

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

In the Matter of)	
Preserving the Open Internet)	GN Docket No. 09-191
Broadband Industry Practices)	WC Docket No. 07-52

REPLY COMMENTS OF THE AMERICAN CONSUMER INSTITUTE

The American Consumer Institute (“ACI” or “Institute”) hereby submits its reply in response to comments filed with the Federal Communications Commission (“FCC”) respecting the Notice of Proposed Rulemaking in the above-captioned proceeding.

INTRODUCTION AND SUMMARY

The American Consumer Institute is an independent organization founded in 2005. The Institute’s mission is to identify, analyze and project the interests of consumers in selected legislative and rulemaking proceedings in information technology, health care, insurance and other matters. Recognizing that consumers’ interests can be variously defined and estimated, and that numerous parties purport to speak on behalf of consumers, the work of the Institute attempts to differentiate its approach by consistently bringing to bear the tools of economic and consumer welfare analyses as rigorous as available data will allow and taking care to assure that its policy recommendations are based on analyses that reflect relevant and significant costs and benefits borne by, or created for, consumers.

In our initial comments in this proceeding we emphasized the absence of evidence of market failure sufficient to warrant new rate and service regulations as well as the salutary performance of broadband network providers in the absence of regulation – as measured by falling prices, high rates of capital formation, and modest (sub-normal) profits and rates of return. We called attention to consumer welfare enhancing attributes of both price discrimination and two-sided market pricing in this sector and documented their widespread use throughout the economy and within the Internet Ecosystem by Google and others. Finally, we noted the fact of government imperfections and the potential for substantial costs to consumers of unintended and

unanticipated consequences of regulatory delay, ambiguity, uncertainty and risk as they might negatively impact the rate of buildout of broadband networks. We have weighed these conclusions against the evidence in the course of our review of the record – in particular, filings from major players in the net neutrality debate – and find no compelling basis for abandoning or modifying them. Indeed, our examination of the record and our concurrence with Chairman Genachowski’s commitment to a process governed by facts has strengthened our conviction that proponents of the proposed new regulation have failed to present data or other factual evidence to justify new rules. There is no evidence of market failure or abuse of market power to justify new constraints on operators of broadband networks, nor is there any evidence that the proposed rules will stimulate additional investment, innovation or jobs.

Our replies below commence with consideration of areas of consensus, before turning to what we believe to be the decisive issue in this proceeding, namely the extent to which the Commission stays with its announced course of insisting on analysis of facts and data in weighing the record and reaching a decision. We call attention to the central role of facts and data in defining policy goals; the importance of establishing clearly defined criteria for regulatory decision making; and the need to continue assuring consumers and citizens of the Commission’s procedural integrity through the decision phase. We emphasize recognition by Chairman Genachowski of the Commission’s dappled history of success and failures in the context of urging this Commission to balance the potential costs of government imperfections and failures against those perceived to accompany the operation of markets to date or likely occur in the future.

Points of Consensus

There is one point of agreement in the filings. It mirrors that of the National Broadband Plan recently released by the Commission. The Internet Ecosystem is and will continue to be an enormous, broad and deep driver of overall macroeconomic performance of the US economy. All hands appear to agree that it will impel a restructuring of the economy and be the impetus for investment, innovation, jobs, productivity gains, general economic growth and, some say, the source of our continued international leadership.

Stakeholders on all sides agree in principle that the goals of the Commission in this proceeding should be to maintain an environment conducive to investment and innovation in the Internet Ecosystem as the means for achieving ubiquitous, affordable broadband for all Americans. All agree on the pursuit of “neutral” networks. Parties agree in principle that

“consumer welfare” should be the focus for weighing policy alternatives; that the Internet should be “open;” that “reasonable” network management is necessary; that firms within the Commission’s regulatory jurisdiction should be permitted to practice “reasonable” discrimination with respect to “some classes” of network users; and that “workable” competition should continue to be protected and promoted. To be sure, there is some disagreement on each of these points, but these limited and minor exceptions serve to prove the rule.

