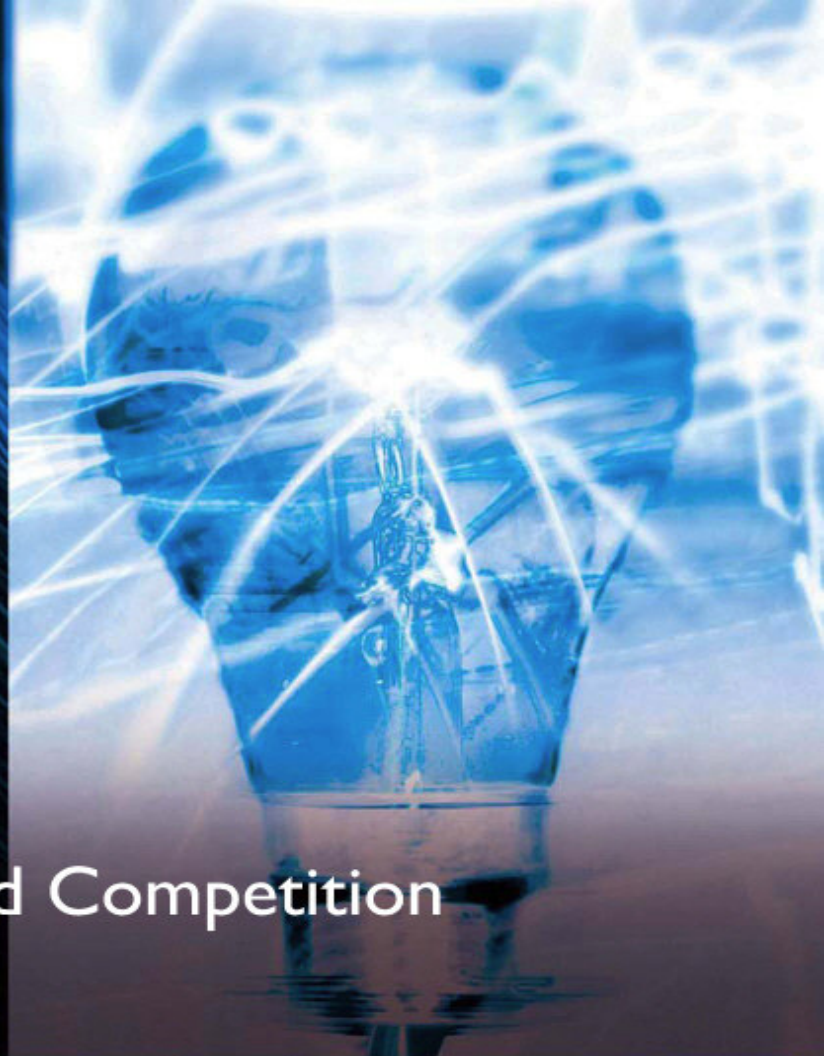




Intellectual Property and Competition Policy Papers

Staying in Neutral: European Implications of the Network Neutrality Debate

By Simon Moore



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“When I invented the Web, I didn't have to ask anyone's permission. Now, hundreds of millions of people are using it freely. I am worried that that is going to end in the USA.”¹ So began a blog by Sir Tim Berners-Lee in June 2006, in response to the failure of an amendment that would have legally guaranteed net-neutrality to pass through the subcommittee stage of the House of Representatives. With such respected and influential figures wading into the debate and expressing such vehement concern, the perceived seriousness of the topic is not in question. Nonetheless, American legislators made their view abundantly clear, and despite vociferous protestations from parts of the Democratic Party and from IT companies, the draft was comprehensively defeated.²

All, however, is not quite as it seems. That the issue has become a political hot potato in the US while remaining largely depoliticised in Europe indicates that the core argument is not about the universal themes of freedom versus governmental or corporate oppression, but centres instead on unique characteristics within each market, particularly the inefficiency of the American domestic telecommunications sector in generating competition to a sufficient standard to render neutrality concerns moot. Understanding this will enable legislators to avoid pushing egregious and ill-conceived regulatory devices and instead focus on the competitiveness of the market.

