

NET NEUTRALITY POLICY RECOMMENDATION FOR FACEBOOK, INC.

by  
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MEMORANDUM FOR Head of Public Policy, Facebook, Inc.

FROM: Jeff Harris, Deputy Director of Public Policy

SUBJECT: Policy Options Regarding Net Neutrality

DATE: March 1, 2014

## **I. Action-Forcing Event:**

On January 14, 2014 a US Appeals Court struck down the Federal Communications Commission's (FCC) net neutrality rules. In its ruling the Court said that the FCC did not have authority to regulate broadband providers in the manner in which they were attempting to regulate them.<sup>1</sup>

## **II. Statement of Problem:**

The overturning of the FCC's net neutrality rules has created a market failure where the supply of broadband internet access has become a limited rival and excludable good. The effect of the ruling was to move the pricing decisions from content providers to internet service providers (ISPs). This transfer of power to ISPs, as will be demonstrated in this memo, will have negative consequences for Facebook's business model as it relates to potential growth opportunities.

ISPs often have a monopoly or duopoly in place for customers at the majority of small and medium businesses and individual households, especially those outside of major cities.<sup>2</sup> Having limited service provider choices is a problem for a customer that's

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<sup>1</sup>Andrew Zajac and Todd Shields, "Verizon Wins Net Neutrality Court Ruling Against FCC," *Bloomberg.com*, January 14, 2014. Accessed January 28, 2014, <http://www.bloomberg.com/news/2014-01-14/verizon-wins-net-neutrality-court-ruling-against-fcc.html>.

<sup>2</sup>Shane Greenstein, "Economic Experiments and Neutrality in Internet Access," *Innovation Policy and the*

further exacerbated by the ability of ISPs to now dictate the conditions for entry into the market for content providers.<sup>3</sup> In light of the FCC rules being overturned, it is now easier for ISPs to limit consumer choices in their pricing models and to also suppress the innovation of startups by pricing them out of the market before they can even enter.<sup>4</sup>

Large companies will be better equipped to take on the projected higher costs associated with fees for content providers to partner with ISPs in the delivery of content over the internet. However, even the biggest content providers will not be able to cover all costs. According to some estimates, Netflix will have to raise its prices as much \$4.80 per user due to the court ruling overturning the FCC rules on net neutrality.<sup>5</sup>

Compared to large companies like Netflix and Facebook, tech startups already faced a challenging climate for success prior to the upending of net neutrality. Making the price for entry into the market for internet content providers more excludable will only serve to decrease the rate of success for new startups going forward. As it stands today, 90% of tech startups fail.<sup>6</sup>

This failure rate is detrimental because of the contributions to the overall US economy from startups. Startups accounted for 40 percent of private sector employment in the US over the last two decades, and at the same time small businesses made up 43

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*Economy* 8, (2007): 88.

<sup>3</sup> Ibid. 94.

<sup>4</sup> Jeremy Hsu, "'Net Neutrality' Ruling Opens Door for 2-Tiered Internet Market," *Scientific American*, January 15, 2014. Accessed February 7, 2014, <http://www.scientificamerican.com/article/net-neutrality-ruling-opens-door/>.

<sup>5</sup> Ryan W. Neal, "How Net Neutrality Affects Netflix: Court Ruling Could Raise Netflix Fees \$4.80 Per User," *International Business Times*, January 15, 2014. Accessed February 8, 2014, <http://www.ibtimes.com/how-net-neutrality-affects-netflix-court-ruling-could-raise-netflix-fees-480-user-1541796>.

<sup>6</sup> "Transformational Entrepreneurship: Where Technology Meets Societal Impact," *Compass*, April 13, 2012. Accessed February 8, 2014, <http://blog.startupcompass.co/transformational-entrepreneurship-where-techn-11064>.

percent of a high-tech employment.<sup>7</sup> Furthermore, small businesses, like tech startups, contribute a great deal in terms of new ideas and creativity to the overall US economy. When looking at firms that apply for patents at a high rate, defined as 15 or more applications over four years, smaller businesses generate patents at a rate sixteen times greater than large firms.<sup>8</sup>

These numbers further emphasize the value of tech startups to the overall economy. Moving the pricing decisions from content providers to ISPs, and the ensuing market failure, will damage the ability of startups to succeed. If this trend takes hold it will become problematic for Facebook's business model as we emphasize our own growth, of both services and talent, through the acquisitions of startups.<sup>9</sup>

In 2012 Facebook bought Instagram for \$1 billion. In February 2013, Facebook bought WhatsApp for \$13 billion.<sup>10</sup> Both of these landmark deals involved mobile messaging startup companies. This was not a coincidence as Facebook now receives half of its ad revenue from mobile devices.<sup>11</sup> However, at the time of purchase, neither Instagram nor WhatsApp had ads running on their platforms. This was because they were startups that still had funding coming from investors. The flexibility to not host ads was further enabled because these apps could not be blocked or denied access to a free and

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<sup>7</sup> "Frequently Asked Questions," *SBA: Office of Advocacy*, September 2012. Accessed February 8, 2014, [http://www.sba.gov/sites/default/files/FAQ\\_Sept\\_2012.pdf](http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf).

<sup>8</sup> Ibid.

<sup>9</sup> Jason Abbruzzese, "Facebook's Formula: Buy Startups, Absorb Products, Keep Talent," *Mashable*, January 30, 2014. Accessed February 4, 2014. <http://mashable.com/2014/01/30/facebook-acquihire-strategy/>.

<sup>10</sup> David Gelles and Vindu Goel, "Facebook Enters \$16 Billion Deal for WhatsApp," *The New York Times DealBook*, February 19, 2014. Accessed April 14, 2014, [http://dealbook.nytimes.com/2014/02/19/facebook-to-buy-messaging-startup/?\\_php=true&\\_type=blogs&\\_r=0](http://dealbook.nytimes.com/2014/02/19/facebook-to-buy-messaging-startup/?_php=true&_type=blogs&_r=0).

<sup>11</sup> Tom Risen, "Facebook, Apple, Google and the Tech Startup Gold Rush," *US News*. February 24, 2014. Accessed April 14, 2014, <http://www.usnews.com/news/articles/2014/02/24/facebook-apple-google-and-the-tech-startup-gold-rush>.

open internet. Protecting the ability of future Instagrams and WhatsApps to exist will be critical to Facebook's growth as a business.

### III. History

Columbia Law Professor Tim Wu brought the term "net neutrality" into the mainstream with his 2003 paper entitled *Network Neutrality, Broadband Discrimination*.<sup>12</sup> However, the concept and concerns behind net neutrality began to take hold at the end of the previous decade.<sup>13</sup> Despite being a hotly debated topic for nearly two decades, there is still not agreement about the best definition of network neutrality. For the purposes of this memo it is best to turn to the man who first popularized the term.

Professor Wu describes net neutrality as a network design principle. As he puts it, "The idea is that a maximally useful public information network aspires to treat all content, sites, and platforms equally."<sup>14</sup> This concept has created a tension between content providers, like ourselves, and the internet service providers, such as Comcast and Verizon, that we are dependent on to deliver access to our content to consumers. In essence, ISPs have become the middlemen in a network otherwise designed on the principles of "end-to-end," service.

The debate surrounding net neutrality essentially boils down to this: will the internet become more like cable television or like the electric grid? As the graphic below demonstrates, all of these networks are structured to have three main components. Each

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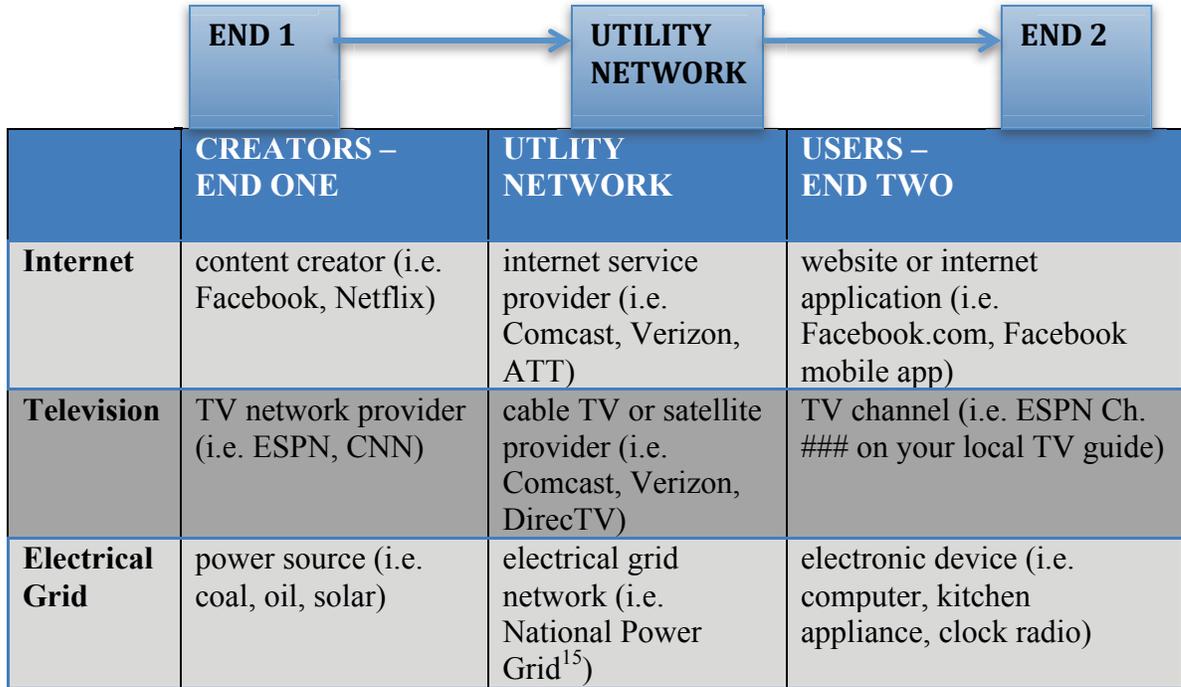
<sup>12</sup> Rachel Nuwer, "Here's the Paper That Popularized Net Neutrality," *Smithsonian Magazine*, January 16, 2014. Accessed February 19, 2014. <http://www.smithsonianmag.com/smart-news/heres-paper-popularized-net-neutrality-180949376/>.