The disagreement stems not from these laudable goals, but the meaning to be assigned to each of them in the course of setting forth rules to implement consensus goals of national policy. The contention arises in the context of competing views of how the Commission should define each of the terms around which there is consensus: “neutral,” “consumer welfare,” “open” networks, “reasonable” network management, privileges and protections of different “classes” of network users, “reasonable” discrimination, and (most fundamentally) what constitutes a “market failure” that demands remedial government action. The devil is in the details, and those can only be established through diligent pursuit and evaluation of facts and data. Opinions are important of course, but without data and facts and analysis they have modest value where the cost of error is, as it is in this proceeding, potentially so great. We emphasize the need recognized by Chairman Genachowski to balance well known infirmities of government processes against whatever market imperfections the Commission might ultimately find. Finally, we offer a summary of recent ACI, data-rich, fact-based studies on relations among regulation – namely, investment, jobs and innovation – three critical elements of traditional “public interest” analysis.

Role of Facts, Data and Analysis

In a comparative and historical sense, this proceeding is notable in several respects. It brings together matters that just a decade ago would have been considered in the context of separate industry and policy “silos” reflecting technology, economic structures and public interest aspects of different information distribution platforms. Consideration of the Commission’s role with respect to the “Internet Ecosystem” subsumes and blends these issues and then some. Secondly, this very complex “Internet Ecosystem” is young, changing dramatically and has a very uncertain evolutionary path, with or without new rules – a fact that daunts those who claim to know the context of any new rules. Third, as noted above, performance of the sector will continue to be a huge driver of the performance of the US and global economy. Finally, the potential costs of regulatory error are monumental. We cannot afford mistakes. We must get it right so as not to side track the development of this critical national asset.

In this context the pledge of Chairman Genachowski to “...ensure that the rulemaking process will be fair, transparent, fact-based, data driven.” is laudable and encouraging. The Chairman repeated that commitment at the time of the initiation of this NPRM by referring to the launch of a “fact-based” process that would provide the basis for record building and decision making. The process to date has been true to that commitment. The record compiled in this proceeding and in the companion effort to formulate a national broadband plans reflects an enormous, unprecedented in FCC history, amount of data and fact and solid economic analysis of costs and benefits of alternative courses of action. The Commission has done extraordinarily well to date. But, even more important is the Commission’s remaining chore of weighing carefully the quality of evidence reflected (or not) in data, facts and analyses submitted by parties.

Policy Goals, Decisional Criteria, and Procedural Integrity

In keeping with its commitment to a fact-based process and orientation of its consideration of the proposed rules, the Commission will be required to distinguish carefully between facts that are verifiable and opinions which by definition are not. Procedural integrity will turn on the Commission’s success in doing so. While there is an enormous amount of data and fact in the record, much of the record does not reasonably qualify or comply. And, facts are frequently presented in ways and contexts and in analytical frameworks that have to be evaluated for their conformance to generally recognized standards of evidence and proof.

We call attention to the thousands of pages of argument and advocacy centered on what is good or bad in the context of network “openness” or “neutrality” as the main policy goal and figure of merit, or metric used, to measure or evaluate policy alternatives. There is no good metric for measuring openness or neutrality and none is offered. With no definition or metric for making ordinal comparisons of the impact of policy alternatives, attempts to equate or convert or evaluate events related to pricing, network management or other elements of market conduct to degrees of “openness” or “neutrality” are arbitrary in the extreme. The equation or likeness is very much in the eye of the beholder and in no ways quantifiable or given to description by data or empirical means. Such efforts are decisively not fact-based or data driven.¹

¹ Thus, for example, how are fact-based analysts to measure the degree of “openness” or “neutrality” of the proposed rule that permits price discrimination among consumers, but forbids it with respect to applications or content providers? What meaning must be ascribed to “openness” to justify this differentiation? In what sense, consistent with common usage, is the Internet any less “open” if network operators are permitted to manage traffic and to practice pricing principles that are in evidence everywhere in the economy and are especially pervasive among other firms in the Internet Ecosystem? How, if at all, would a similar standard apply to say, American Express credit cards (permission to charge cardholders, but not merchants),

A well known, widely observed axiom of the economic policy community is that the policy goals must be clearly stated.² Otherwise, analysis devolves to discussion of ends rather than means and calls into play alternative paths for which there is no basis for evaluating. There is a troubling disjunction between the Commission’s call for policy analyses based on data and facts, on the one hand, and on the other, its willingness to construe the “public interest” (the statutory standard) as including policy goals expressed in terms like “neutrality” and “openness” that are not defined, cannot be calibrated, and are fundamentally subjective and perceptual – not unlike a Rorschach Inkblot test. The trouble is traceable to the unavoidable fact that claims of merit or costs in the context of goals “openness” or “neutrality” are not amenable to evaluation, testing or contradiction using facts and data. They are not subject to proof or disproof. And, they are nowhere in the record defined by the Commission or their advocates in any but circular, tautological, vague or otherwise subjective ways. Data and facts are inherently objective, while notions of open networks and neutrality are inherently subjective. We urge the Commission to resolve that dilemma as it moves toward a decision.

