Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Restoring Internet Freedom, WC Docket No. 17-108

Comment of MFRConsulting

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August 23, 2017

Net Neutrality – Regulation for the Digital Economy

Key Points about Net Neutrality

1. The findings of harmful consequences from significant net neutrality regulation repeatedly presented by economists hired by, as well as other supporters of the major US broadband operators, and their characterizations of the US broadband market as "intensely competitive", have been consistently discredited over the years.
2. The purpose of net neutrality regulation is to ensure and sustain effective competition in broadband access markets where this competition is inevitably limited by the special rights inherent in the franchises and licenses awarded to the large operators.
3. The purposes of this regulation are to:(i) Limit the ability of any player with substantial market power, *whether itself a network operator or not*, and whether individually or in collusion (including tacitly) with another player or limited set of players, to pursue anti-competitive and customer-hostile policies and actions, and (ii) Ensure that new entrants with innovative ideas can continue to break into the market.
4. The justification of net neutrality regulation is not based solely on concerns about the abusive behavior of broadband operators. It encompasses all digital players in positions to wield substantial market power that, in the absence of effective regulation, may be abused to stifle new market entrants and subsequent waves of innovation, and to act with impunity to the

detriment of consumer welfare. The potential for abuses of market power in the digital economy by large players are substantial through the exercise of their overwhelming negotiating and purchasing power compared to new entrants and much smaller players as well as consumers, which is the result of returns to scale and network effects characteristic of this economy.

5. The economic theories and literature used by opponents of net neutrality regulation to justify their position do not reflect how human nature and organizational incentives affect corporate decisions in the real world, and moreover are outdated in the era of the digital economy which calls for a rethink in the theory of competition and antitrust policy.

Introduction

The comments by economists in consultancies filed on behalf of large network operators such as AT&T in opposition to significant rules on net neutrality are depressingly predictable and unimaginative in their stale arguments. I will take just one as an example, namely the Economic Declaration ("Declaration") filed as part of a submission by AT&T on July 17, 2017 - **https://ecfsapi.fcc.gov/file/10717906301564/Econ%20Declaration.pdf**. This Declaration was prepared by three economists at the consultancy Compass Lexecon, which frequently supports AT&T's positions on matters before the FCC.

The Declaration reiterates familiar findings, most notably that:

(i) Title II regulation reduces investment, for which allegedly there is empirical evidence, and is the result to be expected from economic theory and the contents of economic literature;

(ii) Competition for broadband access services is effective and even intense, both between wireless-based services and between wireless-based and fixed services thanks to convergence.

If indeed competition is intense then there is little need for significant rules or regulation to limit the ability of the largest competitors to act in ways that unfairly harm smaller players. Competitive pressures will restrain them from neglecting the interests of customers who have alternatives they can readily turn to. Services providers will not be able to extract monopoly or oligopoly rents from customers and will be strongly motivated to improve their services and customer care to retain existing and capture new customers.

However these findings of a causal negative link between net neutrality regulation and investment and of a state of intense competition in the US broadband market have been rebutted and discredited on multiple occasions in the past[1]. Nevertheless

[1] See for example:
"Title II and Broadband Investment: Spurious Correlations," Martyn Roetter, April 2015, https://ecfsapi.fcc.gov/file/60001044394.pdf, and "Internet Incentives, Investment, and Innovation: The FCC Got It Right," July 2015 Martyn Roetter, https://ecfsapi.fcc.gov/file/60001112190.pdf

they reappear like zombies, reanimated by their proponents in the hope that constant and widely publicized repetition by one or more well funded consultancies and think tanks will make them respectable and accepted as the truth.

Regulation, Investment Drivers, and Competitive Realities

The use of the raw metric "dollar volume of investment" as a key indicator of the health of the broadband environment is naïve and misleading, if not plain silly. The obsession with trying to establish a causal reduction in investment to specific regulation – or the reverse for that matter - fails to recognize the complexity of the factors that drive investment decisions, including important ones that are independent of sector-specific regulations. Investment volumes at any one time may be inflated by an atmosphere of "irrational exuberance" such as arose in the late 1990s and around the turn of the century. Alternatively investment volumes may be depressed as a result of high taxes on equipment and/or services (such as exist in some countries), and/or an economic depression that cause demand to be suppressed so that investments are correspondingly reduced below what is needed to provide widespread broadband coverage with modern facilities. Among other factors the "right" amount of investment at any one time is a function of the status of existing networks, perceptions of the addressable solvent demand and hence revenue and profit potential, and the efficiency of an investment dollar in terms of delivering improvements in network capacity, performance and coverage. This efficiency is itself a function of multiple factors from network and device technology to the costs and other burdens of local requirements for obtaining installation permits for cables, base stations etc.