<sup>13</sup> Tim Wu, "Network Neutrality FAQ," *TimeWu.org*, Accessed February 2, 2014. Network Neutrality FAQ. [http://www.timwu.org/network\\_neutrality.html](http://www.timwu.org/network_neutrality.html).

<sup>14</sup> Tim Wu, "Network Neutrality FAQ," *TimeWu.org*, Accessed February 2, 2014. Network Neutrality FAQ. [http://www.timwu.org/network\\_neutrality.html](http://www.timwu.org/network_neutrality.html).

starts with the originator of a good or service, then moves to a network that transfers that good, and then finally reaches the end users.

**End-to-End User Experience:**



Where the differences for each network appear is in the power of the utility network to control the speed and pricing of service depending on how much strain the two ends put on the network. In the case of the electrical grid, users at end 2 are charged a fee for the rate of usage, regardless of what devices they are running off of the grid. That is to say, the more electrical power you use, the more you pay. On the opposite end of the spectrum, television users at end 2 are charged varying rates depending on which channels they are subscribed to, not the quantity of hours spent consuming individual programming.

<sup>15</sup> "U.S. Energy Information Administration - EIA - Independent Statistics and Analysis," *U.S. Energy Information Administration*, April 27, 2012. Accessed February 22, 2014. EIA's Energy in Brief, [http://www.eia.gov/energy\\_in\\_brief/article/power\\_grid.cfm](http://www.eia.gov/energy_in_brief/article/power_grid.cfm).

The place of the internet on this spectrum is what the net neutrality debate is attempting to solve. Proponents of net neutrality would like to see it continue to remain at the same end as the electrical grid, where the internet has been for most of its life. Opponents of net neutrality are trying to move the internet towards a model similar to that of cable television.

### FCC Rules and Regulations

This debate over the future of net neutrality takes place in several arenas: public opinion, the Courts, Congress, and industry, among others. However, the focal point for the future of net neutrality is the Federal Communications Commission. The FCC did not engage much on regulating internet providers until the early to mid-2000s. The timing of when the FCC began to engage directly coincides with an explosive growth period for broadband access in individual households. In the summer of 2000 less than five percent of US households had broadband access. By 2006, at which point the FCC was firmly entrenched in this issue, roughly 30 percent of households had some access to broadband internet service.<sup>16</sup>

In 2002 the FCC made a determination about how to classify internet services that is still at the heart of the debate today. The FCC ruled that broadband internet provided by cable television networks would fall under Title I of the 1934 Communications Act. This meant that broadband service was determined to be an interstate information service.

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<sup>16</sup> Shane Greenstein, "Economic Experiments and Neutrality in Internet Access," *Innovation Policy and the Economy* 8, (2007): 84-85.

<sup>17</sup> The FCC felt that this classification would be the best way to encourage, “ubiquitous availability of broadband access to the Internet to all Americans.”<sup>18</sup>

On June 27, 2005 the US Supreme Court upheld the FCC’s classification in the case *National Cable & Telecommunications Association v Brand X Internet Services*.<sup>19</sup>

In practice what this classification did was hamstringing the FCC in its regulatory powers. If they had decided to classify broadband internet as a telecommunications service under Title II, known as the common carrier title, then the FCC would have much tighter controls in place over the internet. Title II allows for much more explicit controls on anti-discrimination, which is a key concept for proponents of net neutrality.<sup>20</sup>

The FCC began to further assert its authority to regulate broadband internet service in early 2004, the year after Tim Wu wrote his seminal paper on net neutrality. That February, then FCC Chairman Michael Powell gave a speech in which he outlined guiding principles for preserving internet freedom.<sup>21</sup> In this speech Powell outlined four freedoms that consumers were entitled to in the view of the FCC. The FCC didn’t formalize their views until a year a half later when, on August 5, 2005, they issued a brief policy statement in which they formally adopted these four essential freedoms. The freedoms were, as written by the FCC:

- (1) consumers are entitled to access the lawful Internet content of their choice;
- (2) consumers are entitled to run applications and services of their

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<sup>17</sup> Angele A. Gilroy, “Access to Broadband Networks: The Net Neutrality Debate” (Congressional Research Service, CRS.gov, February 14, 2013), 1.

<sup>18</sup> Federal Communications Commission, *FCC Classifies Cable Modem Service As “Information Service”*, (press release) March 14, 2002.

<sup>19</sup> “Supreme Court Rules in Brand X Case, 6/27/2005,” *Tech Law Journal*, June 27, 2005. Accessed February 24, 2014. <http://www.techlawjournal.com/topstories/2005/20050627b.asp>.

<sup>20</sup> Angele A. Gilroy, “Access to Broadband Networks: The Net Neutrality Debate” (Congressional Research Service, CRS.gov, February 14, 2013), 2.

<sup>21</sup> Michael Powell, “Preserving Internet Freedom: Guiding Principles for the Industry” (speech, Silicon Flatirons Symposium on “The Digital Broadband Migration Toward a Regulatory Regime for the Internet Age” Boulder, CO, February 8, 2004).

choice, subject to the needs of law enforcement; (3) consumers are entitled to connect their choice of legal devices that do not harm the network; and (4) consumers are entitled to competition among network providers, application and service providers, and content providers.<sup>22</sup>

On the same day that the FCC issued this statement they also made another important decision for the future of net neutrality. The FCC ruled that telephone companies that were providing internet access would be subject to the same looser regulations that covered broadband providers under Title I.<sup>23</sup> The ruling allowed the FCC to regulate all high speed internet under the same rules. Now Verizon Wireless and Comcast would be subject to the same regulatory authority of the FCC. More vividly, AT&T broadband would now be regulated the same way as AT&T Wireless.

This FCC decision on wireless internet providers, coupled with the Supreme Court ruling from the Brand X case, opened the door for ISPs to charge content providers extra fees for delivery to consumers. Several months later AT&T became the first ISP to propose such a fee.<sup>24</sup> Predictably, other ISPs, both cable broadband and telecom companies, began proposing similar fees and even the idea of virtual “slow” and “fast” access lanes, like you would find driving a car on a multi-lane highway.<sup>25</sup>

In October 2005, the same year these fees were first proposed by companies, the FCC was faced with the approval of two major telecomm mergers: Verizon/MCI and SBC/AT&T. As a condition for approval, the FCC made these companies promise to

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<sup>22</sup> Federal Communications Commission, *New Principles Preserve and Promote the Open and Interconnected Nature of Public Interest*, (press release) August 5, 2005.

<sup>23</sup> Angele A. Gilroy, “Access to Broadband Networks: The Net Neutrality Debate” (Congressional Research Service, CRS.gov, February 14, 2013), 1.

<sup>24</sup> Nicholas Economides and Benjamin E. Hermalin, "The economics of network neutrality," *The RAND Journal of Economics* 43, no. 4 (2012): 603.

<sup>25</sup> *Ibid.*

abide by their 2005 policy statement for at least two years.<sup>26</sup> Just over a year later, in December 2006, the FCC had to approve another AT&T merger, this time with BellSouth. As part of the approval AT&T agreed to again abide by the 2005 policy statement, this time for 30 months. Furthermore, AT&T agreed to more stringent requirements for the next two years. The FCC's approval of the merger said AT&T would have to, "maintain a neutral network and neutral routing in its wireline broadband Internet access service."<sup>27</sup>

On October 22, 2009 the FCC issued a notice of proposed rulemaking that sought public input on proposed rules to further entrench the acceptance of net neutrality in the law. On December 21, 2010 the FCC adopted the rules known as the Open Internet R&O, and they went into effect on November 20, 2011.<sup>28</sup> The rules called for three things: *disclosure of broadband providers network management, the prevention of blocking lawful content, and a ban on unreasonable discrimination against lawful traffic.*<sup>29</sup>

At the time of the approval in 2010, then FCC Chairman Julius Genachowski described the justification for these rules when he said there were,

"[n]o rules on the books to protect basic Internet values. No process for monitoring Internet openness as technology and business models evolve. No recourse for innovators, consumers, or speakers harmed by improper practices. And no predictability for Internet service providers, so that they can effectively manage and invest in broadband networks."<sup>30</sup>

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<sup>26</sup> Angele A. Gilroy, "Access to Broadband Networks: The Net Neutrality Debate" (Congressional Research Service, CRS.gov, February 14, 2013), 2.

<sup>27</sup> Ibid.

<sup>28</sup> "Open Internet," *FCC.gov*, Accessed February 22, 2014, <http://www.fcc.gov/openinternet>.

<sup>29</sup> Ibid.

<sup>30</sup> Grant Gross, "FCC approves compromise Net neutrality rules," *Computerworld*, December 12, 2010. Accessed February 21, 2014, [http://www.computerworld.com/s/article/9201918/FCC\\_approves\\_compromise\\_Net\\_neutrality\\_rules?pageNumber=1](http://www.computerworld.com/s/article/9201918/FCC_approves_compromise_Net_neutrality_rules?pageNumber=1).

## Legal History

Besides the 2005 Supreme Court ruling in the Brand X case, there were two other landmark court rulings in the brief history of the net neutrality debate. In both instances the cases stemmed from ISPs suing the FCC: Comcast in 2009 and most recently Verizon in 2011. The fact that the lawsuits were initiated by ISPs was entirely predictable. For starters, the FCC's net neutrality rules, while intended to protect the end consumer, also served to protect the content providers from the otherwise monopolistic service providers.

Furthermore, representatives from ISPs were not shy about voicing their displeasure with the protections they saw being afforded to content providers. In November 2005, Ed Whitacre, CEO of SBC before their merger with AT&T, was asked by Bloomberg BusinessWeek about his company's relationship with content providers such as the internet phone company Vonage, and new kid on the block at the time, Google. Whitacre responded:

Now what they would like to do is use my pipes free, but I ain't going to let them do that because we have spent this capital and we have to have a return on it. So there's going to have to be some mechanism for these people who use these pipes to pay for the portion they're using. Why should they be allowed to use my pipes?<sup>31</sup>

Whitacre's comments offered the perfect foreshadowing to the tense legal battles to come between ISPs and the FCC.