Europe, for its part, observed quietly as the storm raged in the US. While any changes to the American Internet structure would not directly affect European consumers, it may spur European governments and the EU to examine whether the current structures are the best means for fostering competition and innovation in the industry. The European Commission issued a statement notifying its intent to “closely monitor attempts to call into question the neutral character of the Internet”, but has thus far refrained from introducing legislation to mandate this, preferring instead to rely on restraint from, and competition

¹ Berners-Lee, Tim; 'Net Neutrality: This is Serious' (21st June 2006); Cambridge, MA; 2006; <http://dig.csail.mit.edu/breadcrumbs/node/144>

² The amendment was lost by 269 votes to 182. BBC News; 'Defeat for net neutrality backers' (June 9th 2006); London; 2006; <http://news.bbc.co.uk/1/hi/technology/5063072.stm>

among, telecoms providers and on the spirit of existing regulations to guide its course.³ It has therefore been left for American legislators, lobbyists and thinkers to conduct the debate.

The concept of network neutrality is difficult to pin down to a specific definition. Its conventional usage refers to a range of interlinking ideas about how the Internet does and should operate. Politically, it has come to embody the idea that Internet Service Providers (ISPs) may offer differentiated [i.e. non-neutral] levels of access to and for particular Internet applications (the world wide web, voice-over-IP (or VOIP) telephony, or online gaming), or particular subdivisions of these applications (specific websites or software programs). This, in turn, has spread into a regulatory discussion about how much, if any, influence government should have over the operation of the Internet. The situation was exacerbated by an inflammatory - and now notorious - interview given by AT&T CEO Edward Whitacre to *Business Week* in November 2005, which led some activists to foretell an Internet vastly different from the one seen up until now. An Internet where telecoms companies (telcos) get to determine winners and losers in the provision of Internet-based services, rather than allowing end-users to exercise choice in whose services they utilise.⁴ Telcos, the contention goes, would become an impediment to application innovation, favouring established players who could contribute fees to enable preferential treatment at the expense of new (and, by implication, more innovative) startups.

The significance of the Internet to economic output, particularly in most developed countries, is evident without any proof. In an 'information society', the rapid access to knowledge the Internet provides can account for billions of Euros across the European economy.⁵ Internet access facilitates business in the 21st century in the same manner as good roads and canals did in the Industrial Revolution, or as telephony and air travel did in the 20th century, enabling trade to be conducted worldwide, and instantaneously.

Europe's 'Lisbon Agenda', agreed by heads of government in 2000 to make the EU "the most dynamic and competitive knowledge-based economy in the world" by 2010, is hugely dependent on investment in communications technology. Without continuous improvements in Internet capabilities, its high-tech, web-based and knowledge-based industries will not be able to attain the growth needed to reach the

³ European Commission; 'Towards a global partnership in the information society: Follow up to the Tunis phase' (April 27th 2006); Brussels; 2006; http://europa.eu.int/information_society/activities/internationalrel/docs/wsis/communication_wsis_follow_up_final_en.pdf; pp5

⁴ When asked "How concerned are you about Internet upstarts like Google, MSN, Vonage, and others?", Whitacre's response was "How do you think they're going to get to customers? Through a broadband pipe. Cable companies have them. We have them. Now what they would like to do is use my pipes free, but I ain't going to let them do that because we have spent this capital and we have to have a return on it. So there's going to have to be some mechanism for these people who use these pipes to pay for the portion they're using. Why should they be allowed to use my pipes? The Internet can't be free in that sense, because we and the cable companies have made an investment and for a Google or Yahoo! or Vonage or anybody to expect to use these pipes [for] free is nuts!"

