
TELECOMMUNICATIONS

THE DANGERS OF MANDATING NETWORK NEUTRALITY

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Some communications policymakers have recently become strong advocates of a government requirement to ensure the benign-sounding concept of “Network Neutrality.” Network Neutrality, as defined in a recent Federal Communications Commission (FCC) Policy Statement, holds that consumers are entitled to: (1) access lawful Internet content of their choice; (2) run applications, and use services of their choice; (3) connect devices of their choice to any broadband platform so long as they do not harm the network; and (4) benefit from competition among network providers, application and service providers, and content providers.¹ While these are fitting aspirations for America’s broadband future, there are significant dangers at this stage of the market with reifying these principles into a new and complex *ex ante* regulatory structure or enforcement regime. Indeed, a robust broadband marketplace and the emergence of new broadband platforms may well depend on regulatory restraint—not regulatory action.

By now it is evident that Internet Protocol or “IP-Enabled” services, many of which are accessed over the public Internet, have had and will continue to have an enormous impact on our Nation’s communications landscape. As a truly global network providing instantaneous connectivity to individuals and services, the Internet has become one of the greatest drivers of consumer choice and benefit, technical innovation, and economic development in the United States. Customers are beginning to substitute IP-Enabled services for traditional telecommunications services and networks; customers today speak with each other using Voice over Internet Protocol (VoIP) instead of circuit-switched telephony and view content over streaming Internet media instead of broadcast or cable platforms. These new advanced services are transforming our Nation’s and the world’s communications industry and driving more and more Americans to subscribe to broadband services.

This explosive development has occurred “in an environment that is free of many of the regulatory obligations applied to traditional telecommunications services and networks.”² But now some federal policymakers are considering imposing broad new regulation on the broadband platform. These policymakers argue that a preemptive Network Neutrality regulatory regime is necessary to ensure that Internet users continue to have open and unfettered access to online content and services. Without such regulation, they contend, the cable and telephone companies will use their control over their networks to give advantage to preferred applications and content and otherwise exploit their market power.

Policymakers should be extremely cautious and skeptical in developing a new regulatory paradigm based on these

principles. Thus far, there is little evidence of a broad market failure that would require such regulation. Indeed, there are strong economic and business reasons to believe that network providers have no real long term incentive to engage in such behavior. And, perhaps most troubling, efforts to draft and enforce rules that will adequately respect and continue to foster the innovation, investment, and competition that has typified the Internet seem predestined to fail.

Network Neutrality and Broadband Regulation

As the cable and communications companies roll out high-speed broadband platforms capable of providing IP-Enabled services and applications to customers throughout the United States, regulatory policymakers are wrestling with fundamental questions regarding how these platforms and the services that ride over them should be regulated. The FCC has established a largely “hands off” regulatory paradigm for high-speed broadband facilities capable of bringing IP-Enabled services to the public. Cable modem and digital subscriber line (DSL), the two current dominant broadband platforms, are now regulated as information services under Title I of the Communications Act of 1934, as amended, which places a high value on the free market for facilities-based providers.³ With regard to IP-Enabled services, the FCC has determined that VoIP services are not subject to telephone company regulation by state public utility commissions, but are rather obligated to comply solely with a national set of standards.⁴ Finally, the FCC has consistently urged “the great majority” of IP-based services “should remain unregulated.”⁵

There is, however, a growing unease with this commitment to regulatory restraint among some policymakers. They have become concerned that there is a need for rules to guarantee consumers open and unfettered access to online content and services in the future. As FCC Commissioner Copps recently put it:

This new era of telecommunication is rife with all sorts of exciting opportunities for both consumers and entrepreneurs. But there are also new perils. . . . [L]arge carriers “are starting to make it harder for consumers to use the Internet for phone calls or swapping video files.” The more powerful and concentrated our facilities providers grow, the more they have the ability, and perhaps even the incentive, to close off Internet lanes and block IP byways. I’m not saying this is part of their business plans today; I am saying we create the power to inflict such harms only at great risk to consumers, innovation and our nation’s competitive posture. Because, in practice, such stratagems can mean

filtering technologies that restrict use of Internet-calling services or that make it difficult to watch videos or listen to music over the web. . . . This is why. . . enforceable net neutrality principles. . . are so vital.⁶