The first of the major court cases began in August 2009 when Comcast sued the FCC over a recent ruling that ordered Comcast to stop limiting peer-to-peer (P-to-P)

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<sup>31</sup> "Online Extra: At SBC, It's All About "Scale and Scope," *Bloomberg Business Week*, November 6, 2005. Accessed February 24, 2014, <http://www.businessweek.com/stories/2005-11-06/online-extra-at-sbc-its-all-about-scale-and-scope>.

traffic on its network.<sup>32</sup> A year earlier, in August 2008, the FCC ordered Comcast to stop limiting P-to-P traffic or they would face possible injunctions or stricter regulatory action. The ruling stemmed from widespread press reports of Comcast's actions that began circulating in late 2007 after users began to notice broadband speed changes in their P-to-P activities.<sup>33</sup>

At the time of the ruling then Chairman of the FCC, Kevin Martin equated the actions of Comcast to the US Postal Service handling of mail. Martin rhetorically asked if people would be accepting and understanding if the Post Office, "opened letters mailed to you, decided that because the mail truck is full sometimes, letters to you could wait, and then hid both that they read your letters and delayed them? Unfortunately, that is exactly what Comcast was doing with their subscribers' Internet traffic."<sup>34</sup>

Despite the warnings of and ruling by the FCC, on April 6, 2010, the US Court of Appeals for the District of Columbia ruled that the FCC did not have the authority to regulate the network management practices of ISPs, such as Comcast.<sup>35</sup> This ruling vacated the FCC's rules from August 2008 that had tried to prevent Comcast from controlling P-to-P traffic.

However, the FCC was not completely deterred by this ruling. In response to the Appeals Court's decision, then FCC Chairman Julius Genachowski responded, "[T]he court did not question the FCC's goals; it merely invalidated one, technical, legal

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<sup>32</sup> Jordan Golson and Stacey Higginbotham, "Comcast Lawsuit Questions FCC Right to Enforce Net Neutrality — Tech News and Analysis," *Gigaom*, August 12, 2009. Accessed February 22, 2014, <http://gigaom.com/2009/08/12/comcast-lawsuit-questions-fcc-right-to-enforce-net-neutrality/>.

<sup>33</sup> Grant Gross, "FCC rules against Comcast P-t-P throttling," *Computerworld*, August 1, 2008. Accessed February 21, 2014, <http://news.idg.no/cw/art.cfm?id=7F0DF512-17A4-0F78-317789B4C24713C4>

<sup>34</sup> *Ibid.*

<sup>35</sup> Angele A. Gilroy, "Access to Broadband Networks: The Net Neutrality Debate" (Congressional Research Service, CRS.gov, February 14, 2013), 3.

mechanism for broadband policy chosen by prior Commissions.”<sup>36</sup> The FCC reinforced Genachowski’s point, nine months later in December of 2010 by passing their Open Internet R&O.<sup>37</sup>

It was this decision to pass the Open Internet R&O that led to the Verizon v FCC lawsuit that was decided in January of 2014. The R&O was passed in December 2010 and by the next month in January 2011 Verizon had filed a formal challenge in court.<sup>38</sup> Verizon filed in the same DC Court of Appeals that had ruled against the FCC in the Comcast case. Initially the court dismissed the case because the rules had not yet gone into effect. However, once they did so later in 2011 Verizon refilled its challenge and the court agreed to hear it this time.<sup>39</sup> On September 9, 2013 the court began hearing arguments in the Verizon v FCC case.<sup>40</sup> On January 14, 2014 the court that had already ruled against the FCC once on net neutrality, struck a further blow to the FCC’s hopes of regulating a free and open internet by ruling in favor of Verizon.<sup>41</sup> The implications of this ruling are still taking shape and will be the subject of greater discussion in the “background” section of this memo.

### Legislative History

In recent years Congress has proposed many different pieces of legislation that attempted to assert authority over the net neutrality debate. Some of these bills were

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<sup>36</sup> Ibid. 4.

<sup>37</sup> Ibid. 4.

<sup>38</sup> Grant Gross, “Net neutrality at the FCC: A brief history,” *PC World*, September 5, 2013. Accessed February 18, 2014, <http://www.pcworld.com/article/2048209/net-neutrality-at-the-us-fcc-a-brief-history.html>.

<sup>39</sup> Ibid.

<sup>40</sup> Deborah Collier, “Citizens Against Government Waste America’s #1 Taxpayer Watchdog,” *Citizens Against Government Waste*, October 2013. Accessed February 24, 2014, <http://cagw.org/media/wastewatcher/court-begins-hearing-net-neutrality>.

<sup>41</sup> Andrew Zajac and Todd Shields, “Verizon Wins Net Neutrality Court Ruling Against FCC,” *Bloomberg.com*, January 14, 2014. Accessed January 28, 2014, <http://www.bloomberg.com/news/2014-01-14/verizon-wins-net-neutrality-court-ruling-against-fcc.html>.

directed solely at the issue of net neutrality and others were more comprehensive in nature and included only some sections about net neutrality within larger pieces of legislation. Congress remains divided over the issue, which is why proposed legislation has come from both supporters and opponents of net neutrality. This division within Congress is also why no major piece of legislation has been passed in regards to net neutrality.

The current Congress is the 113<sup>th</sup> in American history. Its predecessor, the 112<sup>th</sup> Congress, proposed eight different pieces of legislation that would in one way or another address issues surrounding net neutrality.<sup>42</sup> The closest Congress came to taking action wasn't even a piece of legislation, but merely a resolution. In April of 2011 the House of Representatives passed a resolution that stated disapproval for the FCC's Open Internet Order. The Senate tried, but was unable to also approve a similar measure.<sup>43</sup>

The 111<sup>th</sup> Congress was not more successful, however, they did try to address net neutrality head on in a single comprehensive act. Democratic Congressmen Edward Markey and Henry Waxman proposed House Resolution 3458, better known as the "Internet Freedom Preservation Act of 2009." The Act was very much in line with the FCC's stated goals of openness and nondiscrimination over public access to the internet.<sup>44</sup> On the other side in 2009, Republicans in both the House and Senate proposed separate bills that were each aimed at limiting the FCC's ability to further regulate internet service.<sup>45</sup>

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<sup>42</sup> Angele A. Gilroy, "Access to Broadband Networks: The Net Neutrality Debate" (Congressional Research Service, CRS.gov, February 14, 2013).

<sup>43</sup> Ibid.

<sup>44</sup> Ibid. 17.

<sup>45</sup> Ibid. 18.

While the actions of Congress recently have tried to tackle net neutrality, either by itself or in more comprehensive pieces of legislation, there has not been a major piece of legislation passed successfully. Despite Congress' best attempts of late, the two most impactful pieces of legislation around the issue of net neutrality were passed years and decades before the emergence of net neutrality, or even broadband internet service: the Telecommunications Act of 1996 and the Communications Act of 1934.

The 1934 Act, as discussed previously, provided the framework for the legal classification of broadband as a Title I information service instead of a Title II common carrier service. Again, this classification under Title I is largely responsible for the FCC having less regulatory authority over ISPs than if broadband fell under a Title II classification.

The second impactful piece of legislation, the 1996 Telecommunication Act, was at least passed at a time when the internet was already in existence. Despite this, internet access for residential use was very much in its infancy. As its name implies, the 1996 Act was aimed more at telephony than internet service. The Act's goal was to encourage competition in the telephone service industry.<sup>46</sup>

The increased competition in the telephone industry had an unintended consequence when regulation of internet service became a bigger issue. The 1996 Act ensured that telephone companies were subject to the stricter common carrier rules under Title II of the 1934 Act. At the same time, cable television fell under the less strict Title I

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<sup>46</sup> Shane Greenstein, "Economic Experiments and Neutrality in Internet Access," *Innovation Policy and the Economy* 8, (2007): 85.

classification.<sup>47</sup> This became an issue when cable companies and telephone companies began competing directly with each other to provide internet service.

These different rules for each industry were what eventually forced the FCC on August 5, 2005, to loosen the restrictions on telephone companies that were providing internet service. Looser restrictions served to level the playing field between telephone and cable internet companies in terms of their providing internet access. Once the field was leveled, the divisions between ISPs and content providers became starker and helped to set the stage for today's current environment.

#### **IV. Background**

The market failure created by the ruling in the Verizon v FCC case is the result of two underlying factors. The first factor that will exacerbate the market failure is the lack of competition in consumer access to broadband and wireless high-speed internet service. The second factor at play here is the growing value to Americans of internet access and usage.

##### Internet Access

Today 70 percent of households in the US have two or fewer options for providers of their high-speed internet access.<sup>48</sup> If the proposed merger of Comcast and Time Warner Cable that is currently being reviewed at the FCC were to go through, Comcast would be the dominant high-speed internet provider in 19 of the 20 largest markets in the

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<sup>47</sup> Shane Greenstein, "Economic Experiments and Neutrality in Internet Access," *Innovation Policy and the Economy* 8, (2007): 85-86.

<sup>48</sup> Nilay Patel, "The internet is fucked," *The Verge*, February 25, 2014. Accessed March 1, 2014, <http://www.theverge.com/2014/2/25/5431382/the-internet-is-fucked>.

United States.<sup>49</sup> The limiting of choices for broadband access is mirroring the already limited choices consumers have in wireless internet access.

Internet usage patterns by broadband and mobile users are becoming more and more similar. In early 2014 the average mobile phone user in the US used 1.2 gigabytes of data per month. This was double the average monthly amount used in 2012.<sup>50</sup> Much of this growth has been attributed to mobile video, which surpassed 50 percent of mobile data usage for the first time in 2012 and grew to 53 percent in 2013.<sup>51</sup> These video trends are similar in more traditional broadband usage as well as the growth in video sharing services like Netflix and Hulu.

Growth has also been seen over the last two decades in the number of Americans that use the internet. As the graph below, from the Pew Research Center, demonstrates an overwhelming majority of Americans, 87 percent, use the internet in some capacity.<sup>52</sup>

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<sup>49</sup> Ibid.

<sup>50</sup> Nick Wingfield, "Wireless System Could Offer a Private Fast Lane," *The New York Times*, February 19, 2014. Accessed February 19, 2014, <http://www.nytimes.com/2014/02/19/technology/wireless-system-could-offer-a-private-fast-lane.html>.

