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

In the Matter of	)	
Preserving the Open Internet	)	GN Docket No. 09-191
Protecting and Promoting the Open Internet	)	GN Docket No. 14-28

REPLY COMMENTS OF THE AMERICAN CONSUMER INSTITUTE

The American Consumer Institute (ACI) hereby submits its reply in response to the Federal Communications Commission ("FCC") regarding the above-captioned proceedings.

Introduction and Summary

In response to the Federal Communications Commission's (FCC) notice on protecting the Internet, the following are the comments of ACI. ACI is a nonprofit (501c3) educational and research organization with the mission to identify, analyze and protect the interests of consumers in selected policy and rulemaking proceedings in information technology, healthcare, retail, insurance, energy and other matters. While ACI is a member of the FCC's Consumer Advisory Committee (CAC), and participates on the CAC's Broadband, Healthcare Working Groups and IP-Transition Working Groups, the following comments are solely ACI's views and do not necessarily represent the views of the CAC or its members.

Based on growing dynamic competition in the market, as well the state of broadband service's market structure, conduct and performance, we find no definitive evidence of a market failure that would justify reclassifying broadband services under Title II regulation. As we explain below, because *ex ante* broadband regulations could lead to regulatory errors, the costs of broadband regulations may far outweigh any consumer benefits. In addition, we have seen no demonstration on record that the costs and failures from imposing Internet regulations would be significantly less than any costs or failures resulting from imperfect markets.

With these general findings in mind, we strongly recommend that FCC employ a quantitative cost/benefit standard to demonstrate to the public that new Internet rules and reclassification of Internet services would enhance consumer welfare. In the absence of this demonstration, we implore the FCC to refrain from imposing regulations that could be potentially harmful to the public's interest.

Market Competition

The communications market is rapidly changing. Today, there are more than twice the number of broadband lines and more than three times as many wireless subscribers than traditional telephone company lines. Consumers with broadband services are bypassing the old network with Internet-based voiced services, including services offered by cable, telecommunication, satellite, other wireless and Internet service providers. The current market exhibits a high degree of intermodal rivalry.

The Internet has seen explosive growth. Compared to when the Telecommunications Act of 1996 was enacted, the facts show that the Internet speeds have increased by more than 100-fold, as services went from dialup to broadband speeds. Excluding satellite and mobile services, fixed broadband services are now available to households in nearly every census tract in the U.S. and at half the price. The feat was largely the result of investments and a "hands off" regulatory approach favored by then-FCC Chairman Kennard.

Like broadband services, wireless consumers have also benefited from this "hands off" approach. Since 1996, the number of wireless subscribers grew eight-fold, and today, after adjusting for inflation, a wireless minute costs less than one-tenth of its 1996 price. Compared to its European counterparts, the US wireless market leads the world in usage and speed, has more competitors and devices for sale, offers the lowest usage prices, and faster wireless Internet speeds. Most Americans use their wireless phone as their predominant telecom service, and most wireless consumers use their service to access the Internet. Today, there are 300 million wireless broadband subscribers in the U.S.[1] and wireless data usage will likely top 2 trillion megabytes by the end of this year. Consumers can browse the Internet, watch videos, use apps like free navigation, make phone calls and send messages with a handheld device.

In short, the broadband market appears to be vibrant, innovative and competitive, and consumer benefits are being achieved without the help of onerous regulations. Moreover, the imposition of Title II regulations is a step toward monopoly-era regulation that would discourage network investment and be counter to the spirit of the Telecommunications Act of 1996.

No Rationalization for Onerous Regulations

Market failure can sometimes be a justification for government intervention. For communications services, regulation was a historical development stemming from monopoly services. Later in the 1990s, price-cap regulations were used to transition the industry from monopoly to competition. Today, the reasons for common carrier regulation have disappeared.

As the Commission's economists are, of course, aware of the conclusions of numerous industrial organization experts and studies holding that market structure alone is an unreliable indicator of the efficacy of competition, and that competent analysis requires looking instead at the record of market conduct and of actual market

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[1] See http://www.ctia.org/resource-library/facts-and-infographics/archive/broadband-subscriptions-US-highest.

performance, both of which address matters of interest to consumers – prices, progress, innovation, investment, service diversity, functionality, and adaptations to each of these over time.[2] In this regard, there is no economic evidence on record showing a market failure. Broadband subscription and investment are increasing, prices are decreasing and quality of service is improving – characteristics not indicative of a market power or anticompetitive risks.

