs like Comcast cannot discriminate against them, cannot withhold programming from them, and cannot throttle their traffic when they provide online service.

Ms. WATERS. Thank you very much.

Let me just ask in what ways can Internet service providers impede access to content, products, services available on the Internet, and what options do Internet users have if they find they cannot access certain content, products, or services?

Ms. SOHN. They can either slow an application for a service provider's service. They can block it. Or they can slow it so much that it is almost like blocking it. That is what we were challenging in the Comcast-BitTorrent case.

So there are many different ways that Internet access providers can hurt consumers' access to the things they want to access over the Internet.

What is the recourse? Well, that is what the FCC rules are all about. They are about providing rules of the road so that consumers, if they do see that they are being unlawfully blocked or degraded from the content, services, and applications that they want to access, that they can go somewhere and have some recourse. And if these rules are overturned, either in court or by the Congress, through the Congressional Review Act or by any other method, then consumers will not have that. They will basically be out in the cold.

Ms. WATERS. You are basically saying there will be no options?

Ms. SOHN. Absolutely. Again, as I mentioned before you were here, antitrust law has been so neutered for regulated industries like broadband Internet access providers, that right now without some kind of law being passed by this Subcommittee and the Judiciary Committee, there is no recourse there either for consumers.

Ms. WATERS. If I have time left, do you have an opinion about what you saw happening in the Congress of the United States? I found, in talking with Members, that many Members were confused or misled as to what net neutrality is or should be, and so

many of them didn't even know—of the 74 who signed on to that letter, didn't realize. What is the confusion, and do you have any ideas how we can help people clear up what net neutrality is and what it isn't?

Ms. SOHN. Net neutrality, quite simply, prohibits telephone and cable operators who are the two main, who provide the two main on-ramps to the Internet, from picking winners and losers, from deciding that Microsoft is going to win over Google. Or deciding that LinkedIn is going to win over Facebook. So that's what it is about.

It is really no different than the telecommunications regulation we have had in this country for 100 years that said that telephone companies cannot decide whether your phone call is going to go faster than my phone call, or whether Mr. Glass's phone call is going to be a better quality than my phone call. It is that simple.

Ms. WATERS. Thank you very much.

I yield back the balance of my time.

Mr. GOODLATTE. It is now my pleasure to recognize the gentleman from Arizona, Mr. Quayle, for 5 minutes.

Mr. QUAYLE. Thank you, Mr. Chairman.

Ms. Sohn, I am going to get back to some of the beginning testimony because I am trying to figure out the numbers. The 92 percent of people who live in areas where broadband is only a monopoly or duopoly, does that include wireless providers in that number as well?

Ms. SOHN. To the extent that wireless providers are providing what the FCC now says is broadband, so the FCC's definition of broadband is 4 megabits down and one megabit up, and a lot of wireless providers are not providing those kinds of speeds. That may change soon, but it is not the case today.

Mr. QUAYLE. So that is only wired?

Ms. SOHN. To the extent that there are any wireless, I don't know of any wireless providers that are providing those kinds of speed. So the answer is yes.

Mr. QUAYLE. So as wireless continues to evolve and innovation continues to evolve on the wireless front with the expansion of 4G and then 5G, won't that alleviate any of the competition concerns that you have going forward, because there will be enough competition via wireless carriers, via phone, via cable, via probably other avenues where you can actually address this with the market system rather than having the FCC regulate this on this basis?

Ms. SOHN. I am afraid not, particularly because the two largest landline providers, AT&T and Verizon, are also the two largest wireless providers. Everybody else is struggling for air. I mean, T-Mobile, Leap, Sprint, they are struggling to compete against AT&T and Verizon. So, no. I wish it was the case, but it is not at all the case that as—and again, in so many issues that I work on in Public Knowledge, we are always told the next great thing is around the corner, so why regulate? I am still waiting for broadband over power lines. Clearwire just abandoned residential service. That is a wireless home service. They just abandoned it to go to enterprise.

Mr. QUAYLE. Mr. Downes, can you address that question? Do you agree with Ms. Sohn's assessment?

Mr. DOWNES. Only in part. It is true that the statistics that Ms. Sohn and some of the other members have cited from the national

broadband plan, that was a reference to wire-line broadband. There is a separate set of statistics that are in the plan to talk about wireless competition. And, of course as we know, wireless competition is much more robust. There are many more providers.

I think it is absolutely the case that as 4G networks and later networks get rolled out, assuming that we can solve our spectrum issues, and we know this as consumers, we are moving away from the sort of fixed computer experience of the Internet and moving to a mobile Internet. It is app-based. It is an app-based economy. As that happens and as we get the 4G speeds and the kinds of capacity, yes, it will provide more options and more competition.

It is true that one of the most promising technologies, particularly for the rural areas that may today have no options, is broadband over powerline. And I would reference my written testimony where I point out that the FCC has been delaying and interfering with the ability of VPL providers to do experiments. So if what the FCC wants is more competition, they really ought to be more supportive of new technologies rather than holding them up.

Mr. QUAYLE. Mr. Glass, Ms. Sohn was talking earlier about innovation within Internet companies, Facebook, Twitter. Now, how would the Open Internet Order deter other companies like yours from expanding and upgrading their services, because it seems like there would be a lot of capital-intensive improvements that you do that could fall by the wayside to somebody else?

Mr. GLASS. Mr. Quayle, actually we are involved right now in some very capital-intensive upgrades. This radio I have here in my hand, we are deploying these. These allow access to the Internet at 54 million bits per second. We can attach these to an antennae, put it on your house, and you can get up to that speed. There is a question of cost still, but we are working on that very heavily.

The big problem we see is being able to raise capital, as I mentioned before. If people believe that we are a little guy and we are unduly impacted by regulation, that is what is going to hurt.

When we recently expanded our network, and as a matter of fact, we are in the process of completing the expansion now. We went to our customers and we asked them if they would invest in us by paying ahead for a year of service. Now, that is a Faustian bargain because it kills your cash flow. You get a lot of money up front, a lot of capital up front, but you also have a huge liability at that point. We had to do that because we could not get conventional investors to invest in our company.