The obsession of opponents of net neutrality regulation with its alleged causal connection to investment can be ascribed to the headline grabbing quality of this metric, despite the simplistic assumption or implication that somehow it is a cardinal and always valid rule that more investment is "good" and less investment is "bad". A focus on this misleading investment metric as a key indicator in the cost/benefit or harm/benefit analysis of net neutrality regulation distracts attention from its other more serious and durable consequences for competition and consumers.

A few telling points in the past rebuttals of the findings in the Declaration are worth repeating:

(a) Fixed and wireless broadband are services which are more complementary than broadly competitive, given their different characteristics and capabilities (e.g. the much greater potential bandwidth per user of the former compared to the latter, and the ability of the latter but not the former to provide contiguous and continuous service throughout an area and to connect with users when they are mobile). In many locations customers confront a duopoly supply situation for fixed broadband that is not effectively competitive;

(b) Major telephone operators have exploited Title II regulations in several jurisdictions to which they were subject in their telephone franchise areas – the very regulations they now attack as harmful to them - to help defray the costs of their deployment of new broadband infrastructure;

(c) If the "light" regulation enamored of the advocates for AT&T's and other broadband operators' opposition to net neutrality regulation that prevailed before the FCC's Internet Order of 2015 was so admirable, why do US broadband customers not enjoy the best value or performance and price for the broadband access services they need, but are instead more poorly served in this regard than their counterparts not only in countries such as South Korea and Japan but also in several European nations whose stricter regulatory regimes are cited as examples to avoid?

Opponents of Title II typically refer to it as a throwback to utility regulations of the 1930s that are outmoded and harmful in today's very different technological and market environments given 21st century customer needs and expectations. However in taking this position they ignore the durable values and principles that undergird the Communications Act of 1934 and its updating in 1996. These principles are as valid today as they were then. They include the goal of providing universal, affordable service to all residents and organizations within the US, and of curbing the freedom of service providers with substantial market power to discriminate unreasonably against some customers and other providers. By the very nature of networks the latter depend on their much larger competitors for being able to deliver a competitive portfolio of end-to-end services to the customers they are targeting.

If anything it is even more important to honor these principles today than it was over 80 years ago. Affordable access to broadband services is a more critical and pervasive influence on the economic, social and personal lives and welfare of humans than was narrowband telephone service in the 20th century. The value of achieving this goal in economic terms and in enabling equality of opportunity for all US residents has increased.

The refutation of the arguments of major broadband operators opposing significant net neutrality regulation, buttressed by economists they commission, rests on a broader and more durable foundation than the rebuttal of specific claims or findings about the allegedly harmful consequences of this regulation. Anti-regulation findings may be valid within the theoretical constructs of corporate behavior and economics favored by these economists but they contradict reality and experience. They may be valid in theory, but they do not reflect observable corporate practices. They ignore how humans and organizations behave and reach decisions in the real world under the influences of the incentives offered to them, their perceptions of the risks of punishment, and the proclivities of human nature. A previous Comment in this Proceeding covered this reality and experience.[2]

Implications of the Digital Economy for Regulation

In addition the claims and findings of the opponents of net neutrality regulation fail to consider the changes wrought by and inherent in today's digital economy that change the rules of the game as compared to traditional pre-digital markets. This is strange given that these opponents claim to represent a forward-looking approach to regulation designed to abolish outdated views of markets and competition.