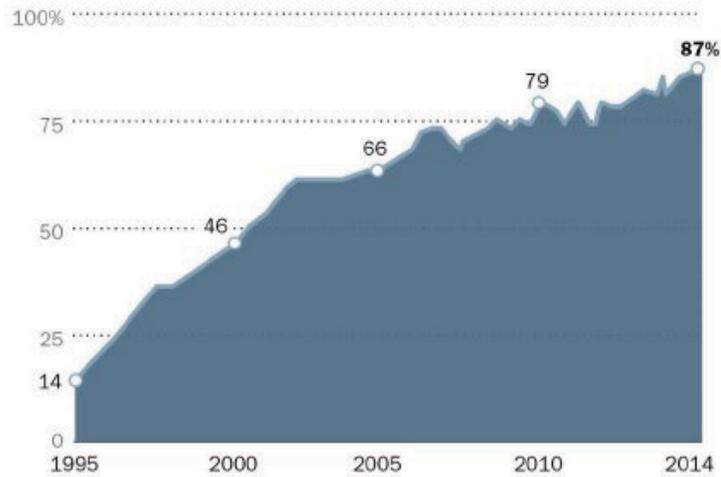
<sup>51</sup> Ibid.

<sup>52</sup> Susannah Fox and Lee Rainie, "The Web at 25 in the U.S.," *Pew Research Centers Internet American Life Project*, February, 27, 2014. Accessed March 1, 2014, <http://www.pewinternet.org/2014/02/27/summary-of-findings-3/>.

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### Internet use, 1995-2014

*% of American adults who use the internet, over time*



Source: Pew Research Center surveys, 1995-2014.

**PEW RESEARCH CENTER**

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Unsurprisingly, as more Americans use the internet, more Americans value the internet. According to a study just released by the Pew Research Center, the number of Americans who said the internet would be the most difficult technology for them to live without has reached a plurality for the first time. In second, third, and fourth places respectively were cellphones, television, and e-mail.<sup>54</sup>

When these numbers are put in the context of cellphones providing a rapidly growing number of Americans with internet access and televisions now running apps like Facebook and Netflix, the value of the internet in daily lives of Americans becomes overwhelmingly apparent.

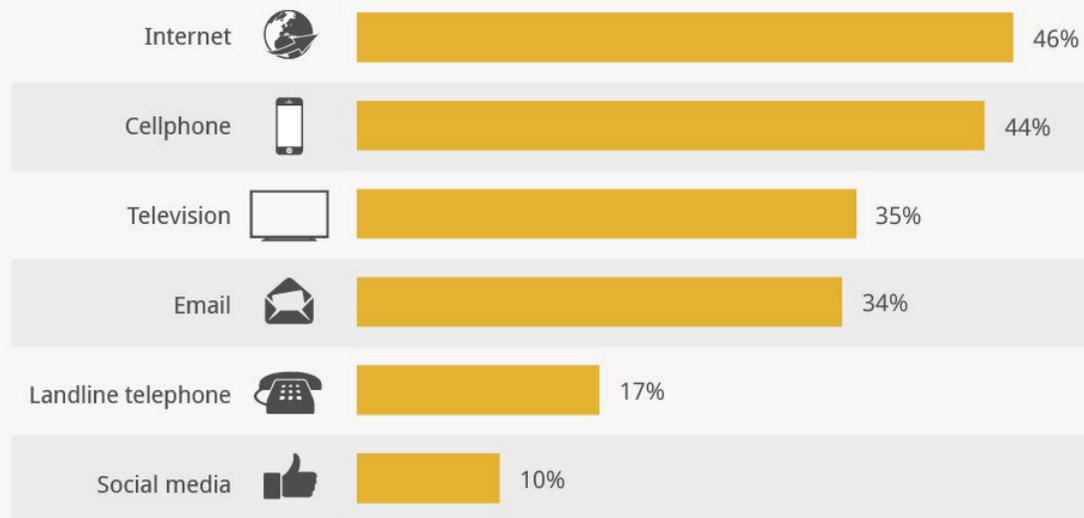
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<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

## Americans Would Choose Internet Over TV If They Had To

% of adults who say these technologies would be very hard or impossible to give up



Source: Pew Research Center

Mashable statista

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### Verizon v FCC

Understanding the implications of the Verizon v FCC ruling on ISPs, consumers, and content providers is critically important. With the effective overturning of the FCC's net neutrality rules, ISPs are now free to charge content providers, and possibly even consumers, higher prices. The pricing models will become increasingly more complex if the effect of this ruling is allowed to stand.

After the ruling, Farhad Manjoo, then a technology writer at *The Wall Street Journal*, described the possible effects when he wrote, “[t]oday, you pay for a specific type of broadband line (slow or fast, say), and you're then free to browse or download any content over that line. Under the emerging rules, broadband providers would be able

<sup>55</sup> Matt Petronzio, "Most Americans Would Choose Internet Over TV or Cellphones," *Mashable*, February 27, 2014. Accessed February 28, 2014, <http://mashable.com/2014/02/27/internet-tv-chart/>.

to charge you different prices based on content, not just speed.”<sup>56</sup> Put in even starker terms, Tim Wu described the current landscape to *The Washington Post* when he said we are, “in completely uncharted territory. There’s never been a situation where providers can block whatever they want.”<sup>57</sup>

However, the ruling in *Verizon v FCC* by Judge David Tatel was a bit more nuanced than the news headlines might imply. While Tatel’s ruling did overturn the FCC’s net neutrality rules, he also wrote in his ruling that the FCC’s presumption that ISPs abused their market power and thus needed to be regulated was, “a rational connection between the facts found and the choices made.”<sup>58</sup> Tatel went on to say that the FCC was simply regulating net neutrality in a manner that was not legal based on their authority. In his ruling Tatel offered a word of caution against the ISPs reading too far into his decision, when he wrote, “[b]roadband providers represent a threat to internet openness.”<sup>59</sup> Furthermore, Tatel upheld the FCC’s rules that require Verizon and other ISPs to be transparent and disclose the network management practices.<sup>60</sup>

### Comcast/Netflix Deal

On February 23, 2014 Netflix and Comcast announced they had reached a deal wherein Netflix would pay Comcast an undisclosed amount of money in exchange for

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<sup>56</sup> Farhad Manjoo, "Will Net Neutrality Ruling Make Web More Like Cable?," *The Wall Street Journal*, January 15, 2014. Accessed February 27, 2014, <http://online.wsj.com/news/articles/SB10001424052702304149404579322652413548052>.

<sup>57</sup> Matthew Ingram, "What you need to know about the court decision that just struck down net neutrality — Tech News and Analysis," *Gigaom*, January 14, 2014. Accessed February 27, 2014, <http://gigaom.com/2014/01/14/what-you-need-to-know-about-the-court-decision-that-just-struck-down-net-neutrality/>.

<sup>58</sup> Nilay Patel, "The internet is fucked," *The Verge*, February 25, 2014. Accessed March 1, 2014, <http://www.theverge.com/2014/2/25/5431382/the-internet-is-fucked>.

<sup>59</sup> Ibid.

<sup>60</sup> Matthew Ingram, "What you need to know about the court decision that just struck down net neutrality — Tech News and Analysis," *Gigaom*, January 14, 2014. Accessed February 27, 2014, <http://gigaom.com/2014/01/14/what-you-need-to-know-about-the-court-decision-that-just-struck-down-net-neutrality/>.

Comcast ensuring that Netflix's content would be streamed smoothly to their customers' households.<sup>61</sup> This deal, coming just over a month after the Verizon v FCC ruling marks the first time, at least publically announced, that Netflix has paid an ISP to ensure fast and reliable service of their content.<sup>62</sup>

This arrangement is a noteworthy due to the size of Netflix, which by some estimates accounts for more than 30 percent of all broadband internet traffic.<sup>63</sup> The deal is also of high importance as its came on heels of the deal between Comcast and Time Warner. The fact that the largest broadband provider made such a deal with a single content provider that accounts for so much internet traffic is surely a harbinger of things to come. Netflix will assuredly be making deals with the other major ISPs in the near future and Comcast is similarly well positioned to force other major content providers to strike deals to ensure delivery of their content.

#### AT&T Sponsored Data

Even before the US Appeals Court struck down net neutrality, ISPs were beginning to push changes that would upend the payment structure of internet access. Roughly a week before the court ruling, on January 6, 2014, AT&T announced a sponsored data plan. This new concept for their wireless internet service would allow content providers to pay AT&T a special fee that would wave any data usage rates a

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<sup>61</sup> Associated Press, "Netflix reaches deal with Comcast." *The Washington Post*, February 24, 2014. Accessed March 1, 2014, [http://www.washingtonpost.com/business/technology/netflix-reaches-deal-with-comcast/2014/02/23/7e22e846-9cbd-11e3-8112-52fdf646027b\\_story.html](http://www.washingtonpost.com/business/technology/netflix-reaches-deal-with-comcast/2014/02/23/7e22e846-9cbd-11e3-8112-52fdf646027b_story.html).

<sup>62</sup> Thomson Reuters, "Netflix to pay Comcast for faster speeds," *Reuters*, February 24, 2014. Accessed March 1, 2014, <http://www.reuters.com/article/2014/02/24/us-comcast-netflix-idUSBREA1M0X520140224>.

<sup>63</sup> Lance Ulanoff, "Verizon: We're Not Slowing Down Your Netflix," *Mashable*, June 19, 2013. Accessed March 3, 2014, <http://mashable.com/2013/06/19/verizon-not-slowing-down-netflix/>.

customer would incur when accessing the special content.<sup>64</sup> AT&T's sponsored data plan eliminates any pretense of trying to provide a fair and open internet, free of tiers, for all content providers.

## **Stakeholders**

### **FCC Chairman Tom Wheeler**

Chairman Wheeler is ultimately responsible for guiding the policy direction of the FCC. Prior to his being appointed Chairman by President Obama, Wheeler was a lobbyist for cable and wireless phone companies.<sup>65</sup> Given the court's ruling that the FCC is within its right to regulate broadband access, but was doing so in an unlawful way, Wheeler has several options. One would be to reclassify broadband internet as a "common carrier," thus granting the FCC tighter regulatory controls over ISPs. Another option for Wheeler and the FCC would be appeal the court ruling and try to go before the Supreme Court.