Mr. QUAYLE. Mr. Downes, there has been a lot of talk about antitrust laws and how some people believe they are not effective for this area. Do you believe the antitrust laws can adequately account for any misbehavior by Internet service providers and monopolistic opportunities they may have?

Mr. DOWNES. Yes. It is theoretical because we have not tested them, and we have not tested them because there haven't been any serious cases that require testing them. I don't necessarily read the Trinko opinion the same way as Ms. Sohn does. I have every reason to believe that between the FTC and the Justice Department, if there were serious anticompetitive problems that had demonstrable consumer harms, the effect of which was to reduce the

Open Internet, I am quite confident that our existing antitrust laws and enforcement mechanisms would take care of the problem.

Mr. QUAYLE. Thank you very much. I yield back.

Mr. GOODLATTE. I thank you. I am now pleased to recognize the gentlewoman from Texas, Ms. Jackson Lee.

Ms. JACKSON LEE. Mr. Chairman, my interest in this Committee is about creating jobs and competitiveness. I am going to kick the football in your direction, Ms. Sohn. Do you think that the Justice Department—and in this instance I think you said the FTC—the FTC are sufficient and have taken note enough to determine whether or not they need to file action and whether or not there is an anticompetitive impact on some of the entities that you are suggesting are negatively impacted, and is there a reason why they haven't acted?

Ms. SOHN. I believe that the Supreme Court has effectively gutted antitrust enforcement when it comes to regulated companies like the telephone and cable companies that provide broadband Internet access service. The Trinko case and the Credit Suisse case—and it is not just me saying this—Howard Shelanski, I mentioned him before, he testified in front of the Subcommittee on Courts in June, and he basically said that the Trinko and Credit Suisse cases have made it virtually impossible to apply antitrust.

Ms. JACKSON LEE. What would you offer as a remedy?

Ms. SOHN. I think Congress has to reverse those decisions and revivify antitrust law. I think it will be helpful in a lot of different ways.

Ms. JACKSON LEE. And that would be overall, because I think the antitrust laws are weak, period.

Ms. SOHN. Absolutely.

Ms. JACKSON LEE. We just recently saw a merger dealing with Continental and United, and it is almost as if the Justice Department said we have no teeth, we have no ability to respond. So you are suggesting a legislative fix?

Ms. SOHN. Absolutely. That is the only way you are going to be able to overturn a Supreme Court precedent like that.

Ms. JACKSON LEE. Mr. Downes, if you have large telecommunications companies who also operate as Internet service providers, and they might be perceived as unfairly thwarting competition by slowing down the Internet speed of access for customers who access the Web sites, do you see a solution for them? What solution would you offer?

Mr. DOWNES. So you are talking about telecommunication companies who also are service providers?

Ms. JACKSON LEE. And someone is trying to access, and because you have another provider, you might be slow in having access. Do you see a remedy for that?

Mr. DOWNES. Obviously, one remedy is to switch. You don't have to buy the whole bundle of services from the same provider. If you have more than one choice, you can have cable from Comcast and telephone from AT&T and Internet from Verizon if it is mobile. So you have your choice of providers in many areas.

In the areas you don't, I think one of the things to recognize is that—and we see it quite dramatically in what happened in Egypt over the last month. The very tools that have made the Internet

so powerful in the last few years in particular allow consumers really to exercise their dissatisfaction and unhappiness with governments or with companies much more easily and effectively and quickly than ever before.

Ms. JACKSON LEE. What I am trying to say, they try to access these giants from their Web site, from a competitor Internet service. That is the question. And they feel that they are not getting the access as quickly as possible. It can't be that they can go to Verizon. They are talking about those particular entities.

Mr. DOWNES. I'm not clear what you are asking. You're a Comcast customer and you want to go to Verizon?

Ms. JACKSON LEE. No. You are a small consumer and you are trying to go to AT&T or Verizon, and you are not able to access as quickly as you would like; it is a slow process. Do you think there would be any slowing down of the utilization of those services?

Mr. DOWNES. Well, it depends on what is causing the slowdown. A lot of times you experience slowdowns because of technical——

Ms. JACKSON LEE. You don't think it would be purposeful and you don't think that small companies should have some protection?

Mr. DOWNES. It could be purposeful.

Ms. JACKSON LEE. What would you perceive to be a remedy for that?

Mr. DOWNES. The antitrust enforcement mechanisms that already exist for anticompetitive behaviors that have demonstrable consumer harms.

Ms. JACKSON LEE. You feel comfortable that they are sufficient?

Mr. DOWNES. Yes. As I say, since we haven't tested them, we don't know. And we haven't tested them because we haven't needed to.

Ms. JACKSON LEE. Let me go to Mr. Glass. Let me ask you the same question. Do you believe that the current laws which protect against monopolies or duopolies in Internet service providers and broadband providers are sufficient? Do you believe antitrust laws can protect small companies?

Mr. GLASS. Ms. Jackson Lee, I think the law needs fixing. I am especially concerned about what will happen if the FCC rules stand, because as Ms. Sohn sort of alluded, when we become a regulated entity, then suddenly Trinko kicks in and we lose remedies under the laws.

Ms. JACKSON LEE. What do you want to see strengthened under the antitrust laws?

Mr. GLASS. I would like to have the ability to take action under antitrust to deal with the problem I am having right now—anticompetitive pricing of the inputs to my business by the telephone company.

Let me explain. I rent leased lines from the telephone company to connect me to the Internet. They charge me more per megabit per second for wholesale connections to the Internet than they do to retail consumers who are buying DSL from them. As a result, they are trying to make it impossible for me to be competitive and also be profitable. I would like to be able to take action about that.

Ms. JACKSON LEE. Do they argue that you are in an area that is difficult to serve? Do you make that kind of argument?

Mr. GLASS. Actually, there is no rational justification. The physical plant, the wires, have been fully depreciated for decades. There is no reason why they could sell me that access at a very low cost, except they want to prevent me from being a better competitor.