The approaches to competition and antitrust theory implicit in the Declaration fail to provide persuasive guidance to regulators and policy makers as to how to address key questions in today's era of digital platforms and network effects, or the trend towards increasing market power in the digital economy, such as:

1. Will the efficiencies gained by large companies and their consolidation through mergers and acquisition be passed on in reasonable proportion to consumers in the form of lower prices;
2. Will it still be possible for new entrants to break into the market;
3. What is the nature and significance of the interactions between markets as large firms expand inexorably into other activities and markets building on their platforms;
4. How should the purchasing and negotiating power of large companies be taken into account in antitrust analyses?

A number of key questions arise about the effects of increasing concentration in the digital economy in the US. In the case of broadband access and broadband-delivered services particular attention should be paid not only to the power of major broadband operators but also to the roles of companies such as Google and Facebook and their impact on the health of competition in the medium and long term and the potential for harm caused by their increasing market power in the US digital economy.

In all digital markets, the cost structure of high upfront costs and low additional or marginal costs means there are large economies of scale. The broad impact of digital technology has been to increase the scope of the markets a large firm can hope and plan to address. The large firms argue that the efficiencies gained by being large and becoming even larger through mergers and acquisitions are and will be passed on to consumers in the form of lower prices. They also state it is still possible for new entrants to break into the market.

[2] "Internet Freedom cannot be Guaranteed with Promises Alone," MFRConsulting filing in FCC Docket 17-108, May 10, 2017.

However it is not clear whether these arguments or statements are valid, or may be becoming less valid in the environment dominated by digital platforms. The basic economic theory, developed by Jean Tirole and others, holds that in such markets one "side" of the platform will cross-subsidize the other. Hence the signals that prices send about competition differ from those in a traditional market. Platforms also generally expand into adjacent markets, so the standard market definition exercises carried out by competition authorities are not informative about the state of competition.

Large digital companies also argue that the consumer benefits they provide through "free" services (search, zero rated content etc.) are substantial. "Free" means that no money is taken directly from consumers for the "free" service, or that there is no specific line item for it on consumers' invoices. For example Google and Facebook provide services consumers value greatly without taking money directly from them, while broadband operators tout the value of so-called zero-rated services and content (as does the Declaration). However for example advertisers also place great value on these services, and their payments to Google and Facebook are built into their costs and hence ultimately passed on to consumers in the price of whatever is being advertised and sold. While the network effects of digital platforms do produce real economic welfare gains, it is unclear how large they are or who captures them and in what proportions.

Should we rely only on the statements of the large players themselves and those they commission to make their case about the beneficial effects of allowing them to do what they want without any significant restrictions because, so they say, they are bound to act in the best interests of consumers, and moreover "market forces" ensure they will?

The major digital platforms, like the major broadband operators, state that they rely heavily on competition among themselves. They assert further that the threat of digital disruption is significant. Facebook quickly toppled MySpace, so it may be displaced in turn, i.e. competition is intense. In short their position is that bigger is better for everyone in a world of significant returns to scale and network effects. In the context of assessing competitive market intensity the leading digital platforms or Web or tech companies are now adopting similar arguments to those of the major US broadband operators, despite their differences on other matters such as the counterclaims made in the past about whether or not they are somehow "free riders" on investments made by the latter. Whatever their origins and history giant firms that have made it to the top are similar in the arguments they present to justify their untrammeled freedom of action, which may allow them to block the next generation of innovators who could dislodge them.

Conclusions

Net Neutrality regulation and rules that are effective and enforced are justified. They are necessary as a counterweight - following the thoroughly American practice of instituting checks and balances - to the immense power with potential for abuse of the largest companies that provide broadband access services and/or content and applications delivered via broadband. New entrants and much smaller and niche players, and hence the next waves of innovation, as well as consumers are vulnerable to these abuses.

The power of the largest players may well become even greater in future as result of further consolidation or concentration and the large returns to scale and network effects inherent in the digital economy. Absent the check and balance of net neutrality regulation the dynamics of the digital economy outlined above will tend to amplify and enhance the power and temptation of large digital players to abuse their market power.

The performance of these companies provides no evidence that sensible rules are burdensome to them other than by limiting their freedom to act “at their sole discretion.” This freedom allows very powerful companies to act in ways that maximize the rewards that may accrue to a small number of individuals with decision-making power, even if as a result the legitimate interests of others, notably consumers, who have no alternative they can readily turn to are unreasonably neglected or harmed.