Recently, the FCC moved beyond the *Policy Statement* and incorporated its Net Neutrality principles as enforceable conditions on the recent mergers of SBC with AT&T and Verizon with MCI.⁷ The FCC also required the merged entities to provide “naked” or stand-alone DSL services.⁸ This requirement was specifically intended to serve as a prophylactic measure to ensure that the merged entities would not discriminate against VoIP services by requiring consumers to purchase DSL only bundled with voice service. Earlier in 2005, the FCC’s Enforcement Bureau adopted a Consent Decree settling allegations that Madison River Telephone Company was blocking customers’ ability to use VoIP through one or more VoIP service providers.⁹

Chairman Martin has charted a thoughtful course regarding Net Neutrality issues. Chairman Martin oversaw the release of the *Net Neutrality Policy Statement*, emphasizing his belief that “consumers should be able to use their broadband internet access service to access any content on the Internet.”¹⁰ At the same time, he recognized that “cable and telephone companies’ practices already track well with the Internet principles” endorsed in the *Policy Statement*.¹¹ He also expressed his confidence that “the market place will continue to ensure that these principles are maintained” and that “regulation is not, nor will be, required.”¹² In a Commission facing difficult decisions and evenly divided between two Republicans and two Democrats, however, Net Neutrality proponents are in a strong position to press for a more aggressive regulatory posture.

In addition to the FCC’s efforts, Net Neutrality is a central theme in the debate surrounding proposed telecommunications reform legislation. The House Energy and Commerce Committee Revised Discussion Draft and the Draft Broadband Investment and Consumer Choice Act in the Senate each put forth Net Neutrality provisions that address the same concerns expressed in the *Net Neutrality Policy Statement*.

The Principle of Network Neutrality

Net Neutrality proposals appear to be driven by the belief that cable and telephone companies have what is in effect a broadband duopoly that will allow them to use their market power to dominate the broadband platform and the content, services, applications, and devices that depend on it. Consumers Union, for example, told the House Energy and Commerce Committee that:

Giving network operators the power to dictate services opens the door to the “cabalization” of the Internet. Cable and telephone company giants are encouraged. . . to bundle more services together in take-it-or-leave-it packages and to

make it harder, not easier, for competing communications service providers and Internet applications developers or service providers to reach the public. . . . This duopoly dribbles out bandwidth increasingly in bundles that are unaffordable for most Americans.¹³

Net Neutrality advocates argue that, as cable and telephone companies pursue vertical integration of the broadband conduit with IP-Enabled services or applications, they are coming into competition with other Internet-based services such as Vonage, Google, or Yahoo!. This competition in turn creates incentives for the cable and telephone companies to leverage their supposed market power over the physical layer of the broadband platform to bar or discriminate against competitors and to limit customers’ use of their services or applications. For instance, cable and telephone companies might create a “walled garden” blocking access to competitors’ websites, or blocking competing applications or services from their networks. The network providers may elect to give priority to their own content, applications, or services by degrading the delivery of the content, applications, and services of their competitors. Or they may prevent consumers from attaching wireless routers to the edge of their networks. The network providers could also speed up or slow down particular uses and charge competing services to use the “express lanes” on their networks.

Net Neutrality advocates fear that such practices would ultimately stifle the promise of broadband to provide consumers with unlimited access to diverse sources of information and services and prevent the emergence of competitive alternatives to dominant cable and telephone providers. These parties therefore urge policymakers to establish “[s]trong, enforceable nondiscrimination provisions. . . essential to continued growth and competition in not just broadband service, but also for continued innovation in Internet content, services, and applications.”¹⁴ In essence, then, Net Neutrality would be a new regulatory regime aimed at preventing cable and telephone companies from exercising market power based on their control over their networks.

Network Neutrality—Regulations Ahead of Their Time

Those who favor a vast new regulatory regime based on Net Neutrality principles place at risk the core, long term strength of the broadband marketplace in the United States. First, it assumes that the broadband marketplace of the future will be a duopoly between cable and wireline. If that were ultimately to occur, then perhaps some type of Net Neutrality regulation would be warranted. However, public policy should instead be focused on maintaining economic incentives for new broadband platforms to emerge, increasing competition, and eliminating whatever marketplace incentives there are for the dominant carriers to engage in the anticompetitive misconduct Net Neutrality is intended to thwart. Finally, in an ecosystem as complex as the Internet, transforming ideals like Net Neutrality into workable and enforceable regulations is an overwhelmingly complex task and is one that may well frustrate the development of new

broadband platforms.