Ms. JACKSON LEE. Mr. Chairman, to conclude, we have had the privilege of serving on this Committee in past Congresses and, frankly, have had these hearings. I would make the argument that we want to see competitiveness. We like large companies and small companies. But I wonder whether or not we in the Judiciary Committee are going to be the only ones who will raise this concern and whether our collaborators on Energy and Commerce will not, and whether or not we will be able to move forward in trying to answer some of the concerns and still balancing the commitment to competitiveness and providing jobs that our large companies do provide.

I yield back.

Mr. GOODLATTE. I thank the gentlewoman for her comments, and look forward to working with her on that very objective.

It is now my pleasure to yield to the Ranking Member of the Subcommittee, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

I apologize to the Chairman and the witnesses for not being here earlier, and I thank Mr. Conyers and Ms. Chu for substituting for me. I had to go over to the White House to the Presidential Medal of Freedom presentation. One of my constituents, or somebody who lives just outside my congressional district was being honored, so I needed to be there, along with John Lewis and Stan Musial and Yo-Yo Ma and Warren Buffett and some other people. I didn't need to be there for those reasons, but I needed to be there for my constituent.

I thought I would not ask questions, but just sitting here listening to the questions that got asked, I got provoked to ask a couple of questions. Somebody was talking about somebody providing broadband over power lines. Who in the world is doing that, and who would have the incentive to do that in today's market? Is anybody actually doing that?

Mr. DOWNES. Yes. It's a technology that has been in development for quite some time.

Mr. WATT. Is anybody doing it?

Mr. DOWNES. There are a number of companies that are doing trials with it. It is very attractive for rural customers because the infrastructure is already in place. They already have electricity, where they may not have high-speed Internet connections, or they can't get mobile for obvious reasons. So it is, in fact, a very appealing technology, but so far it has not been commercially successful.

Mr. WATT. And would the FCC's order have some impact on that one way or another? I mean, would it disincentivize it or would it have any impact on it at all.

Mr. DOWNES. Well, the BPL providers would be subject to the same rules as any other Internet provider, assuming they're offering broadband speeds, which is what they are doing. My point was just that up until now, the FCC has not been particularly helpful in encouraging this new technology, and in fact has been criticized by the courts for rulings that have slowed down the deployment of

that technology. There is a concern that it interferes with hand radio operators.

Mr. WATT. I thought you all wanted the FCC to get out of the way.

Mr. DOWNES. Get out of the way of the broadband power line, yes.

Mr. WATT. You want them in in some things and out of other things. Okay. All right, I got you. That's what most people want. They want what they want, and then they want them out of the way when they don't want what they want.

Let me just ask a general question to all three of you. I don't know how you promote competition in a capital-intensive, cost-prohibitive industry. I mean, you know, you're ending up with two major carriers here, Verizon and AT&T. I mean, a lot of our private enterprise is becoming more and more concentrated just because, I mean, there's just—these in many ways are utilities, and the capital costs are so heavy. I'm just trying to figure out how do we promote competition in these areas?

Ms. Sohn, and then we will just go down the line, and then I will yield back, Mr. Chairman.

Ms. SOHN. Ranking Member Watt, I mean, you are absolutely correct; there are very high barriers to entry. Not everybody can get spectrum. And T-Mobile and Sprint are begging the Federal Government to perhaps put limits on what AT&T and Verizon has, so they can get some more. Not everybody can lay lines, coaxial cable. You have to get permission from the State government, so the barriers to entry are huge.

So what do you do? I think the answer is to do what the countries in Europe, Scandinavian countries, and in Asia are doing and beating us at broadband value and speed. You have to go back to the way we regulated these entities in the nineties and the early aughts. You have to require the dominant telecommunications and cable providers to open up their networks so competitors can use them as well, what we call line sharing—some call line sharing, unbundling, there are different ways. But the notion is the countries that have dozens of Internet service providers are those that have required the big guys—the British telecoms, the French telecoms, to open up their networks to competitor——

Mr. WATT. So how do you responded to their argument that they paid for that and therefore shouldn't give it away, or give it away at reduced cost after they've developed it?

Ms. SOHN. Well, without public rights of way, there would be no cable industry, there would be no telephone industry. I mean, they are——

Mr. WATT. And basically you're using this as a public utility argument.

Ms. SOHN. Exactly.

Mr. WATT. Okay. Mr. Glass and Mr. Downs, and then I'll yield back.

Mr. GLASS. Yes, Ranking Member Watt. The best way to promote competition, I think, is to do several things. The capital cost of the kind of wireless that I provide is actually within reach. It's not insurmountable. It's never easy to raise capital, but it certainly is possible. What we need to do is encourage investors to bring that

capital to the table, and in order to do that we need to be very careful about deterring them using regulation.

We need to reduce barriers to entry—and again, regulation is potentially a barrier to entry in this arena. We need to come down hard on anticompetitive tactics. We've already talked a little bit about special access as being one of the barriers to rural broadband deployment.That is an anticompetitive tactic. It's not asking to use something for free, it's asking to get something at a reasonable price.

We also need to deal with spectrum. The preemptive bids by the large incumbents so as to lock out competition are something which the FCC hasn't addressed and really does need to address.

But mainly I guess I need to come back to the point that I've been making throughout the hearing. As Henry David Thoreau once said, "Government never furthered any enterprise but the alacrity with which it got out of the way." What we need is simply to remove the barriers, and then the market will encourage investment and will encourage deployment.

Mr. DOWNES. I think for many reasons the most attractive option for more competition, particularly with broadband Internet access, is in the mobile space. With more wireless providers, that's where the technology is going, and also that's where the consumers are going as well. The most effective thing we can do then to promote more competition would be to do a better job of managing the existing spectrum. That was a goal the FCC had last year. They didn't really work on it because of the net neutrality proceeding. We'd like to see them go back to that and actually start with an inventory just of who has what spectrum in the first place, and then see if we can find ways to manage it more effectively so we can speed up the competition offered by broadband mobile providers.

Mr. WATT. My time is up, but it just seems ironic that you're saying on one side get the FCC out of the way, and then saying on the other side put the FCC back in and let them do this. I mean, I don't know how you can have it both ways. I mean, I understand what you're saying, it just seems—but now is not the place to pursue it.

I appreciate the Chairman's indulgence.