The fact is that the broadband market is competitive and becoming more so. Industry investment is strong and consumers have increased choice. As the broadband market continues to expand in terms of output and penetration, and prices are declining.[3] To date, the Bureau of Labor Statistics' Consumer Price Index for Internet Services and Electronic Information Providers indicates that prices have fallen by half in real terms

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[2] For a clear and detailed discussion of the well-known "structure, conduct, performance" (SCP) frame of reference for assessing market competition among firms, see Donald A. Hay and Derek J. Morris, *Industrial Economics and Organization: Theory and Evidence*, Oxford University Press, especially Chapter 8, pp. 204-261. They conclude that the complexities involved undermines "…the direct causal chain from structure to performance…" And that from a policy perspective, "…emphasis would switch from structure to conduct as a basis for [regulatory] intervention." (p. 260) Also, "...the relationship between industrial structure and price setting over times remains very unclear…it is difficult to avoid concluding that, if any such links do exist, they are far from obvious and unlikely to be powerful…Industrial structure may have an important influence on price procedures….but it does not seem to play a central role in the pattern of price changes that develops through time." (p. 200)
The author of a widely used industrial organization text concluded: "Economists have developed literally dozens of oligopoly pricing theories – some simple, some marvels of mathematical complexity. This proliferation of theories is mirrored by an equally rich array of behavioral patterns actually observed under oligopoly. Casual observation suggests that virtually anything can happen…." F. M. Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally, Chicago, Ill., 1970, p. 131.
An exhaustive survey of the literature on oligopoly market structure began with the following: "Before embarking on the analysis, it is best to provide the reader with a word of warning…there is no single theory of oligopoly… I do not expect oligopoly theory... to give tight interindustry predictions regarding the extent of competition or collusion." Carl Shapiro, "Theories of Oligopoly Behavior," *Handbook of Industrial Organization*, R. Schmalansee and R. Willig (eds) p. 333.
[3] A number of sources report significant price decreases, such as prices falling from $80 to $15 per month. See Jerry Ellig, "Public Interest Comment on Broadband Connectivity Competition Policy," Mercatus Center, Project No. V070000, George Mason University, February 28, 2007; "Wireline Broadband Pricing 2001-2007," United States Telecom Association, Washington, DC, June 2008, available online at http://www.ustelecom.org/uploadedFiles/Learn/Broadband.Pricing.Document.pdf; and J. Gregory Sidak, "A Consumer Welfare Approach to Network Neutrality Regulations of the Internet," forthcoming in the *Journal of Competition Law & Economics*, Oxford Press, Vol. 2:3, 2006, p. 400.

since 1998.[4] Meanwhile, broadband speeds have increased. These market performance statistics (again) suggest no market failure to justify increased regulations.

Based on SEC filings covering the latest three years of operations, the top 10 network service companies have invested over $165 billion. In addition, a study by Darby, Fuhr and Pociask found that network communications companies reinvested 64% of cash flow from operations, compared to 28% for edge companies.[5] The study also found that network companies earned 14% of their cash flow as profits, while edge companies earn 49%.[6] In other words, the broadening and deepening capital formation underway is occurring without extraordinary profits. Moreover, the profits by Internet Service Providers have been generally below the average experienced by the S&P 500.[7] In other words, there is no evidence of excessive profits or market failure of any kind. With modest industry profits, we are at a loss to understand how net neutrality regulations would increase network service revenues and earnings, so that Internet Service Providers could finance increased investment in broadband infrastructure.

Improving Consumer Welfare

If improving economic welfare is a goal of the Commission, and it should be, then a discussion and collection of comments on regulatory remedies should come after identification of market failures. To date, as we have stated, we find no empirical evidence entered into the public record that demonstrates the presence of market failure. However, substantial evidence has been provided that demonstrates that proposed Internet regulations would impede network investment, increase consumer

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[4] BLS CPI-U indexes available at www.bls.gov.

[5] Larry F. Darby, Joseph P. Fuhr and Stephen B. Pociask, "The Internet Ecosystem: Employment Impacts of National Broadband Policy," The American Consumer Institute Center for Citizen Research, Washington, DC, January 28, 2010, p. 24, Chart 4.

[6] Ibid.