If the Commission decrees that a particular practice or element of market conduct threatens or is inconsistent with the goal of net neutrality or concludes that permitting it will mean that networks are less open, there is no way to refute that subjective conclusion. Claims about the value of openness or neutrality are incontestable, incontrovertible, immune from data or fact-based refutation, indisputable or unanswerable except with counterclaims of the same sort. To follow the counsel of Free Press and make “...open networks or network neutrality... the cornerstone of America’s broadband policy...” would be to commit evolution of the entire Internet Ecosystem to years of litigation without the benefit of any case law for guidance.³ Net neutrality or openness is an entirely new statutory standard for which there is no legislative guidance or FCC (or other regulatory) frame of reference to guide stakeholders or the Courts. It may well be “arbitrary and capricious.” Parties might disagree, but no amount of data or fact can contest it or prove it wrong.

newspapers or Google (permission to charge end users, but not advertisers)? These are more than rhetorical questions. They go to the heart of procedural integrity and objectivity of the Commission’s decisions.

² The essence of the admonition of policy sciences was anticipated by Lewis Carroll in Alice in Wonderland who observed that if you do not know where you are going, any path will get you there.

³ Free Press, p. 2.

A major challenge for the Commission is to bring to bear the facts and data in the record on objectives – as in the title of this proceeding, “preserving the open Internet” -- that are fundamentally perceptual rather than quantitative. Thus we urge the Commission to consider carefully the probative value – of lack thereof – of arguments and conclusions linked only to representations of their value as means to network openness or neutrality that are not robust policy goals and for which there are no known policy evaluation criteria.

Balancing Imperfections in Markets and Infirmities of Government Regulation

We take recent remarks of FCC Chairman Genachowski as in substantial agreement with the need to take a realistic view of not only market imperfections, but of government imperfections as well. The Chairman recently emphasized the importance when considering new regulations of “getting it right,” while also being candid about the Commission’s mixed history of doing so:

“The Commission’s history in this area holds great examples of success... But there are also examples of failures... In short, at times the Commission has gotten it right, and at times it has gotten it wrong.”⁴

Working with stylized textbook models, it can be shown that both markets and government action are capable of maximizing consumer welfare. In hypothetical worlds of power unchecked by markets or directly by voters; unburdened by incomplete and asymmetric information; shorn of distorted incentive structures; and uncluttered by appreciable external benefits and costs of individual decisions, perfect governments, like perfect markets, generate welfare maximizing outcomes. Not so in the real world.

Imperfections in markets and regulation mean that policies must harmonize and balance the comparative advantages of each. The record in this proceeding calls attention to the infirmities of both, but our reading suggests that market imperfections are cited and analyzed more extensively than government failures.

Markets and government actions fail for the same reasons – information imperfections, perverted incentives, absence of consumer choice among alternatives, externalities, transactions

⁴ Prepared Remarks of FCC Chairman Julius Genachowski, “Preserving a Free and Open Internet: A Platform for Innovation, Opportunity, and Prosperity”, September 21, 2009, online at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-293568A1.pdf.

costs and others.⁵ Market failure or imperfection is not sufficient reason to substitute or to superimpose complementary or corrective government action.⁶

We know pretty well how the Internet Ecosystem performs without the rules proposed in the NPRM, and there is no denying the value of an open Internet, even if there is no agreed definition of what it means. It is clear that there have been a handful of events, isolated events, that would threaten the “open” Internet if in the future they became the rule rather than the exception of the past.

In the Internet environment, government officials, like managers of firms make mistakes. They struggle to overcome what has been called the “illusion of control and predictability of events.”⁷ The struggle is particularly difficult in the context of behavior and performance of the “Internet Ecosystem.” We must consider the possibility, some say likelihood, of the appearance of some forms of government failure in processes put in place to “fine tune” markets. In this context, no less an authority than Professor Joseph Stiglitz, Nobel prize-winner and formerly Chairman of the President’s Council of Economic Advisors recently wrote:

“Anyone who has watched the U.S. government in the last seven years is well aware not only of the possibility of government failure but also of its reality. In some cases it is a matter of incompetence, in others of corruption, in still others it is a result of ideological commitments that preclude taking appropriate actions...Government programs can be subverted.”⁸

Net Neutrality Regulations, Investment, Jobs, and Innovation

Unlike openness and neutrality, the policy implications expressed in terms of impacts on traditional regulatory goals like consumer choice; competition; innovation; jobs; investment; and other legacy “public interest” goals are subject to evaluation using data and facts and traditional forms of economic and policy analyses. They can be addressed quantitatively, albeit imperfectly

⁵ Charles Wolf, Jr., “A Theory of Nonmarket Failure: Framework for Implementation Analysis:” Journal of Law and Economics, Vol. 22, No. 1 (Apr., 1979), pp. 107-139.