Mr. GOODLATTE. I appreciate the gentleman's comments as well. And I will just close by saying that it was over 10 years ago that I introduced legislation—probably the first net neutrality legislation introduced in the Congress—along with Congressman Rick Boucher in 1999, I think. We didn't call it "net neutrality," we called it "open access." It was designed to make sure that there was open competition on the Internet, but it was antitrust-based. And it never got to the finish line because the various interested parties in this kept shifting sides, and the sands underneath our legislation kept shifting. Some of the companies that were supporting our legislation back then are now looking in a different direction. Some that were opposing our legislation back then would very much support the idea today.

I very much agree with Mr. Downes' comment; the principle purpose of the FCC is to allocate spectrum and to try to find the most efficient way to do that; that spectrum is public property, if you will, and therefore it is the reason for the existence of the FCC.

I think the FCC has been on mission creep for decades now. And we need to be very, very careful that we don't put ourselves in a situation where we think that it is a great idea to have the FCC regulate the Internet the same way they have regulated the telecommunications industry and others. This is a rapidly changing, dynamic environment, and all kinds of decisions are made by all kinds of companies based upon what's going to be available in terms of capital, what's going to be available in terms of new technology and new ideas.

And I don't think it's going to happen if we empower the FCC in a way that they have clearly not been empowered in the past. They've been rebuffed by the courts in this area. They have chosen to take a different route that I think is very spurious in what they are attempting to do, and I hope the courts will rebuff them again. But failing that, I think that Congress should act, and I agree that it shouldn't just be a negative act to stop the FCC; it should be a positive act to look at our antitrust laws and see if they give appropriate access to small actors like Mr. Glass, and to look to see whether laws written 100 years ago are responsive to this dynamic environment.

But if they are clear rules of the road that exist before a decision is made to develop a product or to come up with the finances for it, we will be better served than to go down a path where we set about trying to find the capital, find the people to take the risks, and then have the rules changed in the middle of the game, which is where I fear the FCC will lead us.

So I thank everyone for their participation. It has been a very, very good discussion.

And without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for witnesses, which we will forward and ask the witnesses to respond as promptly as they can so that their answers may be made a part of the record.

And without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in the record.

And with that, I again thank our great witnesses, and this hearing is adjourned.

[Whereupon, at 4:20 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Written Statement of Randolph J. May

President, The Free State Foundation

Hearing on "Ensuring Competition on the Internet: Network Neutrality and Antitrust"

before the

Subcommittee on Intellectual Property, Competition, and the Internet

Committee on the Judiciary

U.S. House of Representatives

February 15, 2011

Testimony of Randolph J. May

President, The Free State Foundation

Mr. Chairman and Members of the Committee, thank you very much for inviting me to submit this written statement for inclusion in the Committee's record of the February 15, 2011, hearing on "Ensuring Competition on the Internet: Net Neutrality and Antitrust." I am President of The Free State Foundation ("FSF"), a non-profit, nonpartisan research and educational foundation located in Rockville, Maryland. The Free State Foundation is a free market-oriented think tank that, among other things, does research in the communications and Internet law and policy areas.

Despite ongoing efforts by Congress to consider the creation of a new legislative framework for addressing broadband Internet service issues, the FCC imposed a network neutrality regulatory regime in December 2010. But the new regulatory framework for broadband Internet services is plagued by several serious legal problems and policy defects.

In significant measure the problems with the FCC's net neutrality regulation spring from the Commission's inability or unwillingness to identify any current market failure problems in the broadband Internet marketplace. The FCC instead adopts its regulatory framework as a prophylactic response to the Commission's own supposed concerns over hypothetical future conduct in the evolving broadband Internet marketplace. The FCC flatly rejected employing a market power or consumer harm evidentiary standard as the basis for regulatory intervention. Instead, it opted to grant

itself wide-ranging authority to decide what kinds of future conduct it wants to prohibit and how deeply into the market it wants to insert government restrictions and mandates.

In opting for this new nearly unconstrained regulatory regime, the FCC has likely exceeded its statutory authority. A federal appeals court ruling less than a year ago rejected the Commission's claims for authority to regulate broadband Internet services, and the Commission's new attempt to regulate such services will likely suffer the same fate in court. Congress has not expressly granted authority to the FCC to regulate broadband Internet services. And one of the statutory provisions on which the Commission principally relies to claim it has "ancillary" regulatory authority is actually a Congressional policy statement favoring *de*regulation to promote the deployment of broadband networks, not new regulation.

Moreover, the regulatory framework adopted by the Commission raises serious constitutional issues under the First Amendment. Prior court cases have recognized that First Amendment protections accorded to the editorial judgments of newspaper, radio and broadcasting media are accorded to broadband ISPs' editorial discretion regarding the traffic they choose to carry on their networks and what kind of content they choose not to carry. But the FCC's regulations now restrict such editorial discretion on the part of broadband ISPs. And lacking any existing market power or consumer harm evidentiary findings, the FCC cannot likely show its regulations further any substantial governmental interest. Parties challenging the constitutionality of the FCC's rules will likely be able to show that the regulatory burdens placed on broadband ISP editorial judgments sweep more broadly than necessary to advance any government interest. To the extent that any government interest is shown to exist, a variety of less onerous

alternatives for addressing Internet provider practices are available to the Commission and to other federal agencies through antitrust enforcement.

The FCC's net neutrality regulations constitute unsound public policy, especially because they threaten future innovation and investment in broadband infrastructure and services. For example, investment and innovation likely will be chilled because the FCC's new rules prohibiting "unreasonable discrimination" by Internet providers necessarily will have a deterrent effect on ISPs wishing to differentiate their services from their competitors in response to rapidly evolving consumer demands. Innovation, and investment to support such innovation, depends on the prospects for realization of real returns, rather the prospects for realizing recurring litigation. While the Commission acknowledges that some "discrimination" by Internet providers is beneficial to consumers, based on the FCC's history of administrative overreaching, it is likely the sorting out process will not be conducive to fostering entrepreneurial experimentation.