Policymakers should recognize that, at this point, there is scant evidence of the types of anticompetitive behavior that Net Neutrality is designed to prevent. Indeed, the *Madison River* case is the sole adjudicated example to date of a network provider unfairly blocking access to websites or online services today.¹⁵ Moreover, there are sound reasons why the cable and telephone companies are not now and will not likely in the future engage in the kind of discriminatory and anticompetitive “bad acts” that Net Neutrality is intended to remedy.

First, the market power problem that Net Neutrality presumes is not likely to occur. Net Neutrality assumes that cable and telephone companies, as the current dominant broadband platforms, have overwhelming market power. While these platforms may enjoy a dominant position in the market today, the market is in fact typified by a competitive free-for-all with “several emerging platforms and providers, both intermodal and intramodal, in most areas of the country.”¹⁶ The FCC’s Wireline Competition Bureau reports that high-speed connections¹⁷ to end users by means of satellite or terrestrial wireless technologies increased by 30% during the second half of 2004, and connections by means of fiber optics and electric power lines increased by 9%.¹⁸ Furthermore, providers continue to invest billions of dollars in expanding competitive broadband networks to compete with cable and DSL.¹⁹ The continuing development of such competitive broadband platforms undermines any justification for the adoption of Net Neutrality as competition creates incentives for network operators to keep their networks open to meet consumer needs. At a minimum, it makes no sense to impose a new regulatory regime against these emerging entrants as they seek to make a mark in the broadband marketplace.

Second, the existing marketplace already acts strongly to discipline network operators from adopting unduly restrictive limitations on the use of their networks. Broadband networks are extraordinarily expensive to construct and network operators can recover their investment only by carrying traffic. Network operators thus have no incentive to unreasonably restrict or encumber consumers’ use of the network; to do so will lead to consumer frustration and encourage consumers to reduce their usage or to leave the network altogether. In a recent example, subscribers to the social-networking site MySpace began experience trouble accessing YouTube—a competing site—and even experienced erasures of any reference to YouTube.²⁰ MySpace subscribers reacted with indignation and appear to have forced a resolution of the problems.²¹

Net Neutrality’s Potential Unintended Consequences

In short, the government should not undertake broad, new *ex ante* regulation of the Internet, absent any substantial evidence of actual harm or the imminent likelihood of harm. The explosive development of the Internet has occurred precisely because the Internet remains free of the

“regulatory obligations applied to traditional telecommunications services and networks.”²² Further, a minimal regulatory environment is critical to promote continued infrastructure investment and encourage the ubiquitous availability of broadband to all Americans.²³ Government interference, by contrast, would discourage investment and innovation in broadband networks and may have the perverse result of solidifying a “broadband duopoly.”

Net Neutrality regulation would effectively dampen the incentives for continued investment and innovation in broadband networks. Simply put, in order to justify deploying broadband networks and next-generation technologies, network providers must have the ability to generate revenue from the networks. To that end, network operators may wish to promote their own branded content and services by offering access and services in bundled packages or with premium quality of service. They may also enter joint or exclusive marketing arrangements with service and content providers as a mechanism for differentiating themselves from competitors. These types of offerings can create rewarding online experiences for users and can help network operators entice consumers to use their networks. Satellite radio offers an excellent example of this point. XM Satellite Radio and Sirius Radio both utilize exclusive content arrangements and have leveraged these arrangements to enhance their competitive positions. Indeed, it appears that such exclusive agreements have been a major factor in the fledgling satellite radio industry’s ability to expand to over 10 million subscribers in the last three years.

Net Neutrality might also have the perverse result of reinforcing the “broadband duopoly” that it is intended to address. In capital intensive industries, forcing competitors to differentiate themselves solely on the basis of cost gives large, incumbent companies an enormous advantage based upon economies of scale.²⁴ Large companies have larger customer bases over which to spread the costs of their networks, allowing them to charge each customer less.

Allowing networks to differentiate themselves on the basis of product and service offerings, on the other hand, provides important opportunities for small entities and new market entrants.²⁵ A new entrant may be able to survive and compete with the larger incumbent network providers by offering specialized services or exclusive content which justify the higher prices necessitated by the entrant’s smaller customer base. For example, as Professor Yoo points out in his working paper for the Vanderbilt University Law School, if network operators are allowed to restrict the connectivity to their networks, it would be easy to envision three distinct networks competing to serve end users: one optimized for traditional Internet applications such as e-mail and website access; another incorporating security features to facilitate e-commerce and guard against viruses; and a third that facilitates applications such as streaming media and VoIP.²⁶ Each consumer would thus be able to choose and pay for only the degree of connectivity that she needs and wants. The ability to promote proprietary services and content

would similarly allow new entrants to develop bundles of services and content catering to niche markets where customers value such services and are willing to pay more for the package.