In a blog posting written on January 14, 2014 as a formal response to the overturning of the FCC's net neutrality rules, Tom Wheeler laid out the framework for how the FCC would proceed. Wheeler began by emphasizing the part of the US Appeals Court ruling that upheld the FCC's authority granted under Section 706 of the 1996 Telecommunications Act.<sup>66</sup> Section 706 authorizes the FCC to, "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability

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<sup>64</sup> Russell Brandom, "Sponsored Data: AT&T will now let companies buy out your data charges for specific videos and apps," *The Verge*, January 6, 2014. Accessed March 1, 2014, <http://www.theverge.com/2014/1/6/5279894/at-t-announces-net-neutrality-baiting-sponsored-data-mobile-plans>.

<sup>65</sup> Edward Wyatt, "The Nuts and Bolts of Network Neutrality," *The New York Times*, January 14, 2014. Accessed March 3, 2014, <http://bits.blogs.nytimes.com/2014/01/14/the-nuts-and-bolts-of-network-neutrality/>.

<sup>66</sup> Tom Wheeler, "Ensuring an Open Internet Now and for the Future," *FCC*, January 14, 2014. Accessed March 1, 2014, <http://www.fcc.gov/blog/ensuring-open-internet-now-and-future>.

to all Americans.”<sup>67</sup> Wheeler also took the legal justification for FCC involvement in net neutrality back to the 1934 Communications Act.<sup>68</sup>

A month later, on February 19, 2014, Wheeler issued a statement on the formal steps forward that the FCC would be taking to address the Verizon v FCC ruling. This statement was largely a list of things Wheeler would ask the Commission to look into, rather than concrete action. Wheeler did also note that the Court of Appeals left in play the possibility of reclassification under Title II. However, he said the FCC would merely be keeping that option on the table, rather than pursuing it currently.<sup>69</sup>

At this point the FCC is keeping all options open. However, these recent statements from Wheeler hint that the FCC will look into finding a new legal justification for net neutrality under its already granted Congressional authority.

#### Internet Service Providers

To date Comcast, Verizon, and AT&T have been three of the most active ISPs in the net neutrality debate. They have similar histories of publically supporting an open internet, while speaking against the FCC’s process for regulating their industry. Furthermore, many industry analysts question the sincerity of ISPs when their actions tell a different story.

In response to the ruling in Verizon v FCC, a spokesperson for Verizon tried to allay fears that the decision would upend the ecosystem in which internet users had become accustomed to operating. In their official response statement, Verizon said,

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<sup>67</sup> "47 U.S. Code Â§ 1302 - Advanced telecommunications incentives," *Cornell University Law School*, Accessed March 2, 2014, <http://www.law.cornell.edu/uscode/text/47/1302>.

<sup>68</sup> Tom Wheeler, " Ensuring an Open Internet Now and for the Future," *FCC*, January 14, 2014. Accessed March 1, 2014, <http://www.fcc.gov/blog/ensuring-open-internet-now-and-future>.

<sup>69</sup> FCC, *Statement by FCC Chairman Tom Wheeler on the FCC’s Open Internet Rules*, (statement) February 19, 2014.

“Today's decision will not change consumers' ability to access and use the Internet as they do now.” Verizon went on to stress that they have been and will remain, “committed to the open Internet that provides consumers with competitive choices and unblocked access to lawful websites and content when, where, and how they want. This will not change in light of the court's decision.”<sup>70</sup>

Similarly, AT&T tried to strike the same tone in their official response; "AT&T has been committed to the open Internet since our endorsement of the FCC's statement of Internet freedoms in 2004." They went on to turn an eye towards the future in saying, “[a]s the FCC assesses the impact of today's court decision, AT&T can assure all of our customers and stakeholders that our commitment to protect and maintain an open Internet will not change.”<sup>71</sup>

Comments like these certainly seem encouraging for advocates of net neutrality, but they do not paint the full picture. What worries advocates of net neutrality is when ISPs begin to try and square their professed support of net neutrality with their publically stated business models. A prime example is a recent statement from Verizon’s CEO Lowell McAdam where he said, “We make our money by carrying traffic. That's how we make dollars. So to view that we're going to be advantaging one over the other really is a lot of histrionics, I think, at this point.” However, in the same statement McAdam opened the door to a tiered internet when he went on to say, "It's only natural that the heavy users help contribute to the investment to keep the Web healthy.”<sup>72</sup>

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<sup>70</sup> Mike Dano, "Verizon, AT&T reiterate 'open Internet' support, while FCC mulls net neutrality options," *FierceWireless*. January 15, 2014. Accessed March 3, 2014, <http://www.fiercewireless.com/story/verizon-att-reiterate-open-internet-support-while-fcc-mulls-net-neutrality/2014-01-15>.

<sup>71</sup> Ibid.

<sup>72</sup> Karl Bode, "Verizon Thinks 'The Most Important Concept Of Net Neutrality' Is Giving Verizon More Money," *Techdirt*, February 26, 2014. Accessed March 2, 2014,

Adding to fears of hypocrisy are statements like the following from Comcast in January 2014, on their view of the FCC open internet rulemaking process:

And while, as we will make clear in our comments, we continue to question whether the record will show a need for new rules — because broadband competition and consumer demand will ensure that the Internet remain open as it has always been — the FCC may decide otherwise.<sup>73</sup>

This statement was released more than a month before the announced deal between Comcast and Time Warner. However, in light of their upcoming merger it is difficult to see how Comcast truly values broadband competition when they themselves are in the process of consolidating and limiting consumer choice.

Another reason net neutrality proponents worry about the influence of ISPs is the so-called revolving door between ISPs and the FCC. The most glaring offense here took place in the first half of 2011 when Meredith Attwell Baker became a lobbyist for Comcast. In accepting the position, Baker had to step down from her post as a Commissioner at the FCC, where she had just helped to approve Comcast's acquisition of NBC.<sup>74</sup> Today, the FCC is facing heavy lobbying from Comcast as their deal with Time Warner is pending approval on behalf of the FCC.

### Internet Content Providers

Whereas ISPs have near universal agreement on their perspectives about net neutrality, content providers vary widely. There are two main types of content providers worth exploring here. The first are large companies like Netflix, Google, and Facebook. The second sub-category of content providers is startups.

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<http://www.techdirt.com/articles/20140226/06392826349/verizon-thinks-most-important-concept-net-neutrality-is-giving-verizon-more-money.shtml>.

<sup>73</sup> David Cohen, "Comcast, the FCC, and "Open Internet" Rules: Where We Stand," *Comcast Voices*, January 11, 2010. Accessed March 2, 2014, <http://corporate.comcast.com/comcast-voices/comcast-the-fcc-and-open-internet-rules-where-we-stand>.

<sup>74</sup> Craig Aaron, "Stop the revolving door at the FCC," *The Hill*, January 3, 2011. Accessed March 2, 2014, <http://thehill.com/blogs/congress-blog/politics/164601-stop-the-revolving-door-at-the-fcc>.

## *Large Content Providers*

Large content providers generally favor net neutrality. However, given the competition among content providers, these perspectives are much more nuanced depending on a given company's personal interests. In immediate response to the Verizon v FCC ruling, which Netflix called "unfortunate," they released the following statement:

In principle, a domestic ISP now can legally impede the video streams that members request from Netflix, degrading the experience we jointly provide. The motivation could be to get Netflix to pay fees to stop this degradation. Were this draconian scenario to unfold with some ISP, we would vigorously protest and encourage our members to demand the open Internet they are paying their ISP to deliver.<sup>75</sup>

From the perspective of net neutrality proponents, this statement was encouraging given the size of broadband traffic for which Netflix is responsible. However, in just over a month Netflix had essentially completely reversed its position when they struck a deal with Comcast that they had previously called a "draconian scenario." Netflix did their best to portray the deal in a positive light in their joint statement announcing the agreement when they said the agreement was, "a mutually beneficial interconnection agreement that will provide Comcast's U.S. broadband customers with a high-quality Netflix video experience for years to come."<sup>76</sup> Despite their best PR spin, this deal by Netflix is in essence an admission on their part that net neutrality as we know it is an outdated concept that is no longer fully applicable to their business model.

The other major content provider worth looking at here is Google. Google stands

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<sup>75</sup> Steve Kovach, "Netflix Issues Warning On The Dangers Of Ending Net Neutrality," *Business Insider*, January 22, 2014. Accessed March 2, 2014, <http://www.businessinsider.com/netflix-net-neutrality-statement-2014-1#ixzz2uotqitlT>.

<sup>76</sup> Netflix, *Comcast and Netflix Team Up to Provide Customers Excellent User Experience*, (press release) February 23, 2014.

apart from its peers in that they are also trying to become an ISP with their Google Fiber projects that bring high-speed internet access to select US cities. In fact, on February 19, 2014, Google announced an expansion of their Google Fiber project to an additional 34 cities around the US.<sup>77</sup> By committing so many resources to this project Google is clearly positioning themselves as a hybrid content and internet service provider. Despite being one of the single largest content and internet traffic drivers in America, Google is positioning itself to be a winner regardless of the outcome of the net neutrality debate.

While Netflix and Google are just two of the major content providers, they are more than representative of the problems that content providers face in this debate over net neutrality. There are so many content providers fighting for the attention of customers, especially compared to the small number of major ISPs delivering that content, that it is unreasonable to expect all content providers to unify behind one position on net neutrality.

#### *Startup Content Providers*

On the other end of the continuum from Google and Netflix are the startups. These are companies like Instagram and WhatsApp that we are acquiring as part of our growth model. However, there are certainly so many more companies than we would ever be interested in, but their collective success is essential to a vibrant and open internet.

Many internet startups depend on funding from venture capital (VC) firms to get started and enter the marketplace. Fred Wilson, a well-respected venture capitalist with Union Square Ventures, wrote in response to the Verizon v FCC ruling that VCs would

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<sup>77</sup> Milo Medin, "Exploring new cities for Google Fiber," *Google Official Blog*, February 19, 2014. Accessed March 2, 2014, <http://googleblog.blogspot.com/2014/02/exploring-new-cities-for-google-fiber.html>.

be forced to think harder about funding an internet startup under these new rules. Wilson wrote on his blog after the ruling came down, that ISPs, “will pick their preferred partners, subsidize the data costs for those apps, and make it much harder for new entrants to compete with the incumbents.”<sup>78</sup> This scenario is no longer theoretical. Comcast has picked Netflix as a preferred partner and Netflix has demonstrated willingness to pay-to-play.