Moreover, the FCC's regulatory framework establishes a set of anticipatory *ex ante* rules built upon dubious, non-exclusive, and unstable definitional distinctions. For example, the regulations distinguish between "edge providers" and other "end users" in a way that gives the former special privileges over the latter regarding pricing arrangements with broadband ISPs. This constitutes a "competitor welfare" approach to the broadband Internet market, rather than a "consumer welfare" approach. And it invites special interest lobbying for future Commission rulings regarding who should receive "edge provider" favoritism. By rejecting market power and consumer harm evidentiary showings as a predicate for regulatory enforcement under its framework, the Commission necessarily arrogates to itself nearly unbridled discretion in determining

what kinds of services and practices in the Internet marketplace should be permitted and how it should regulate them.

I. The FCC's Net Neutrality Regulations Are Not Authorized by Congress

The FCC's net neutrality regulations most likely lack proper congressional authority. The Commission's previous attempt to regulate broadband network management practices was struck down by the U.S. Court of Appeals for the District of Columbia Circuit last April.[1] In that ruling, the D.C. Circuit concluded that the FCC did *not* have statutory authority to regulate the Internet network management practices at issue in that case.

The FCC's new broadband Internet services regulatory framework will more likely than not be struck down for the same reason. (Lawsuits challenging the FCC's regulation have already been filed.) A federal court, be it the D.C. Circuit or some other court, will likely reiterate that Congress never granted the FCC the power to regulate broadband Internet services.

The FCC's claimed legal basis for imposing regulation is highly problematic. The weakness of the FCC's claimed statutory authority is revealed by the Commission's resort to an "everything-but-the-kitchen-sink" approach to asserting its authority over broadband Internet services. The Commission invokes numerous provisions that deal with separate, specific subjects — such as common carrier telephony, broadcasting and licensed mobile radio service or wireless, and multivideo programming services such as cable television.[2] But nowhere do Titles II, III and VI of the Communications Act ever give the Commission authority to regulate broadband Internet services. Rolling all of

[1] *See Comcast Corp. v. FCC*, 600 F.3d 642 (D.C. Cir. 2010).
[2] *See* FCC, Report & Order ("Order"), *In the Matter of Preserving the Open Internet*, GN Docket No. 09-191, WC Docket No. 07-52 (December 23, 2010), at 68-77.

those provisions together does not somehow create any new delegation of agency authority to regulate broadband Internet services. And neither do any Title II, III or VI provisions, singly or jointly, provide grounds for the Commission to anchor its exercise of ancillary authority under Title I.

The Commission's arguments that Section 706 gives it authority over broadband Internet services are also highly dubious. Section 706 is best read as a statement of Congressional policy, not a separate delegation of authority to the FCC. In particular, both Section 706(a) and –(b) state Congressional policy in favor of *de*regulation and "removing barriers to infrastructure deployment," not new regulation and raising additional barriers.[3] For these reasons, the Commission's order establishing its regulatory framework also has to overcome and explain away the Commission's prior interpretation of Section 706 as a statement of policy that provides no independent basis of authority.[4] But even if Section 706 provided an independent source of agency authority, that authority would best be understood as authority for eliminating regulation, not establishing regulation. It strains credulity to think that an expansive, open-ended broadband Internet services regulatory framework can be created by invoking a deregulation-minded statutory provision.

The FCC's attempts to claim that adopting its broadband Internet services regulatory framework is reasonably ancillary to satisfying the purposes behind the several statutory provisions it listed will likely prove futile. Taken on its own terms, the FCC's rationale for its claimed statutory authority under Title I ancillary jurisdiction

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[3] *See* 47 U.S.C. §§ 1302 (a), (b).
[4] *See* Order, at 64-65, para. 118 (discussing the Commission's *Advanced Services Order*). *See also Comcast v. FCC*, note 1, *infra*, at 655, observing with respect to Section 706 that the FCC "[a]cknowledged that it has no express statutory authority over [an Internet service provider's network management] practices".

admits no limiting principle. Federal courts have rejected limitless agency ancillary powers.[5] The D.C. Circuit rejected precisely that kind of limitless exercise of Title I ancillary authority last April in *Comcast v. FCC*.[6] A future court will likely do the same when the FCC's broadband Internet services regulatory framework is subjected to judicial review.

II. The FCC's Regulation Is Likely Unconstitutional Under the First Amendment

Constitutional problems also plague the FCC's net neutrality regulation. Fifth Amendment regulatory takings issues are implicated by the FCC's broadband Internet services regulatory framework. But this written statement will focus on First Amendment issues raised by such regulation.

By characterizing broadband ISPs as "conduits of speech,"[7] the Commission attempts to push broadband Internet access services outside the scope of First Amendment protection. The FCC also tries to downplay the editorial decisionmaking of broadband ISPs, reducing it to a level of constitutional insignificance. But a federal court will *not* readily allow an administrative agency to shrink the scope of constitutionally protected activity in order to regulate it. The FCC's attempt to escape constitutional scrutiny by relabeling speech and editorial activities that it seeks to restrict as mere transmission is misguided. A federal court will look past the Commission's relabeling attempt and look instead at the regulation's burden on speech and editorial activity.

Private actors, including persons acting in association through media corporations, possess freedom of speech rights in making editorial judgments about

[5] *See, e.g., FCC v. Midwest Video Corp*, 440 U.S. 689 (1979).
[6] *See* note 1, *infra*.
[7] Order, at 78, para. 141.

whether and what sorts of contents are delivered through their respective speech communication mediums. Courts have recognized that First Amendment protections for editorial judgments about content apply with respect to newspapers.[8] They also apply to those engaged in editorial and other speech activities using modern mass media technologies such as cable TV companies.[9] Rulings by two federal district courts have treated broadband ISPs as deserving of free speech protection from government restrictions.[10] It follows that regulation that limits or infringes on broadband ISPs' editorial judgments to the extent that such regulation dictates whether or to what extent broadband Internet service providers can or cannot block, filter, or otherwise decide what sort of content can travel through their networks is constitutionally suspect.