Net Neutrality: The Practical Dilemma

At its most benign, Net Neutrality can be viewed as a necessary, albeit temporary, regulatory remedy for anticompetitive “bad acts” such as the port blocking that occurred in *Madison River*. *Madison River*, however, represents the “easy case” in which government intervention may well have been necessary to address a specific instance of anticompetitive conduct on the part of an identified network provider. The arrival of additional competitive broadband platforms should eliminate the need for such intervention as competition compels carriers to keep their networks open. Many Net Neutrality proponents nevertheless support establishing a broad new *ex ante* regulatory structure to prevent network providers from generally discriminating in terms of access to its network or in the content, applications, and services running on their network.

It is not at all clear that government could, as a practical matter, craft enforceable regulations that would meet this goal. There are many legitimate reasons for carriers to engage in some forms of theoretically “discriminatory” conduct. Access to networks may need to be limited in order for operators to maintain the technical integrity of their network, to prevent the spread of viruses, to disrupt the distribution of unlawful content such as child pornography, or to manage capacity. Similarly, network operators may need to prioritize the transmission of certain time sensitive traffic such as streaming video to avoid delays in users receiving such traffic. Moreover, as discussed above, there are legitimate reasons for network operators to develop branded content and services by offering access and services in bundled packages or entering joint or exclusive marketing arrangements with service and content providers as a mechanism for differentiating themselves from competitors.

Can policymakers craft a readily-understood distinction between lawful and unlawful discrimination given these realities? Can a set of *ex ante* rules resolve issues such as whether network providers can provide select services or applications with exclusive access to a premium level of service quality or speed? Can a network operator sign an exclusive arrangement with a local television station to provide content? Can a network operator prevent consumers from accessing pornography? Could an equipment manufacturer sign an exclusive deal with a network provider for a sleek new handset? How will regulators enforce nondiscrimination requirements? If my broadband service provider signs a deal with the local newspaper that creates a speedy link to their content, is that a violation of Net Neutrality? If my wireless carrier prevents the use of certain applications because they consume too much spectrum bandwidth does that run afoul of the rules?²⁷

The answer to these questions is likely to be no. More

important, the Internet has thrived in part because policymakers have been humble in their assessment of their own abilities to control it. Congress itself has enshrined the idea that “it is the policy of the United States” that the Internet remain subject to “the vibrant and competitive free market. . . unfettered by Federal or State regulation.”²⁸ Efforts to define “nondiscriminatory” Internet access or applications—or to assess the technical impact of various operating protocols places policymakers squarely in the middle of the broadband business and network operations. Yet the strength of the vibrant marketplace has been derived in large part from policymakers’ reluctance to assume such a prominent position in the marketplace. The Net Neutrality principles—with their unintended consequences—should not tempt policymakers to reassess their role in this booming market.

The principles of Net Neutrality signal important policy signposts for network operators today who may be tempted to engage in anticompetitive conduct in order to gain short term market advantage. However, moving beyond these principles into detailed rules or enforcement may well put at risk the long term consumer benefits that will be derived from multiple broadband platforms. In the end, it is the broadband network, the “last mile” connection to the consumer, which at this stage of its development has a substantial degree of concentration. Thus, competition policy would be better served by fostering competition in the networks that provide broadband.²⁹ Net Neutrality does not serve this goal, and may in fact undermine efforts to promote the continued development of facilities-based competition. In effect, Net Neutrality could sacrifice competition in broadband networks, in order to preserve one vision of competition elsewhere. Even if these harms were not realized, the complexity and costs associated with development, implementation and enforcement of a Net Neutrality regulatory regime outweigh its consumer benefits. For now, policymakers are best served by keeping a watchful eye on broadband networks and developing policies that guarantee the health and freedom of the Internet in the long term through competition between platforms rather than through regulation.

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Footnotes

¹ *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 1498 (2005) (“*Net Neutrality Policy Statement*”).

² *IP-Enabled Services*, 19 FCC Rcd 4863 (2004).

