# The Economics and Law of Net Neutrality

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## INTRODUCTION

For roughly a decade a massive debate has been waged over the merits of economic regulation of the Internet. Simplified, but with no real inaccuracy, the debate has largely been one between partisans from two ideological camps. One camp passionately champions treating Internet infrastructure as if it were a public utility and regulating it as such under Title II of the Communications Act. The other camp, equally passionate, argues that the consequence of extending a Title II suite of regulations to Internet-based communications services would deal a crushing blow to both investment and innovation. While the partisans have held fast to their positions, a series of court battles have increasingly led many to conclude that, by either legislation or brutish regulatory efforts, the nation must choose to endorse one camp or the other. Under this thinking, policy is doomed to move forward along one of two extreme trajectories – either by providing a *laissez faire* green light to the emergent communications platform of the 21st century, or by extending a telephone-centric 20th century regulatory framework into the new and vibrant Internet ecosystem. The partisans have, however, established too narrow a set of choices for Internet governance.

## ANALYSIS

Plainly stated, the "sailing between Scylla and Charybdis" choice is inapt. Section 706 of the Communications Act provides the FCC with the authority to use "regulatory methods" to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans." Section 706(b) also charges the Commission with "determin[ing] whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion." This language provides a clear policy tool to regulators for establishing Internet-related regulations under existing law.

The mere fact of legal authority, however, does not necessarily make the economic case for exercising that power. In this instance, however, Section 706 provides for a congruence between legal authority and sound economic policymaking. By setting the FCC's sights on output, Section 706 actually enables the FCC to both spur investment and innovation along the Internet value chain, and to guard against anticompetitive behaviors. The reason is that while corrective economic policy analysis more routinely focuses on price-elevating consequences of monopolistic behavior the corollary economic metric (and policy lever) to price is output, which is conveniently inscribed into Section 706.

Consider the following. Monopolies raise price – and *reduce output*. Anticompetitive oligopolistic practices that elevate prices are achieved by *reducing output*. And price discrimination that diminishes economic welfare *reduces output* relative to uniform pricing.[1] Thus, a suite of regulations premised on increasing output is by its very nature capable of ensuring competitive behavior. The reason is that the way in which anticompetitive price increases are affected, either by unilateral firm behavior or by collusive practices, is by reductions in output.[2] In this way, the output-centric Section 706 smartly aligns the economic policy rationale for Internet governance with the traditional, policy-proven antitrust tools that focus on the output-altering effects of firm

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[1] See, e.g., Hal Varian "Price Discrimination," in *Handbook of Industrial Organization*, Richard Schmalensee and Robert D. Willig , Eds., Volume 1, 1989, pp. 597-654, stating that a necessary condition for economic welfare to increase in the presence of third-degree price discrimination "is that total output increase." (p. 621)

[2] See, e.g., Phillip Areeda, Louis Kaplow and Aaron Edlin *Antitrust Analysis: Problems, Text and Cases*, 5th Edition, 2004, stating that relative to competitive firms a monopolist "contrives a scarcity of its product. It 'withholds' some output from consumers to raise price and thereby maximize its personal gain at the expense of society." (p. 13)

behaviors.  While less familiar than traditional public-utility-style price regulation embodied in Title II, the authority in Section 706 provides regulators a more economically sound, pro-growth basis for  assuring that firm behavior  promotes output -- deployment and expansion of Internet infrastructure and advanced telecommunications services – which is by definition not possible if firms engage in anti-competitive behavior.

Importantly, an output-centric 706 approach allows the nation to move forward without *ex ante* Title II regulatory rules imported from an era of public-utility regulation of telephone service.  Imposing such *ex ante* rules risks proscribing novel, but output-enhancing, business practices, sweeping them in with anticompetitive practices that should be halted.  And, such extensions of the traditional regulatory apparatus to innovative services that blend voice, data and video features would create the profound risk of stifling the rich innovation that has become the hallmark of the high-tech sector.

And just as surely, the output-centric Section 706 approach provides regulators with sufficient teeth under existing law to halt business behaviors that constrict outputs and retard the deployment of advanced telecommunications services from those we would expect in a competitive environment. In particular, with burgeoning demand for new voice, video, and data communications anytime, anywhere, and on any device, output growth should be a normal feature of a well-functioning Internet eco-system.  This feature is reinforced by the routinization of innovation which should be expected to produce a flow of more, better and faster services and applications.[3]

[3] See William J. Baumol *The Free-Market Innovation Machine: Analyzing the Growth Miriacle of Capitalism*, 2002; Larry Downes and Paul Nunes *Big Bang Disruiption: Strategy in the Age of Devastating Innovation*; and Larry Downs and John W. Mayo "The Evolution of Innovation and the Evolution of Regulation: Emerging Tensions and Emerging Opportunities in Communications, working paper, 2014.

Against this backdrop, a vigilant FCC may use its Section 706 authority to ensure the continued growth in output and deployment of advanced telecommunications capabilities. And, it can use this authority with full force to take corrective actions in the event of untoward actions by firms that retard output. If for instance, a provider of Internet access service were to undertake anticompetitive behaviors that subsequently denied the ability of Internet edge providers to expand investment, this denial would *discourage* rather than, as indicated in Section 706, "*encourage"*, the "deployment on a reasonable and timely basis of advanced telecommunications service to all Americans." In such instances, the enforcement authority of the FCC under Section 706 would become both relevant and apt.

## CONCLUSION

While the specific manifestations of a Section 706 regime for enshrining the Open Internet principles into the law of the land will need to be developed, a 706-fulcrum for Internet governance appears to be both legally within reach and smartly centered on the effects of Internet eco-system providers on output. The path forward is not a choice between Scylla and Charybdis. Applying Section 706 steers us away from the pitfalls of either a completely unregulated internet or last century's public utility regulation model. Instead, the navigable waters of Section 706 create the opportunity for both maximizing output and economic welfare while also protecting the public against anti-competitive harms.