O'Connell, Patricia; 'At SBC it's all about "scale and scope"' in *Business Week* (November 7th 2005); http://www.businessweek.com/@n34h*!UQu7KtOwgA/magazine/content/05_45/b3958092.htm

⁵ For instance, a study by risk-management consultancy mi2g concluded that Internet access accounted for some 62% of annual GDP (1.2% of the annual GDP each week) of a developed nation (Switzerland was the case study used). Mi2g; 'More than 1% GDP drop estimated per week of Internet blackout' (July 22nd 2005); London; 2005; <http://www.mi2g.com/cgi/mi2g/frameset.php?pageid=http%3A/www.mi2g.com/cgi/mi2g/press/220705.php>

Agenda's targets.⁶ Yet this cannot come from nowhere. Someone has to pay to construct the infrastructure necessary for this to all take place. So far, in Europe, telecoms companies have borne the brunt of this investment cost, with occasional government subsidy or regulation incentivising investment into rural and remote locations. However, without the ability to recoup their costs, these investors may be driven away.

The difficulty in discussing network neutrality in this instance occurs in separating it from more fundamental issues regarding the structure of the various telecommunications markets. Without an understanding of how developed telecoms sector competition is, it is impossible to gauge how hysterical pleas for network neutrality legislation are.

In the US, the dismantling of the national AT&T monopoly in 1974 led to the creation of a group of regional monopoly providers (the so-called 'Baby Bells' or RBOCs – regional Bell operating companies). These firms were originally precluded from offering 'long-distance' (i.e. inter-state) services, with the intent of opening up the long-distance market to new competition.

In 1996, the 'Telecom Act' facilitated a second stage of reform. Local (intra-state) markets were opened up to competition, with the RBOCs being granted permission to get into the long-distance market once their region's local market had been liberalised. At this stage, concerns about the success of the second wave of liberalisation became more vociferous. The RBOCs' position as incumbent monopolies in each of their respective regions had not been seriously attacked since the days when they were a single state-sponsored entity and without a more forceful state-backed dismantling of the originally state-created monopoly, these firms were able to successfully shield the sector from any noteworthy competition. Over the course of time, many of these RBOCs have consolidated again under the AT&T umbrella. However, the changing nature of consumer demand, and particularly, the vast increase over the past five years in broadband Internet connectivity, alongside the merging of long-distance and local markets into a single entity has blurred these earlier distinctions.

A further factor in the broadband market is the prevalence – much greater than in Europe – of cable television, which acts as a further broadband provider. What this leads to is "a series of non-overlapping geographically specific duopolies for wired broadband services at the retail level in most parts of the United States"⁷. According to Marcus, by late 2005, no cable TV provider or 'incumbent local exchange carrier' (ILEC, as distinct from 'competing local exchange carriers' or CLECs) had been motivated to compete outside their respective incumbent geographical terrain.

⁶ European Commission; 'Facilitate innovation, the uptake of ICT and the sustainable use of resources'; Brussels; 2004; http://ec.europa.eu/growthandjobs/areas/fiche06_en.htm

⁷ Marcus, J. Scott; 'Is the US Dancing to a Different Drummer?' in *Communications & Strategies* (#60; 4th Quarter 2005); Montpellier, France; 2005; http://www.idate.fr/fic/revue_telech/132/CS60%20MARCUS.pdf

Both sides in the US network neutrality debate observe some key symptoms, but neither seems capable of offering an appropriate cure. Telecoms providers have little interest in engendering competition in an industry they control. They are able to reject calls for further regulation under the guise of libertarianism, with a fair degree of success, but they betray this cause by seeking to maintain advantages gleaned from their status as a single state-guaranteed monopoly 30 years ago. Net neutrality activists, meanwhile, observe the problems this lack of competition causes (what they might see as the ability of telcos ‘to hold content providers to ransom’), but fail to recognise its real cause. Rather than aim for liberalising the telecoms sector through the removal and rejection of the old advantages the Baby Bells had at their conception, instead take the route of least resistance and request further regulation on top of that which already exists. In the end, both sides are misguided, and ultimately harmful to consumers and to business. True liberalisation of the telecoms market is the only way the industry can progress.