³ 47 U.S.C. §§ 151-161; *National Cable & Telecommunications Ass’n v. Brand X Internet Services*, 125 S.Ct. 2688 (2005) (upholding the FCC’s decision to regulate cable modem service as an information service under Title I of the Act); *Appropriate Framework for*

Broadband Access to the Internet Over Wireline Facilities, 20 FCC Rcd 14853 (2005), petition for review pending; Time Warner Telecom Inc. v. FCC, 3d Circuit No. 05-4769 (filed Oct. 26, 2005) (finding that DSL-based Internet access should likewise be regulated under Title I).

⁴ *Vonage Holding Corp.*, 19 FCC Rcd 22404 (2004), petition for review pending; Minnesota Public Utilities Comm'n v. FCC, 8th Circuit No. 05-1069 (filed Jan. 6, 2005); *see also* *Petition for Declaratory Ruling that Pulver.Com's Free World Dialup Is Neither Telecommunications nor a Telecommunications Service*, 19 FCC Rcd 3307 (2004) (holding that an Internet application enabling computer-to-computer telephony only among Pulver "members" was to be regulated under Title I of the Act).

⁵ *Id.* at ¶ 35.

⁶ *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Statement of Commissioner Michael J. Copps, Concurring, pp. 3-4, 2005 FCC Lexis 6386 (rel. Nov. 17, 2005).

⁷ *See Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, 2005 FCC Lexis 6386 (rel. Nov. 17, 2005); *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, 2005 FCC Lexis 6385 (rel. Nov. 17, 2005).

⁸ *See id.*

⁹ *Madison River Communications, LLC and affiliated companies*, 20 FCC Rcd 4295 (EB 2005).

¹⁰ *See* Press Release, FCC, Chairman Kevin J. Martin, Comments on Commission Policy Statement (August 5, 2005), *available at* 2005 FCC LEXIS 4494.

¹¹ *Id.*

¹² *Id.*

¹³ Gene Kimmelman, Senior Director of Public Policy and Advocacy, Consumers Union, Testimony before the United States House of Representatives, Energy and Commerce Committee, Subcommittee on Telecommunications and the Internet, November 9, 2005, pp. 3-4 (<http://energycommerce.house.gov/108/Hearings/11092005hearing1706/Kimmelman.pdf>).

¹⁴ Consumers Union Testimony at 4.

¹⁵ *See Madison River Communications*, 20 FCC Rcd 4295.

¹⁶ *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 20 FCC Rcd 14853 at ¶ 3.

¹⁷ INDUSTRY ANALYSIS AND TECHNOLOGY DIVISION, WIRELINE COMPETITION BUREAU, HIGH SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2004, at p. 2 (rel. July 2005) (<http://www.fcc.gov/wcb/stats>). High speed services refer to services offering transmissions to the subscriber at a speed in excess of 200 kbps in at least one direction. *Id.*

¹⁸ *Id.*

¹⁹ *See, e.g.*, Edward A. Salas, Vice President, Network Planning, Verizon Wireless, Statement before the United States House of Rep-

resentatives, Energy and Commerce Committee, Subcommittee on Telecommunications and the Internet, November 9, 2005, pp. 2-3 (Verizon Wireless has "invested well over \$1 billion in expanding our EVDO offering to encompass more than 170 major metropolitan markets and 84 major airports across the nation, and we will continue to expand the customers' ability to access this amazing technology")(<http://energycommerce.house.gov/108/Hearings/11092005hearing1706/Salas.pdf>).

²⁰ Bosman, Julie, *Lesson for Murdoch: Keep the Bloggers Happy*, N.Y. TIMES, January 2, 2006, at <http://www.nytimes.com>.

²¹ Factiva, *Murdoch to take on Yahoo! with MySpace.com*, BRAND REPUBLIC, January 11, 2006 (www.brandrepublic.com).

²² *IP-Enabled Services*, 19 FCC Rcd 4863 (2004).

²³ *See Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 20 FCC Rcd 14853 at ¶ 1.

²⁴ Christopher S. Yoo, "Beyond Network Neutrality," Vanderbilt University Law School, Public Law & Legal Theory, Working Paper Number 05-20, at pp. 30-31 (<http://assets.wharton.upenn.edu/~faulhabe/732/NNYoo.pdf>).

²⁵ *See* Yoo at pp. 30-31.

²⁶ *See id.* at p. 33.

²⁷ Yang, Catherine, *At Stake: The Net as We Know It*, BUSINESSWEEK ONLINE, December 15, 2005, at http://businessweek.com/technology/content/dec2005/tc20051215_141991.htm.

²⁸ 47 U.S.C. § 230(b)(2).

²⁹ Yoo at p. 16.