⁶ To our knowledge the point was first made more than a century ago: “It does not follow that whenever laissez faire falls short government interference is expedient; since the inevitable drawbacks of the latter may, in any particular case, be worse than the shortcomings of private enterprise.” Henry Sidgwick, *Principles of Political Economy* (1887), p. 414 as cited by Wolfe referenced in note 5.

⁷ See Paul Ormerod, *Butterfly Economics*, Pantheon Books, New York, 2000, especially discussion in chapter 6 -- “Illusions of Control -- of the limits of government regulation in dynamic environments concluding with: “Illusions about prediction are widespread...a great deal of economic policy making...is based upon delusions that prediction and control of the economy are feasible” (at p. 75).

⁸ Joseph E. Stiglitz, “Government and Markets: Toward a New Theory of Regulation”, Government Failure vs. Market Failure: Principles of Regulation, Edward Balleisen and David Moss, Eds., The Tobin Project, (Forthcoming November, 2009), at p. 17. Available online at: <http://www.tobinproject.org/twobooks>.

so. Unlike those in support of “openness” or “neutrality which are fundamentally incontrovertible, statements about the impact of rule changes on these traditional elements of the public interest may be debated in the context of competing viewpoints that can be supported by facts and data.

In recent months we have undertaken to provide facts and data with respect to what we regard as four of the most important and empirically verifiable elements of the consumer welfare and the broad public interest in this proceeding – the state of competition in the broadband market place; the relationship between Net Neutrality regulation and investment; net neutrality regulation and jobs; and, innovation in the Internet Ecosystem. We summarize those briefly below.

The State of Broadband Competition. Much of the case for regulation that goes beyond hollow calls for rules to ensure openness or neutrality is based on claim of market failure derived from characterizations of current structure, recent conduct, and current performance in markets for broadband network services. We tested those claims with data and available facts germane to the matter and found:

Market structure in the current debate is a red herring. It provides no reasoned basis, and certainly none from consumer welfare analysis, for imposing conduct constraints on broadband network providers. Nor for that matter do factual assessments in the context of traditional economic welfare analyses of conduct and performance reveal compelling signs of market failure. Misconduct appears limited to isolated events, while profits (the traditional sign of market power) of broadband network providers are modest by any standard. The telcos and cable companies providing broadband networks earned roughly half the return on capital over the past five years of that earned by the average of the S&P 500 companies (10.7%) and about a quarter of the return on capital earned by Google (19.7%) over the same period. The impetus for regulation must lie elsewhere.⁹

Regulation and Investment. Net Neutrality advocates consistently deny that regulation will have a negative impact on investment despite mountains of evidence linking FCC regulations to adverse impacts on what financial analysts agree are the main determinants of investment for regulated firms -- risk, growth, earnings and future business opportunities. In our rebuttal to claims put forth by Free Press, we expressed full agreement with their admonitions that “Policymakers should look at the data themselves” and that “The FCC must be guided by

⁹ Larry F. Darby, “To Regulate; or Not to Regulate: Where's the Market Failure?” *The Consequences of Net Neutrality Regulations on Broadband Investment and Consumer Welfare: A Collection of Essays*, Released by The American Consumer Institute, November 19, 2009, pp. 76-77.

evidence, not rhetoric.”¹⁰ Following our detailed examination of Free Press claims that net neutrality regulation will not deter network investment, but may, indeed, encourage it, we concluded:

There is no reasoned, factual and analytical basis for concluding that network neutrality rules will not impact the rate of investment in existing broadband networks. Some rules will have more impact than others, but any rule that constrains the ability of firms to pursue business activities that may increase shareholder value will almost certainly affect their allocation of cash to different uses, including domestic network investment... [T]he Free Press conclusion that broadband providers are in fact disinvesting reflects a surprising lack of understanding of the nature of accounting depreciation (a noncash cost) and its relationship to capital investment (a real cash outlay). The two are not economically related and comparing them is meaningless.¹¹