The FCC's broadband Internet services regulatory framework includes significant restrictions on editorial judgments by broadband ISPs. It includes a rule that generally prohibits the blocking or degrading of content.[11] And another rule prohibits broadband ISPs from giving discriminatory, preferential treatment to certain types of content over others, depending on its source and the content message.[12] These rules are subject to exceptions, including where the FCC concludes it is reasonable to block or degrade certain types content that consumers would not likely want, including spam or viruses.[13] As FCC Commissioner McDowell pointed out in his statement dissenting from the

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[8] *See, e.g., Miami Herald Publishing Company v. Tornillo*, 418 U.S. 241 (1974).
[9] *See, e.g., Turner Broadcast Systems, Inc v. FCC*, 512 U.S. 622, 636 (1994); *Nat'l Cable Television Ass'n v. FCC*, 33 F.3d 66 (D.C. Cir. 1994).
[10] See *Illinois Bell Telephone Co. v. Village of Itasca*, 503 F. Supp. 2d 928 (N.D. Ill. 2007); *Comcast Cablevision of Broward County, Inc. v. Broward County*, 124 F. Supp. 2d 685 (S.D. Fla. 2000).
[11] Order, at 37-38, para. 62; *id.* at 39, para. 66.
[12] Order, at 40, para. 68.
[13] *See* Order at 47-52 (adopting and discussing "reasonable network management" rule).

FCC's order imposing net neutrality regulation: "[W]hat are acts such as providing quality of service (QoS) management and content filters if not editorial functions?"[14]

Once First Amendment scrutiny is applied, the FCC's regulatory restrictions on how broadband ISPs manage their networks will most likely be found unconstitutionally burdensome. Absent any evidence of market failure or consumer harm problems, the FCC will have difficulty establishing any "substantial" government interest being furthered by its regulation. Importantly, the First Amendment is a limit on government's power over private conduct — and not a grant of power for government to regulate speech activity. This means the FCC's claims that it can impose net neutrality regulation in the name of promoting speech values will be rejected by a federal court because such claims simply turn the First Amendment on its head.[15]

Lacking any substantial government interest to support its regulation, the FCC will have serious difficulty showing that its regulatory approach does not "burden substantially more speech than is necessary." It is easy to name a number of ways by which the FCC could have limited the reach of its net neutrality regulation. For instance, the FCC could have required a showing of anticompetitive conduct before engaging in regulatory intervention. But as discussed below, the FCC instead adopted an open-ended approach that gives the Commission expansive powers over the Internet marketplace. The Commission could also have clearly placed the burden of proof on complainants alleging rule violations. Instead, however, the Commission requires broadband ISPs to justify their actions by rebutting the claims of complainants who simply make a *prima facie* showing of alleged violations of the FCC's regulation.

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[14] Dissenting Statement of Commissioner Robert M. McDowell (December 23, 2010), at 26.
[15] *See Order*, at 80, para. 146.

III. The FCC's Regulations Address No Existing Problems and Constitute Unsound Public Policy

The FCC's net neutrality regulation is unwise as a matter of public policy. As a foundational matter, its order establishing net neutrality regulation is devoid of any empirical basis for imposing such regulation. The Commission imposed its regulatory framework in the absence of any market power finding. In fact, the Commission made no market power or consumer harm analysis at all. It expressly rejected suggested proposals that any regulation adopted or enforced be based on standards involving anticompetitive conduct.[16] Lacking any solid market analysis to support its new regulation, the Commission merely pointed to a couple well-known anecdotal instances – such as Comcast/BitTorrent – that are well known to all and which were essentially resolved through private efforts.[17] Revealingly, the FCC expressly declined to say whether the broadband network management practices alleged to have occurred in instances like Comcast/BitTorrent would even constitution violations of its new regulatory framework.[18]

Rather than even trying to establish evidence of any kind of existing market failure or consumer harm problem, the FCC justified its new framework as "prophylactic" regulation.[19] In other words, absent evidence of any existing market failure or consumer harm in the broadband Internet services market, the FCC decided to regulate based on its own predictions about what could happen sometime in the future. In particular, the Commission based its regulation on predictions about what might happen in the future

[16] Order, at 45-46, para. 78.
[17] *See* Order at 21-23. *See also* note 1, *infra*.
[18] Order, at 22, para. 36.
[19] *See, e.g.*, Order, at 24, para. 39.

to make the Internet market different than what the Commission would like it to be. And so the FCC – for the very first time – imposed an expansive and open-ended set of government regulation on broadband Internet services.

The Commission's adoption of a set of *ex ante*, anticipatory rules will likely have the effect of reducing investment and stifling innovation. Aggressive investment in broadband infrastructure by competing broadband ISPs is crucial to continuing technological advances and to increasing availability and adoption. A study commissioned by the FCC and released fifteen months ago puts past investments and projected future investments at approximately $30 billion a year by industry.[20] That study projected total broadband investment between 2010 and 2016 of $182 billion.[21] That kind of investing must be further encouraged to meet increasing demands. In fact, the FCC task force that put together the National Broadband Plan estimated that a nationwide network providing 100Mbps speeds would require investment of up to $350 billion over the next several years.[22]

But under the guise of prohibiting discrimination, the FCC's regulations likely will inhibit the ability of broadband ISPs to actively engage in innovative new traffic management practices to meet growing and changing demands. Heaping regulatory restrictions on an industry or industry segment is an unlikely method for encouraging that industry or segment to sustain or increase its investments. But that is precisely what the FCC has done by adopting its net neutrality regulation. The FCC thereby fails

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[20] Robert C. Atkinson & Ivy E. Schultz, *Broadband in America: Where It Is and Where It Is Going (According to Broadband Service Providers)*, Preliminary Report Prepared for the Staff of the FCC's Omnibus Broadband Initiative (November 11, 2009), at 11.
[21] *Id.* at 68. *See also id.* at 66, Table 15.
[22] FCC Broadband Task Force, Commission Open Meeting Presentation on the Status of the Commission's Processes for Development of a National Broadband Plan (September 29, 2009), at 45.

to take seriously the propensity of regulatory restrictions on broadband network management practices to stifle broadband infrastructure investment.

Investment and innovation will be chilled because of regulatory uncertainty and intrusiveness regarding "discrimination" that the FCC determines to be harmful as opposed to discrimination that it acknowledges is beneficial and therefore reasonable. Entrepreneurial experimentation requires freedom to attempt new technological, pricing and service offerings. This is no less the case when it comes to the Internet. Under the FCC's broadband Internet services regulatory framework, however, federal regulators are the arbiters of what broadband network management practices will be permissible.