In Europe, meanwhile, the situation is far rosier. Through a mixture of national and EU-led liberalisation moves, telecoms networks are much more amenable to competition. Without having the crutch of multiple media formats (e.g. cable and wired telephony) between which to encourage competition, Europe was obligated to nurture it within the telecoms broadband sector – something which the US chose not to do. Through local loop unbundling efforts, numerous rivals operate in the market. As a result, none of them feel bold enough to gamble on consumer tastes by dropping neutral access to all parts of the Internet. The UK is particularly well-off in this regard, but the situation in almost all of Europe is markedly better than in the US.

In early 2006, the EU formally warned German market leader Deutsche Telekom in the wake of its attempts to receive regulatory protection from competition from the German government “in order to develop a faster DSL connection”, under existing internal market provisions.⁸ Deutsche Telekom, and Italian market leader Telecom Italia have openly lobbied the EU for the right to charge content providers for access to their service, which has led to the EU initiating a consultation on the net neutrality issue for late 2006. However, it seems unlikely to result in legislation, with the European Commissioner having already expressed a preference for allowing competition to resolve the issue.⁹ The EU has let it be known that it expects certain minimum service levels within the industry, rumoured to include network neutrality. This desire would prove moot anyway if levels of competition in the industry are deemed satisfactory. Telecom Commissioner Viviane Reding has already announced that, “the moment the market is open we can scrap the rules or phase them out”.¹⁰

⁸ *Deutsche Welle*; ‘EU Threatens Sanctions Over Protection Request by Telekom’ (March 14th 2006); Bonn; 2006; <http://www.dw-world.de/dw/article/0,2144,1933722,00.html>

⁹ *Communications Daily*; ‘EC Urges Regulatory Revisions for Telecoms Market’ (June 30th 2006); Washington, DC; 2006; <http://www.ectaportal.com/en/upload/File/Inthenews/communicationsdaily.pdf>

¹⁰ *Ibid*

Indeed, the EU's attitude to this problem has been largely commendable. It has operated with a light touch, unlike the heavy-handedness witnessed in the US in the form of the (now defeated) House amendment. Its regulatory responses, meanwhile, have been largely designed to undo the competitive imbalances created by large state-built national monopolies dating from the early years of telephony. It has avoided penalising companies who have achieved market share through sound business practice as opposed to state-instilled monopoly, and has encouraged the divestiture of these companies in a manner that is conducive to freedom of competition.

Practically speaking, legislating for network neutrality is riddled with problems. Most obvious among these is the dilemma of how one can legislate against 'bad' filtering or prioritisation of data (as attempts to prioritise or de-prioritise certain specific services such as Voice-over-IP (e.g. Skype) have occasionally been cast by neutrality advocates) without also proscribing 'good' filtering such as anti-spam mechanisms or the blocking of virus/worm traffic. Europe has been wise to avoid getting embroiled in such technicalities. The US would be prudent to follow this lead.

The policy implications of the US debate to EU lawmaking need not be overwhelming. The most pronounced effect of network neutrality's controversy will be to increase its prominence as a topic of concern, for those on both sides of the argument. This should not be allowed to transfer itself to a position of comparable prominence on the EU's legislative agenda. Great virtue is to be found in the way the EU has so far conducted itself. The most advantageous course of action is that it not yield in this behaviour to those who would have it legislate further, merely to demonstrate that it has recognised the issue. Monitoring the internal market in telecommunications and enhancing the amount of cross-border competition in the communications sector are appropriate uses of resources. So far, they have brought great success, demonstrated most effectively by the fact that network neutrality has been mostly kept away from the policy agenda.

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