### Congress

To date the debate over net neutrality has revolved largely around the FCC’s ability to regulate ISPs. Even in light of the Verizon v FCC case, much of the action still rests with this independent agency, and not Congress. Despite Congress’ inability to agree on any substantive legislation regarding net neutrality, they still maintain oversight over the FCC, including the Senate’s all-important power of confirming any presidential nominee to head the agency. Furthermore, Congress is responsible for directing the FCC to promote growth and innovation of the internet through its regulation.<sup>79</sup> Congress also has the ability to call public hearings and compel the FCC to testify on matters of net neutrality.

In general Democrats are more inclined to favor net neutrality and Republicans are more inclined to side with ISPs on these issues. This party-line split is relevant because Democrats control the Senate, which has confirmation authority for the FCC Chairman, and Republicans control the House. Despite the Senate’s confirmation authority, both chambers of Congress maintain oversight of the FCC and the views of the

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<sup>78</sup> Fred Wilson, "VC Pitches In A Year Or Two," *AVC.com*, January 15, 2014. Accessed March 2, 2014, <http://avc.com/2014/01/vc-pitches-in-a-year-or-two/>.

<sup>79</sup> Edward Wyatt, "The Nuts and Bolts of Network Neutrality," *The New York Times*, January 14, 2014. Accessed March 3, 2014, <http://bits.blogs.nytimes.com/2014/01/14/the-nuts-and-bolts-of-network-neutrality/>.

chairs of those committees provide a good insight into the thinking of the committee's at-large.

*Senate Committee on Commerce, Science, and Transportation Chairman John Rockefeller (D-WV) and Subcommittee on Communications, Technology, and the Internet Chairman Mary Pryor (D-AR)*

Senator Pryor's subcommittee has the direct oversight for the FCC, but despite this he has not released any recent statements on the recent news. However, Senator Rockefeller, who chairs the larger committee responsible for oversight has released several statements. Like Chairman Wheeler, Senator Rockefeller was disappointed in the Verizon v FCC ruling, but decided to emphasize the part of the decision that upheld the FCC's ability to regulate ISPs.

In the Senator's formal statement on the ruling he said, "At its core, the FCC's fundamental responsibility is the regulation of communications networks for the public interest and consumers everywhere." Senator Rockefeller went on to urge the FCC consider all options at its disposal going forward.<sup>80</sup>

*House Energy and Commerce Committee Chairman Fred Upton (R-MI) and Communications and Technology Subcommittee Chairman Greg Walden (R-OR)*

In the House of Representatives the Republicans that control the relevant oversight committee struck a very different tone than their Senate colleagues. In a joint statement from Congressmen Fred Upton and Greg Walden, they said of net neutrality efforts by the FCC, "These regulations are a solution in search of a problem, and with the many issues on its plate, including implementation of the spectrum incentive auctions, it

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<sup>80</sup> U.S. Senate Committee on Commerce, Science, & Transportation, *Rockefeller Statement on FCC Chairman Wheeler's Open Internet Announcement*, (press release) February 19, 2014.

would be wise for the commission to focus on fostering economic growth, job creation, and competition.”<sup>81</sup>

### US Court System

There have been two major legal challenges to the FCC’s net neutrality rules and regulations. The US Court of Appeals for the District of Columbia decided both cases in favor of ISPs and against the FCC. The most recent ruling in *Verizon v FCC* did acknowledge the FCC’s authority to regulate ISPs and their network management practices, but argued that their current rationale for such regulations was legally unsound.

There is always the option for the FCC to appeal to the US Supreme Court. However, the Supreme Court has so far not shown an interest in taking a case on net neutrality. Furthermore, nearly every legal expert has argued that the Appeals Court decision is on solid legal footing and the FCC likely knows this. Tim Wu went so far as to call the FCC’s legal defense in the *Verizon* case a “FEMA-level fail.”<sup>82</sup>

Given all of these factors, the most likely outcome for net neutrality in the court system is for the FCC to rethink its classification of broadband internet and/or rework the legal framework for its net neutrality rules. Once that plays out, any future legal challenges will come to bear.

### Consumer Interest Groups

The notable consumer interest groups involved in the net neutrality debate support maintaining a free and open internet and oppose further restrictions regarding access to

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<sup>81</sup> House Energy and Commerce Committee, *Upton, Walden Respond to Wheeler Network Neutrality Announcement*, (press release) February 19, 2014.

<sup>82</sup> Brian Fung, “A FEMA-level fail’: The law professor who coined ‘net neutrality’ lashes out at the FCC’s legal strategy,” *The Washington Post*, January 14, 2014. Accessed March 1, 2014, <http://www.washingtonpost.com/blogs/the-switch/wp/2014/01/14/a-fema-level-fail-the-law-professor-who-coined-net-neutrality-lashes-out-at-the-fccs-legal-strategy/>.

content that ISPs are pursuing. These interest groups include Common Cause, Free Press, Public Knowledge, and the American Civil Liberties Union (ACLU), among others. On the whole, interest groups such as these align their views and support with Democrats in Congress. However, their ultimate ability to influence and sway public debate around the issue is debatable.

## **V. Policy Proposal**

It remains clear from our perspective that the most preferred outcome is still the preservation of net neutrality as has been commonly practiced in contemporary years. However, in light of recent events, it is wise to move towards a new approach. Therefore it is in our best interest for the long-term to push the FCC towards market-segmentation of the internet. Specifically, we should lobby for the FCC to create a separate set of rules regulating how ISPs interact with small startups versus larger content providers.

### Authorization

To date the FCC has based its legal argument for regulatory authority over ISPs on Section 706 of the 1996 Telecommunications Act<sup>83</sup> and Title I of the 1934 Communications Act.<sup>84</sup> In light of the recent court rulings it has become evident that the Title I classification of broadband service as an interstate information service, coupled with the Section 706 authority to incentivize telecommunications services, are an insufficient legal framework for the FCC's open internet rules.

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<sup>83</sup> "47 U.S. Code Â§ 1302 - Advanced telecommunications incentives," *Cornell University Law School*, Accessed March 2, 2014, <http://www.law.cornell.edu/uscode/text/47/1302>.

<sup>84</sup> Angele A. Gilroy, "Access to Broadband Networks: The Net Neutrality Debate" (Congressional Research Service, CRS.gov, February 14, 2013), 1.

Instead, the FCC needs to admit its initial Title I classification was a mistake and reclassify broadband internet as a common carrier, under Title II of the 1934 Communications Act. According to Title II, Section 202, this will grant the FCC explicit authority to make it unlawful for ISPs to discriminate in their pricing. Section 202 lays out these restrictions against common carriers in great detail:

It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services for or in connection with like communication service, directly or indirectly, by any means or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.<sup>85</sup>

### Implementation

The reclassification of broadband internet as a common carrier will unburden the FCC from the limits recently imposed upon it by the Verizon v FCC ruling. In doing so, it will allow the FCC to make two new rules that will make entry into the internet market easier for startups. Under Title II, the FCC would be able to apply their current open internet rules to particular companies that they determine need extra protections from fee-for-service charges like those Netflix recently agreed to pay to Comcast. Implementation will require two actions by the FCC.

- The first action will be to create explicit definitions of what companies qualify for special protections under the new rules;

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<sup>85</sup> "47 U.S. Code Â§ 202 – Discriminations and preferences," *Cornell University Law School*, Accessed March 9, 2014, <http://www.law.cornell.edu/uscode/text/47/202>.

- The second action will be to provide these companies with a formal process for filing complaints against ISPs if they suspect access to their content is being slowed down unnecessarily.

To determine what companies qualify for this new protection, the FCC should look at the venture capital world. Internet startups rely heavily on venture capital (VC) funding. This initial amount, or round, of VC funding is known as seed money. From there funding proceeds through subsequent rounds known as series A, B, C, and so on. Each round of funding is meant to help the company expand and grow its business in particular ways. The FCC should use these series of funding rounds as a guide to when to offer protections to companies and when to allow ISPs to charge a company to share its content.<sup>86</sup> Doing so will effectively segment the market between startups and companies that have sufficiently been integrated into the internet market to stand on their own.

The other action for the FCC will be to setup a formal complaint hearing procedure, which would provide legal recourse for startups that suspect their content is being discriminated against by means of slower delivery speed from an ISP. The FCC should follow the guidelines of a proposal for adjudication through administrative law that has been proposed by economists Hal Singer, Bob Hahn, and Bob Litan. In their proposal, the FCC would allow content providers to file discrimination complaints against ISPs. This proposed model follows an already existing program managed by the

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<sup>86</sup> Elad Gil, How Funding Rounds Differ: Seed, Series A, Series B, and C....," *Elad Blog*, March 15, 2011. Accessed March 10, 2014, <http://blog.eladgil.com/2011/03/how-funding-rounds-differ-seed-series.html>.

FCC, which allows for independent cable networks to file complaints of discrimination against cable television operators.<sup>87</sup>

## **VI. Policy Analysis**

Segmenting the market for ISPs and content providers will allay certain fears about the ability of internet startups to succeed in both the short and long-term. Compared to the previous norms of net neutrality this policy is less than ideal. However, given the currently evolving landscape, market segmentation will ultimately be a positive step. To achieve this goal, our proposed policy of market segmentation must be assessed in two respects: authorization and implementation.

### **Authorization**

Regarding authorization, the issue revolves around right of the FCC to make the changes necessary to segment the market between internet startups and large companies.