In many instances the FCC's broadband Internet services regulatory framework establishes standards in general terms rather than specific requirements. This makes it uncertain whether existing or future network management practices will be permissible or not. In order to flesh out the scope of those general terms, the FCC will in many instances make judgments based on a balancing of competing interests.

FCC enforcement of its net neutrality regulation will be as open-ended as whatever purposes the FCC believes will likely create the kind of Internet market that the FCC wants. Because the FCC rejected proposals that anticompetitive conduct and consumer harm findings be required as the basis for adjudicating claims under its broadband Internet services regulatory framework, its reliance on its vaguely articulated "broad purposes" could well result in arbitrary and protectionist regulation for selected segments of the Internet marketplace.[23]

[23] *See* Order, at 45, para. 78.

In particular, the FCC adopted a set of non-exclusive categories for Internet "edge providers" and "end users."[24] It treats Internet "edge providers" differently, and more favorably, than all other "end users" for purposes of judging the lawfulness of pricing and other Internet market transactions with "broadband providers." Under the FCC's regulatory framework, for instance, broadband ISPs apparently have pricing freedom to offer usage-based or metered pricing to end users.[25] But edge providers receive special protections from any broadband ISP practices that would give priority on broadband ISP networks to certain content over others. Broadband ISPs are prohibited from offering priority service to certain edge provider content for a fee.[26]

The durability of the Commission's definitional categories is itself highly questionable. For instance, many consumers reasonably regarded as "end users" under the Commission's framework also produce and make content available on the Internet. Separating privileged "edge providers" from all other "end users," therefore, is no clear-cut task. Future technical determinations by the Commission of what actors are "edge providers" as opposed to mere "end users" could become the occasion for extensive lobbying efforts. The Commission may be opening itself up as a new venue for considering claims of competing parties who hope to gain advantage over broadband ISPs or other marketplace competitors via regulatory adjudications.

Extensive regulatory intrusion is all but invited by the FCC's complaint process. Under the procedural rules contained in its regulatory framework, the FCC gives "any person" the ability to file a formal complaint before the Commission to challenge

[24] Order, at 3, para. 4, fn. 2. *See also id.* at 11, para. 20 (describing "three types of Internet activities").
[25] Order, at 41, para. 72.
[26] Order, at 43, para. 76.

broadband ISP practices.[27] Rather than firmly placing the burden of proof on complainants, the FCC requires broadband ISPs to rebut *prima facie* showings of rule violations.[28] These procedural rules therefore make it relatively easy for the Commission to justify its own regulatory intrusion into the broadband market. And by rejecting any market power or consumer harm evidentiary standard, the Commission assumes for itself a roving mandate for adjudicating such complaints, deciding what kinds of transactions it should permit or restrict based on the Commission's own preferences for what the broadband Internet market should look like.

As a general matter, the FCC has adopted a policy approach making competitor welfare — "edge provider" interests — the underpinning of its regulation. An approach emphasizing consumer welfare — "end user" interests — would make market power and consumer harm the touchstones of its framework. The FCC's policy approach is also unreasonable in light of less onerous alternative approaches to addressing any actual problems in the broadband Internet market.

In contrast to the FCC's approach, antitrust law is premised on consumer welfare. Antitrust enforcement provides a more disciplined set of safeguards in cases of behavior that forecloses market competition. The Federal Trade Commission and the Department of Justice already have authority to investigate and pursue legal action in instances where broadband ISPs engage in anticompetitive conduct. The existing protections for consumers that are supplied by antitrust law need to be taken seriously before any rash move toward regulating the Internet takes place. A significant upshot to antitrust enforcement is its disciplined, case-by-case approach, which requires factual

[27] Order, at 83, para. 156; *id.* at 90 (Appendix B: Procedural Rules: Formal Complaints).
[28] Order, at 84, para. 157.

evidence of actual market power problems or consumer harms and clearly puts the burden of proof on complainants.

Mindful of existing FTC and DOJ authority to pursue antitrust violations by broadband ISPs, the better policy approach would be for the FCC to respect the rapidly advancing dynamic nature of the Internet marketplace by refraining from imposing regulation. It could instead observe market trends, monitor and investigate alleged violations of its *Open Internet Principles*, and bring public attention to areas of concern. At the very least, the FCC could work more closely with Congress to obtain proper authority to address matters involving broadband network management practices.

Thank you for giving me the opportunity to submit this statement for the record.

February 23, 2011

Letter from Lisa R. Youngers, Vice President, External Affairs,
XO Communications, and Others

March 4, 2011

The Honorable Lamar Smith
Chairman
Committee on the Judiciary
House of Representatives
Washington, DC

The Honorable John Conyers Jr.
Ranking Member
Committee on the Judiciary
House of Representatives
Washington, DC

The Honorable Bob Goodlatte
Chairman
Subcommittee on Intellectual Property,
Competition, and the Internet
House of Representatives
Washington, DC

The Honorable Mel Watt
Ranking Member
Subcommittee on Intellectual Property,
Competition, and the Internet
House of Representatives
Washington, DC

Dear Chairman Smith, Ranking Member Conyers, Chairman Goodlatte, and Ranking Member Watt:

On February 15th, the Subcommittee on Intellectual Property, Competition, and the Internet held a hearing on "Ensuring Competition on the Internet: Net Neutrality and Antitrust." As facilities-based communications providers and organizations, we have a great stake in the matters debated that day. In this letter, which we ask to be included in the record of that hearing, we discuss the critical need for the Committee to address the harm to competition caused by the U.S. Supreme Court's 2004 decision in *Verizon Communications Inc v. Law Offices of Curtis V. Trinko, LLP* ("*Trinko*"). The *Trinko* decision has greatly reduced the ability of our antitrust laws to ensure robust competition in the communications industry.

The communications providers and organizations signing this letter seek to ensure our industry is vibrantly competitive which will allow us to accelerate investment in advanced networks and provide high-quality jobs. It also will ensure that consumers, including small businesses, get the most innovative services at the best prices. Because competition produces so many benefits, we are concerned about the unprecedented wave of consolidation by telecommunications companies, including among and with the largest incumbent local exchange carriers, and other anticompetitive activity in our industry over the past decade. We believe your Committee should convene further hearings to investigate whether the antitrust laws are working as intended and being fully enforced. More specifically, the Committee should examine and address the harms to competition by the U.S. Supreme Court's decision in *Trinko*.