Our rebuttal presents evidence and data refuting the Free Press assertion that the “lack of competition in the broadband sector depresses investment and boosts profits.” We confirm the absence of any evidence that network market power is the source of profit or that profits are excessive. We report SEC data documenting the high rate of investment by network operators. Finally, the rebuttal highlights the illogic, in a traditional financial analytical framework, of the Free Press suggestion that net neutrality rules are needed to ensure investment in applications and services. We concluded on that point an obvious but frequently ignored fact: “...since the value of investment in applications and services is directly and critically dependent on the presence and quality of networks, rules that suppress network investment will also reduce the value of investment in applications and services.”¹²

Net Neutrality Regulation and Job Creation/Preservation. A major challenge to all government economic policymakers is to fashion actions that will create or preserve – but do nothing to destroy – jobs in the context of lingering, stubbornly high, and politically unacceptable rates of unemployment. While monetary and fiscal policies are the traditional instruments for redressing them, the consensus is that employment rates will not respond quickly enough to those. Thus, there is some urgency for exploring other paths. With that motivation, we undertook to explore financial and economic principles linking Net Neutrality style regulations, investment and jobs. We presented data (filed by firms with the Securities and Exchange Commission) depicting the employment record of broadband network providers and selected applications providers, then

¹⁰ S. Derek Turner, “Finding the Bottom Line: The Truth About Network Neutrality & Investment,” Free Press, October, 2009. Online at: http://www.freepress.net/files/Finding_the_Bottom_Line_The_Truth_About_NN_and_Investment_0.pdf.

¹¹ Larry F. Darby, “The Informed Policy Maker’s Guide to Regulatory Impacts on Broadband Network Investment.” Online at: <http://www.theamericanconsumer.org/wp-content/uploads/2010/02/fp-crit-aci.pdf>

¹² Ibid.

projected those relationships into the future as guides to the potential responses of firms in the Internet Ecosystem to Net Neutrality type regulatory interventions. We concluded:

In short, these [proposed “net neutrality”] regulations will shift risk, returns, growth and opportunity away from “core” network providers and in favor of “edge” applications and content providers. SEC data show that, historically, “core” companies earn at lower rates, invest more and create more jobs per dollar of value received in the market than do “edge” companies. Regulation that shifts value away from network providers to non-network providers will reduce investment in network infrastructure and citizen access to broadband while dampening creation and preservation of jobs. This conflicts with consensus requirements of a National Broadband Policy and with our macroeconomic policy goals.¹³

Innovation in the Internet Ecosystem. A recurring theme in the briefs of net neutrality advocates is the primacy of innovation at the “edge” (not otherwise defined, but referring in the main to applications and content providers) and the potential negative impact thereon of failure to adopt net neutrality oriented regulatory provisions. After surveying the literature and deriving a definition of innovation (notably absent in advocates claims), we concluded:

This study finds no support in theories of innovation, innovation practice, or reviews of numerous empirical studies, of drivers of and constraints on innovation, for the main contentions of net neutrality supporters. Available data and analysis do not establish: a) the absence of network innovation in general; b) the primacy of innovation at the edge over the core, or most importantly; c) that greater *ex ante* regulation of markets for broadband infrastructure is needed, or can reasonably be expected to increase the rate of innovation and consumer welfare creation by network providers and elsewhere in the Internet Ecosystem.¹⁴

CONCLUSION

A fair reading of the facts and data and analysis put forth by Net Neutrality advocates in briefs urging the Commission to impose new regulations on broadband network providers compels the Scotch Verdict: “Case not proven!”

¹³ Larry F. Darby, Joseph P. Fuhr, and Stephen B. Pociask, “The Internet Ecosystem: Employment Impacts of National Broadband Policy, January 28, 2010. Online at: <http://www.theamericanconsumer.org/wp-content/uploads/2010/01/aci-jobs-study-final2.pdf>. Copy attached to this filing.

¹⁴ Larry F. Darby and Joseph P. Fuhr, “Innovation and National Broadband Policies: Facts, Fiction and Unanswered Questions,” March 2, 2010, p. 2. Released by The American Consumer Institute Center for Citizen Research, online at <http://www.theamericanconsumer.org/wp-content/uploads/2010/03/innovation-final.pdf>. Copy attached to this filing.