[7] Ibid, p. 9, Table 1. Also see "Facts about Market Power and Profits in the Internet Space," ConsumerGram, The American Consumer Institute Center for Citizen Research, October 8, 2009.

prices and reduce consumer welfare.[8] The Commission should insist on empirical evidence of market failures before suggesting remedies to address problems that may not exist.

If the FCC believes that there is a market failure and that Internet regulations should be considered to protect the public's interest, it should quantitatively demonstrate that this is, in fact, the case. Specifically, the FCC should apply an empirically-based cost/benefit standard to justify these new Internet regulations. This cost/benefit standard will provide an assurance to the public that regulatory actions will not reduce social welfare, impede investment nor threaten the deployment of innovative and competitive advanced IP-based services. In the end, policies need to increase consumer surplus and not be concerned with redistributing producer surplus between end and core Internet companies. The latter is not in the public interest.

In terms of Title II regulations, the FCC should avoid reclassifying broadband services, which could one day subject these services to costly common carrier rules, which would stifle investments and innovation in the network.

Regulation is Not Free

There are significant costs associated with communications regulations.[9] Given the flux of technology and uncertainties in the current marketplace, the regulation of services of access providers, or others, will be associated with unforeseen and unintended outcomes which invariably will be costly. Imposing limitations on price

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[8] For example see the essays in *The Consequences of Net Neutrality Regulations on Broadband Investment and Consumer Welfare: A Collection of Essays*, The American Consumer Institute Center for Citizen Research, November 19, 2009. See http://www.theamericanconsumer.org/2009/11/19/aci-releases-a-book-holds-a-capitol-hill-event-the-evidence-on-net-neutrality/.

[9] For example, see Jerry Ellig, Costs and Consequences of Federal Telecommunications and Broadband Regulations, Mercatus Center, George Mason University, February, 2005 (and references cited there); and Jerry A. Hausman, Ariel Pakes and Gregory L. Rosston, "Valuing the Effect of Regulation on New Services in Telecommunications," *Brookings Papers on Economic Activity, Microeconomics*, Vol. 1997, 1997, pp. 1-54, The Brookings Institution, http://www.jstor.org/stable/2534754.

experimentation is sure to affect output, introduce delay, increase uncertainty, add to investment risk and thereby reduce both the rate and likely amount of capital formation on which new services and consumer welfare depend. Given the ambiguities and complexities of measuring cost in a dynamic Internet services environment, as well as the lags and imperfections in measuring costs, new regulations may be the source for substantial dynamic inefficiency and waste. These new costs will flow through to consumers in the form of higher prices, which will dampen demand. These costs would represent government failure, not a market failure. These costs need to be considered in quantifying the costs and benefits of Internet regulations.

Rapid Innovation vs. Regulatory Oversight

Compared to the technical change and speed of innovation found in the private sector, government does not perform as well. As a byproduct of the requirements of good administrative procedures, regulatory processes tend to be slow; conflict resolution is done incrementally; outcomes are often inconclusive and lead to further deliberations; transactions costs are often substantial; and grounds for decision-making are not always known or consistent.

The risk that imposing regulations now could create substantial future uncertainty in the private sector about matters critical to private investment and other elements of market behavior, which could eventually have detrimental effects on innovation and consumer welfare. When regulations are no long needed, it may take years – even decades – for them to be removed. In the meantime, regulatory delay could lead to substantial consumer welfare losses. Any cost/benefit analysis must include these costs to assure that consumer welfare is enhanced by regulations.

Prescriptive Regulations Can Be Costly to Consumers

The cost of *ex ante* regulations, such as proposed net neutrality regulations and those that anticipate market problems, rather than seek to remedy problems, can be very costly to society and should be avoided.[10] These regulations can lead to Type II errors that create more costs than benefits. In order to fully evaluate the effects that Internet regulations will have on consumer welfare, the FCC must consider these costs.

Summary

The FCC should conduct a welfare analysis before imposing any market remedies in the form of new Internet regulations. It should refrain from the imposition of *ex ante*-based regulations, reduce regulatory burdens and encourage experimentation with pricing, services and applications.

Today's communications landscape is rampant with emerging companies, platforms and services that are disrupting, competing and collaborating with each other to offer increasingly faster speeds for Internet service throughout the U.S. economy. Competition – not old monopoly-era telephone regulation – is the best driver of pro-consumer behavior, investment and new innovation.

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[10] "*Ex Post* v. *Ex Ante* Regulatory Remedies Must Consider Consumer Benefits and Costs," The American Consumer Institute, May 14, 2008.