Looking back, the most prominent event to ignite the explosive growth in the communications industry was the government's antitrust case against AT&T and the subsequent consent decree that required the divestiture of that company. Within a matter of a few years, an industry once characterized by high prices, lack of consumer responsiveness, and slow innovation became one of the nation's most dynamic sectors. It demonstrated the enormous value of our antitrust laws, and, yet, despite this fact, it is unclear that such an event could occur today – not because the law itself is irrelevant but because the U.S. Supreme Court and other federal courts have restricted its application.

In the *Trinko* decision, the U.S. Supreme Court raised the bar for private parties and government agencies to bring antitrust actions. The Supreme Court held that a failure to abide by affirmative market-opening obligations in the Telecommunications Act of 1996 does not generate a cause of action under the antitrust laws (Section 2 of the Sherman Act), even though the Act contained an express antitrust savings clause, which the House Judiciary Committee authored. While the court's holding was sufficient to deal with the case, it then added superfluous and vague language implying that a detailed regulatory scheme enables immunity from antitrust enforcement. The court also made a variety of statements about how courts may be ill-suited to address competitive concerns in dynamic industries and that they should defer to regulators.

Unfortunately, rather than adhering just to the Supreme Court's holding in *Trinko*, lower courts have employed the court's dicta to dismiss antitrust complaints, which in turn has discouraged parties from initiating actions for anticompetitive behavior. The Supreme Court has further encouraged this trend with more recent antitrust decisions, such as its 2009 decision in *Pacific Bell Tel. Co. v. linkLine Communications, Inc.*, where the court restricted the ability to pursue price squeeze complaints. In fact, overall, for the past fifteen years, the Supreme Court has consistently decided antitrust cases in favor of defendants. All of these antitrust decisions have occurred despite the fact that, even where putative legal authority exists, regulatory oversight too often has been either significantly limited or simply non-existent.

This expansive application of the *Trinko* decision and the subsequent harm to competition was noted last year in testimony by the Federal Trade Commission ("FTC") before this Committee:

> Our concern is that *Trinko* could be read more broadly by lower courts to block antitrust claims even where regulation does not as directly or effectively address the alleged competitive harm as the Supreme Court found the FCC ["Federal Communications Commission"] rules at issue in *Trinko* to do.

The FTC then called upon Congress to clarify that *Trinko* does not prevent "public antitrust agencies from acting under any of the antitrust laws when they conclude that anticompetitive conduct would otherwise escape effective regulatory scrutiny."

It is evident that *Trinko* greatly reduces the use of our antitrust laws to ensure competition in the communications sector. Since the *Trinko* decision, a number of potentially important antitrust cases were shut down, and no serious cases have been initiated. In overseeing the AT&T antitrust case, Judge Greene found that the FCC "is not or never has been capable of effective enforcement of the laws governing AT&T's

behavior." Anyone familiar with the FCC today, even after passage of the 1996 Act, understands the enormous gaps that exist in the Commission's ability to police the market. It also is true that Judges, reluctant to undertake arduous and complex antitrust cases, have an "easy out" by invoking the dicta in *Trinko*. For a competitive communications industry to flourish, we need to alter the current course and encourage the use of our antitrust laws to protect consumers and competition.

The harm to competition from the *Trinko* decision is apparent. Since 2004, when it was handed down, the communications industry has seen substantial consolidation. For instance, in the telecommunications sector, the once-divested AT&T has been largely recreated through a series of acquisitions by SBC (now called AT&T) and Verizon, and they have increased their market power by adding market-dominating wireless assets. Moreover, all these activities were permitted by the regulatory agencies, which in theory were protecting competition in the industry but in reality were facilitating consolidation. In essence, communications consumers have not had – and still do not have – the antitrust laws protecting their interests. It should not be surprising that where a legal vacuum exists, large companies will take advantage and enhance their market power.

This Committee has been wary of the *Trinko* decision from its inception and has understood the potential for significant harm. To address this concern, immediately after it was handed down, Chairman Sensenbrenner along with Representative Conyers introduced legislation, the "Clarification of Antitrust Remedies in Telecommunications Act of 2004," making it a violation of the Clayton Act for an incumbent local exchange carrier to create or preserve a monopoly by using its network to engage in anticompetitive conduct. The legislation also provided that the mere existence of agency regulation, other than express requirements, would not affect the applicability of the legislation's mandate. Two years later, Chairman Sensenbrenner and Representative Conyers sought to address a specific harm brought about by *Trinko* in introducing and reporting from this Committee the "Internet Freedom and Non-Discrimination Act of 2006."

While these earlier efforts to fix *Trinko* were not successful, the Committee understood the significance of the problem and the need for a solution. With no applicable antitrust laws – and effectively limited protections from regulators – consumers are left vulnerable to anticompetitive forces. It is time for the Committee to assert its jurisdiction, and undertake the serious work required to reinvigorate our antitrust laws to ensure robust competition in the communications industry.

Thank you for your time and attention to this important matter.

/s/
Lisa R. Youngers
Vice President, External Affairs
XO Communications

/s/
Jeff Oxley
Executive Vice President and
General Counsel
Integra Telecom

/s/
Kelsi Reeves
Vice President Federal Government
Relations
tw telecom inc

/s/
Ed Black
President & CEO
Computer & Communications Industry
Association (CCIA)

/s/
Doug Carlen
Senior Vice President and General
Counsel
MegaPath, Inc.

/s/
William A. Haas
Corporate Vice President Public
Policy & Regulatory
PAETEC Holding Corporation

/s/
Steven K. Berry
President and CEO
Rural Cellular Association

/s/
Robert H. Turner
CEO
Pac-West Telecomm, Inc.

/s/
Sarah DeYoung
Executive Director
CALTEL

/s/
Richard A. Jalkut
CEO
U.S. TelePacific Corp.
d/b/a TelePacific Communications

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