#### Pros

On the positive side, the authority of the FCC to regulate the internet and promote innovation is fairly clear, and has been reaffirmed by the US Appeals Court of DC. In the same ruling that overturned the FCC's net neutrality rules, the Appeals Court also told the FCC that by reclassifying broadband internet services as telecommunications services their authority to regulate net neutrality would be on solid legal footing. The court went on to elaborate in its ruling by writing that the FCC has the authority, "to regulate

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<sup>87</sup> Hal Singer, "Has the FCC Chairman Solved the Net Neutrality Quagmire?," *Forbes*, January 31, 2014. Accessed February 2, 2014, <http://www.forbes.com/sites/halsinger/2014/01/31/by-proposing-adjudication-chairman-wheeler-may-have-solved-the-net-neutrality-quagmire/>.

broadband providers' economic relationships with [content] providers if, in fact, the nature of those relationships influences the rate and extent to which broadband providers develop and expand services for end users.”<sup>88</sup>

Beyond opening the door to the possibility of reclassifying broadband internet, the wording of this ruling went so far as to encourage the FCC to pursue this path if it chose to take action in response to the Court’s ruling. In essence this ruling acts as a pre-approval and legitimization by the court system for reclassification.

### Cons

Despite this apparent green light from the court system, reclassifying broadband internet service still comes with some potential pitfalls in terms of authorization. For starters, this sort of step would undo years of legal justification for other regulations on broadband providers. There will surely be consequences, both predictable and unintended, of reclassifying broadband. Accordingly, it is not something that should be done overnight.

Rather, a change in classification of broadband service should be approached with an amount of caution that will allow for a thorough examination of all potential consequences, both positive and negative. While reclassifying may indeed solve the net neutrality problem, such a move needs to be weighed against how it would impact regulatory rules already in place.

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<sup>88</sup> Marguerite Reardon, "Worried about Net neutrality? Maybe it's the FCC that should really concern you," *CNET News*, January 23, 2014. Accessed March 19, 2014, [http://news.cnet.com/8301-13578\\_3-57617576-38/worried-about-net-neutrality-maybe-its-the-fcc-that-should-really-concern-you/](http://news.cnet.com/8301-13578_3-57617576-38/worried-about-net-neutrality-maybe-its-the-fcc-that-should-really-concern-you/).

## **Implementation**

When looking to implement this policy that is intended to segment the market for content providers, the FCC can look in-house for a blueprint. Using the FCC's adjudication process for independent cable networks and vertically integrated cable operators provides a framework for how market segmentation might be implemented in regards to broadband network providers.

### Pros

On the implementation side, the biggest pro for our proposed policy is the ability of the FCC to look at its own policies in a similar area. The FCC today has a process setup that allows for complaints of discrimination to be filed and heard on behalf of independent cable networks. This procedure is meant to prevent cable providers that are vertically integrated with cable networks from giving their own content preferential treatment in the delivery process.<sup>89</sup>

What this means in practical-terms can be demonstrated by looking at Comcast. When Comcast merged with NBC, there were concerns that NBC would receive preferential treatment in the delivery of its cable television content over Comcast's network. The adjudication process described above allows for cable networks that are not integrated with Comcast to have a path for recourse if they believe Comcast is discriminating the delivery of their network's content in favor of Comcast's vertically integrated partners like NBC.

This is not a claim that Comcast is partaking in such discrimination, rather that there is a process to address any claims of discrimination. In looking at Comcast's

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<sup>89</sup> Hal Singer, "Has the FCC Chairman Solved the Net Neutrality Quagmire?," *Forbes*, January 31, 2014. Accessed February 2, 2014, <http://www.forbes.com/sites/halsinger/2014/01/31/by-proposing-adjudication-chairman-wheeler-may-have-solved-the-net-neutrality-quagmire/>.

broadband delivery service it becomes evident just how similar things operate to the cable television field. On the internet NBC delivers a large offering of videos for consumers. Clips and full programs from NBC's shows can be watched online on NBC.com and through video service platforms such as Hulu.

One concern independent video content providers have is that given Comcast's ownership of NBC, videos from competitors would be slowed down in the delivery process to the end users. These concerns remain very real in light of the Appeals Court ruling that the FCC could not regulate network management practices of ISPs. Furthermore, it is widely assumed that these fears of Comcast slowing competing video services were behind their recent deal with Netflix.

These are precisely the kind of deals that small startups cannot afford to pay and why implementing an adjudication process for complaints of discrimination is necessary. In fact, the recent Comcast and Netflix deal offers further urgency for action on the part of the FCC before arrangements of this type become so commonplace that they will become accepted as a new reality.

The FCC not only has their own model for adjudication to follow, but they already have a process by which companies can file complaints about open internet violations.<sup>90</sup> Both of these models add much needed legitimacy to a process that seeks to change the ground rules for companies that have gotten used to one set of regulations. There will surely be some logistical and managerial hurdles to merge this existing process with a new adjudication process. However, the mere existence of the current process means the FCC already has some staff resources and effort focused on being

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<sup>90</sup> "FCC Consumer Complaints," *FCC Consumer Complaints*, Accessed March 19, 2014, [https://esupport.fcc.gov/ccmsforms/form2000.action?form\\_type=2000F](https://esupport.fcc.gov/ccmsforms/form2000.action?form_type=2000F).

receptive to complaints of discrimination by content providers. This means that the internal culture of the FCC is already predisposed to value such a process as we are proposing here. That acceptance of this process will help in the design and implementation phases.

One final pro in regards to implementation of an adjudication process comes in the form of budgetary savings. If an adjudication process were to be implemented, the FCC would save money in its administrative costs. These savings would be realized, as the burden of investigation and proof of discrimination would be put upon the content companies that choose to file the complaints against ISPs.<sup>91</sup>

Some observers may see this shifting of costs as the FCC shirking responsibility and passing a financial burden onto small startups. However, this outcome is also an opportunity for Facebook and our partner companies that value net neutrality. Facebook could potentially help provide funding for investigating these claims or otherwise help startups find the funding to fight discrimination from ISPs that ultimately hurts our business.

### Cons

On the flip side of these positives there are three notable negatives to pursuing adjudication and market segmentation that must be taken into consideration. The first negative has to do with the number of internet content providers. The second appears in the technical difficulty of determining at what point a company is no longer eligible for the adjudication process. Lastly, the FCC will be faced with challenges unique to the implementation of this policy.

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<sup>91</sup> Hal Singer, "Has the FCC Chairman Solved the Net Neutrality Quagmire?," *Forbes*, January 31, 2014. Accessed February 2, 2014, <http://www.forbes.com/sites/halsinger/2014/01/31/by-proposing-adjudication-chairman-wheeler-may-have-solved-the-net-neutrality-quagmire/>.

When it comes to internet startups and content providers, the number of companies seems endless and only continues to grow more rapidly each month and year. The costs to start and sustain a cable television network are so much higher that the pool of companies there is relatively limited comparatively. Due to these differing scales, it is not fair to totally equate the world of independent cable network companies with small internet startups. Not only are there more internet companies than cable network providers, but the growth rate for internet companies is significantly greater. This leads to a constantly evolving landscape for internet companies, compared to a relatively stable, or at least more predictable in terms of growth, environment for cable television networks.

The second negative for this policy comes in determining how to classify each company. As discussed above, startup companies go through several clearly delineated rounds where they are raising funding from investors. Accordingly, it is not always obvious when a company has evolved enough to be considered mature and independent to the point where it can stand on its own against the monopolies that ISPs hold.

The FCC can use the different funding rounds and other tools as guides in this process. However, they ultimately will have to make a determination on where to draw the line. Making this rule is surely something those ISPs, content providers, and investors will want to have a hand in helping the FCC create.

The last notable negative for the policies being proposed here comes in regards to implementation. As noted above, the FCC does have a model for adjudication that they can follow. However, the existence of a model is not the same as having the desire or the staffing structure already being in place. Being able to segment the market effectively and

setup the adjudication process will take staff time and resources away from other projects. As with every resource decision at a federal agency, this will come down largely to the priorities of the FCC, and at what point regulating net neutrality lies on such a list.

## **VII. Political Analysis**

Politically, any actions taken by the FCC will be met with some support and some opposition. On the whole, the stance each player in the net neutrality debate will take is largely predictable.

### **Likely Support**

#### Democrats

Democratic Congressmen, Congresswomen, and Senators will provide a reliable bloc of legislators in support of any steps by the FCC to better regulate a free and open internet. As discussed already in this memo, key Democrats in both houses of Congress have publically expressed support for net neutrality and frustration with the recent ruling in the Verizon v FCC case. Beyond these mere statements, Democrats have proposed legislation in light of the court ruling. Less than a month after the court decision, Representatives Henry Waxman (D-CA) and Anna Eshoo (D-CA) introduced a bill aimed at restoring net neutrality rules until the FCC took action in response to the court. Senator Ed Markey (D-MA) worked at the same time to introduce a similar piece of legislation in the Senate.<sup>92</sup> However, Democratic leadership in both the House and Senate

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<sup>92</sup> Mike Ludwig, "Democrats Introduce Bill to Restore FCC's Net-Neutrality Rules," *Truthout*, February 4, 2014. Accessed March 28, 2014, <http://www.truth-out.org/news/item/21659-democrats-introduce-bill-to-restore-fccs-net-neutrality-rules>.

has remained relatively quiet on the recent developments in the net neutrality debate. This signals that the issue is not a top priority for the party.

### Interest Groups

The bills being proposed by Democrats to support net neutrality received broad support from a coalition of more than 80 interest groups that delivered an open letter to FCC Chairman Tom Wheeler in light of the *Verizon v FCC* ruling.<sup>93</sup> For these groups, the net neutrality debate is a First Amendment issue and one that has intense and mobilized support amongst their supporters. Free Press frames net neutrality as protecting our rights to communicate through, “universally accessible, open, affordable and fast communications networks and devices,” and believes that these rights are, “codified in the First Amendment and the Universal Declaration of Human Rights.”<sup>94</sup>

These interest groups are also very supportive of reclassifying broadband as a common carrier. Former FCC Commissioner Michael Copps, now with Common Cause, put the stakes plainly in a blog post responding to the Verizon ruling when he wrote, “The time is now for the FCC to classify broadband as Title II. Without this step, we are playing fast-and-loose with the most opportunity-creating technology in all of communications history.”<sup>95</sup> Gabe Rottman, legislative counsel for the ACLU, called

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<sup>93</sup> Ibid.

<sup>94</sup> "About the Save the Internet Campaign," *Free Press*, Accessed March 28, 2014, <http://www.savetheinternet.com/about-sti>.

<sup>95</sup> Michael Copps, "The Buck Stops at the FCC," *Benton Foundation*, January 22, 2014. Accessed March 28, 2014, <http://benton.org/node/172880>.

reclassifying a legally, “bulletproof option.”<sup>96</sup> Todd O’Boyle of Common Cause adds that reclassifying is the, “firmest ground for the FCC to stand on, legally speaking.”<sup>97</sup>

## **Likely Opposition**

### Republicans

As clear as the Democratic support for net neutrality remains, the Republican opposition is just as certain. Like with the Democrats above, the comments laid out in the key stakeholders portion of this memo by leading Congressional Republicans are widely representative of the feelings of their broader party members. In fact, just like the Democrats, Republican lawmakers introduced legislation following the Verizon v FCC case ruling to ensure their preferred outcome in regards to the future of the FCC’s open internet rules. Congresswoman Marsha Blackburn (R-TN) introduced a bill to not only overturn the 2010 open internet rules, but to also prevent the FCC from implementing similar rules in the future.<sup>98</sup>

Also like their Democratic counterparts, the Republican Leadership in both the House and Senate has remained relatively silent in recent years about net neutrality. While their positions have been staked out on the issue years ago, the GOP leaders in the Senate and House have allowed the relevant committee leaders for their party to be out front on this issue.

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<sup>96</sup> Anne Kim, "Groups Push Broadband Changes for Net Neutrality," *Roll Call*, February 26, 2014. Accessed March 28, 2014, [http://www.rollcall.com/news/groups\\_push\\_broadband\\_changes\\_for\\_net\\_neutrality-231102-1.html](http://www.rollcall.com/news/groups_push_broadband_changes_for_net_neutrality-231102-1.html).

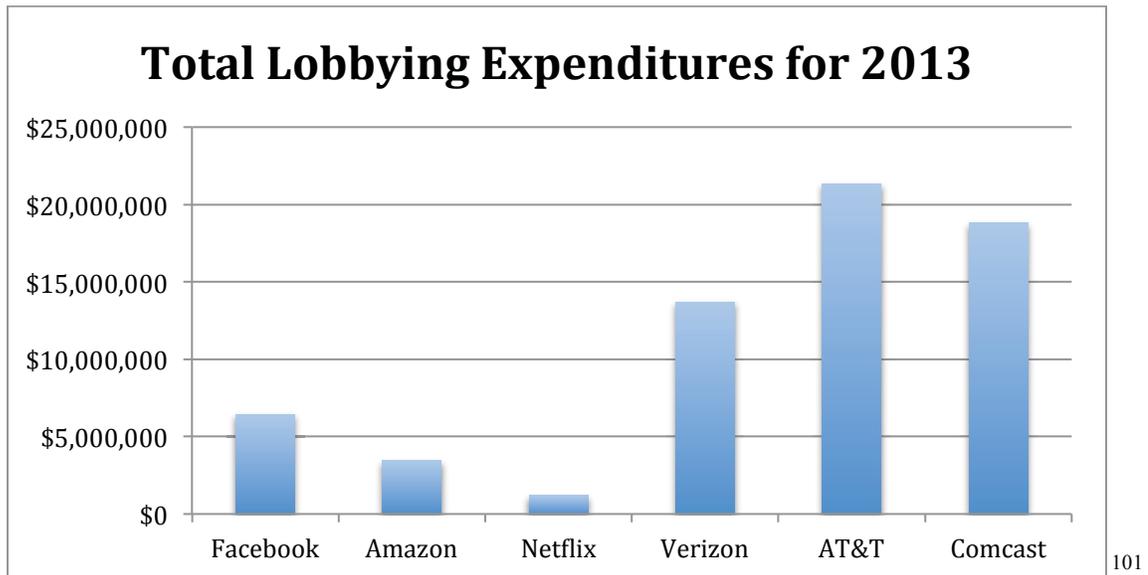
<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

## Internet Service Providers

The opposition to net neutrality by ISPs has been well documented so far in this memo. However, when it comes to their role in the political process, the power that ISPs have, compared to content providers and other pro-net neutrality groups is staggering. The simplest way to see this differential is through looking at lobbying expenditures for the major players on each side. While money spent on lobbying does not tell the whole story, it does provide a useful point of reference.

For this analysis the lobbying numbers provided by Open Secrets paint a shocking picture. Arguably the three most active ISPs in the net neutrality debate are Verizon, Comcast, and AT&T. In 2013 they spent an average of roughly \$18 million on lobbying.<sup>99</sup> By comparison, the total lobbying expenditures in 2013 for Facebook, Netflix, and Amazon was a combined \$11 million.<sup>100</sup> These three leading ISPs outspent their content provider adversaries by roughly a 5-1 ratio.



<sup>99</sup> "Lobbying Database," *Open Secrets*, Accessed March 29, 2014, <http://www.opensecrets.org/lobby/>.

<sup>100</sup> Ibid.

<sup>101</sup> Ibid.

In the interest of transparency, it is worth pointing out here that Google spent roughly \$15 million on lobbying in 2013 on its own. However, as previously noted in this memo, Google is unique among content providers in that it is also an ISP in certain parts of the country and has such a variety in scope of work that it almost deserves to be categorized by itself in this debate.

#### Democratic Members of Congress

If the FCC were to reclassify broadband as a common carrier it is likely that such a move would get broad and nearly complete approval from Congressional Democrats. However, if the FCC stops short of such a move, but still tries to exert some authority over net neutrality, then they might face opposition from members of both parties on Congress. Senator Al Franken (D-MN) laid out such a scenario when he cautioned the FCC against any course of action that would not include reclassification. Senator Franken said, "It's critically important that the approach the FCC takes achieves that goal [of net neutrality], and there are some real questions about whether the path they've chosen will actually accomplish that."<sup>102</sup>

#### **Additional Considerations**

The ruling in *Verizon v FCC* clearly put the onus for action in the lap of the FCC. Despite their public posturing, Congress has been unable to take any concrete action on net neutrality, either in response to the ruling or even in the years leading up to it. Given these factors, the FCC has both the authority and the opportunity to act here. It is in the

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<sup>102</sup> Anne Kim, "Groups Push Broadband Changes for Net Neutrality," *Roll Call*, February 26, 2014. Accessed March 28, 2014, [http://www.rollcall.com/news/groups\\_push\\_broadband\\_changes\\_for\\_net\\_neutrality-231102-1.html](http://www.rollcall.com/news/groups_push_broadband_changes_for_net_neutrality-231102-1.html).

FCC's interest to do so before the debate is framed in terms more preferable to someone else.

Yet there are reasons for less optimism that the FCC will act swiftly. One reason has to do with the revolving door of staff between the FCC and ISPs that was outlined previously in the stakeholders' section. This revolving door dynamic helps foster an environment where the FCC and the ISPs it regulates have personal dynamics beyond the professional world. This may lead to unintended consequences of favoritism from the FCC towards ISPs.

Additionally, the FCC must also be cautioned against making any moves that might upset Congressional Republicans too much. Given that the net neutrality issue is rather technical, it does not attract much attention from the mainstream media or the public at large as evidenced by the near complete lack of public opinion polling on the issue.

Despite this, the Senate still maintains oversight and confirmation authority over the FCC. This means that if they want, the Republican Party has the authority to make life difficult for the FCC now and in the future, and the FCC does not have much public support to fight back. For now, the Republican Party does not control the Senate, but in a midterm election year the FCC must keep a close eye on the future balance of power in Congress' upper chamber.

## **VIII. Recommendation**

The quickest and simplest way to resolve the net neutrality debate would be for the FCC to reclassify broadband internet as a common carrier under Title II.

Reclassification would be in line with the supposed goals of the FCC regarding net neutrality regulation. This would ultimately be beneficial to the growth of Facebook, thus supposedly aligning our priorities with those of the FCC.

However, despite the legal soundness of reclassification and the ability of the FCC to act unilaterally, there is not good reason to believe they will do so based on their history. Furthermore, the potential negatives of reclassification make full-throated, public support by Facebook difficult to justify. Instead, Facebook should focus its efforts on lobbying the FCC to establish an adjudication process for startups to file complaints against internet service providers.

The adjudication process would be of direct benefit to smaller content companies that are trying to enter the market. As discussed in this memo, anything that benefits innovation on the part of new startups will ultimately benefit Facebook's growth. Furthermore, adjudication is a process that the FCC already employs elsewhere and could even potentially save them money. These two factors make adjudication appealing to the FCC, and thus make it easier for Facebook to support.

The ease and legal authority to establish an adjudication process should not be mistaken as equally important regarding reclassification. Despite the US Court of Appeals laying out the legal framework of reclassification to the FCC, there has been little public support for such a move by any of the commissioners or the chairman of the FCC. This lack of public support is perhaps due to recognition by the FCC of the political opposition to net neutrality and the power of the lobbying efforts of ISPs. Facebook should also recognize the lack of enthusiasm from the FCC on this issue to be a tacit admission of net neutrality not being a top priority for the Commission.

Furthermore, if Facebook were to publically support and lobby the FCC to reclassify we would be opening ourselves up to potential blowback. There should be serious concern that the FCC will choose not to reclassify, even with our support for such action. If the FCC does avoid reclassifying despite our potential public support, that would be a good way to anger the ISPs. So long as this scenario remains likely we should be cautious when considering taking a public stance on net neutrality.

Facebook's future growth potential will be impacted by the outcome of the net neutrality debate. Unfortunately, net neutrality is not a top priority for the FCC. Given this fact and the potential consequences we would both face, Facebook should not lobby the FCC to reclassify broadband. Instead, we should focus our lobbying efforts on starting an adjudication process to protect small startup content providers. So long as these small companies can enter the marketplace, then Facebook's future will not be in any serious danger from the defeat of net neutrality.

## **Curriculum Vitae**

Jeffrey Harris joined the Aspen Institute in the spring of 2009 and currently holds the position of Public Affairs and Social Media Manager. Prior to joining the Institute, Jeffrey worked on media logistics for the 2009 Presidential Inaugural Committee and for the 2008 John Edwards for President campaign as a member of the national advance staff. He graduated from Duke University in 2007 with a BA in public policy and a minor in political science. Jeffrey was born in Upper Darby, PA in 1985.