



May 23, 2006

The Honorable James Sensenbrenner
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, D. C. 20515

The Honorable John Conyers
Ranking Member
Committee on the Judiciary
U.S. House of Representatives
Washington, D. C. 20515

Dear Chairman Sensenbrenner and Ranking Member Conyers,

We strongly support H.R. 5417, the Internet Freedom and Non-discrimination Act and urge its adoption during the Committee's markup this Thursday. The Judiciary Committee's active involvement in revision of the Telecommunications Act is essential to the growing debate over the future of the Internet economy, broadband services and network neutrality.

As the Committee well knows, antitrust action was center stage in shaping the contemporary telecommunications industry and it should remain so. The increasing market power and the record of anti-competitive practices of the telephone and cable industries that own and control broadband networks should likewise be the central focus of policies favoring network neutrality. Unfortunately, those critical issues have largely been obscured in the current debate over restoration of the nondiscrimination rules for broadband networks that were eliminated just last year by the Federal Communications Commission.

The telephone and cable industries fighting efforts to reinstate critical nondiscrimination rules for broadband networks have instead cloaked the issue in anti-regulatory rhetoric, ignoring the crucial and historical role of nondiscrimination regulations in promoting a more competitive and efficient telecommunications sector and protecting consumers from the anticompetitive practices of dominant market players. Indeed, the Internet has become the engine of innovation and economic growth precisely because nondiscrimination rules applied to communications networks, preventing network owners from using their market power to exclude competitors.

Attached is a more in-depth analysis of the important historical role of antitrust law and principles in policing the anti-competitive behavior of telecommunications network owners and the applicability of antitrust principles to the growing debate over how and whether broadband network owners should be allowed to discriminate today.

Thank you for your leadership in refocusing the debate on core antitrust issues. We urge your swift action to favorably report H.R. 5417 and restore broadband network neutrality to the nation's communications sector.

Sincerely,

Mark Cooper
Director of Research
Consumer Federation of America

Gene Kimmelman
Vice President,
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Consumers Union

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Policy Director
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NETWORK NEUTRALITY: THE NEED FOR AN ANTITRUST-BASED BAN ON NETWORK DISCRIMINATION

BACKGROUND

History, law and economic analysis support an antitrust-based ban on discrimination in interconnection and carriage for broadband networks.

The obligation of nondiscriminatory interconnection and carriage in the telecommunications industry goes back almost a century and has been codified under the Communications Act. In fact, the obligation of nondiscrimination in access to the means of transportation and communications stretches back through the founding of the Republic to the English common law that many of the nation's settlers brought with them to America.

However, this principle also has a basis in the most significant antitrust action taken under the Sherman Act to alter the shape of the communications industry. The decisive action of the federal courts applying antitrust law in breaking up the national telecommunications monopoly and the simultaneous imposition conditions of nondiscriminatory access to the local telephone exchange market were vital in promoting the competition we enjoy in parts of the communications and information sectors today.

Those conditions codified in the Telecommunications Act of 1996, have been responsible for the miraculous growth of the Internet economy and were, until recently, applied to the broadband network of the future. However, the 2005 decision of the Federal Communications Commission (FCC) to abandon these conditions and the principle of network neutrality for broadband has proven harmful for consumers and threatens the innovations driven by the open platform of the Internet. The 1996 Act did not contemplate the elimination of these vital conditions and, in fact, contemplated their continuation and extension to local exchange markets in order to develop vibrant competition in telecommunications services. In order to promote competition, protect consumers and ensure market driven innovation, the House and Senate Judiciary Committees must act swiftly to restore network neutrality to the nation's communications sector.

HISTORY AND LAW

January 24, 2006 marked the 50th anniversary of the Final Judgment in *U.S. v. Western Electric Company, Inc. and American Telephone and Telegraph Company Inc.* About two weeks later, we marked the 10th anniversary of the Telecommunications Act of 1996. Those two landmark events in the history of the American telecommunications industry are linked together by the 1982 Modification of Final Judgment (MFJ) in the AT&T Case. The 1996 Act adopted

the essence of the MFJ and preserved the involvement of the Department of Justice in oversight of the key competitive aspects of the law.

Title I of the MFJ broke AT&T up into local and long distance companies, a classical antitrust remedy. Title II forbade the newly divested Bell Operating Companies (BOCs) to “provide interexchange telecommunications service or information services,” thereby fencing off the potentially competitive interexchange and information service sectors from the market power in the local exchange market.

Title II of the MFJ also imposed obligations of nondiscriminatory interconnection and access on the BOCs:

Subject to Appendix B, each BOC shall provide to all interexchange carriers and information service providers exchange access, information access, and exchange services for such access on an unbundled, tariff basis, that is equal in type, quality, and price to that provided to AT&T and its affiliates.

No BOC shall discriminate between AT&T and its affiliates and their products and services or other persons and their products and services in the:

- 1. Procurement of products and services*
- 2. Establishment and dissemination of technical information and procurement and interconnection standards;*
- 3. Interconnection and use of the BOC’s telecommunications services and facilities or in the charges for each element of service; and*
- 4. Provision of new services and the planning for and implementation of the construction or modification of facilities, used to provide exchange access and information access.*

The federal courts applying antitrust law and reviewing an antitrust consent decree imposed this strong mixture of antitrust structural separations and communications-like regulation as part of its remedy for good reason: Communications infrastructure is the bloodstream of the information economy. The local exchange network, in today’s parlance – the last mile and the central offices to which they are connected – was and is the essential bottleneck facility at the heart of this infrastructure.

Over the years of its jurisdiction, the federal court overseeing this antitrust case lifted the prohibition on provision of information services and issued a number of other waivers to the bar on provision of service. But it never lifted the obligation of nondiscrimination in interconnection and exchange access that is equal in type, quality, and price.”

When the Congress passed the Telecommunications Act of 1996, it provided a mechanism for lifting the structural separation between local and long distance service, but there was no intention, implicit or otherwise, to abandon this fundamental principle of

nondiscrimination. Indeed, Congress actually moved in the opposite direction, extending the principle of nondiscriminatory access to unbundled network elements within the local exchange in the hope of stimulating local competition.

Through a convoluted and litigious course of misinterpretation of clear congressional language, the Federal Communications Commission has attempted to repeal the principle of nondiscrimination. It refused to extend the obligation of interconnection and equal access to the telecommunications services offered by cable operators. That interpretation was rejected twice by federal courts of appeals. When the issue arrived at the Supreme Court after five years of litigation, the Justices reversed the lower court, not on the basis of sound public policy, but rather in deference to agency discretion.

In other words, one of the most vital principles of antitrust and communications policy was reversed through the back door. The FCC quickly moved to extend this misinterpretation to the telephone companies by removing the obligation of nondiscriminatory interconnection and access from the telephone companies' broadband networks.

The abandonment of such a fundamental principle of the MFJ and communications law without Congressional action has become the subject of intense debate over the significance of a guarantee of "network neutrality" to ensure the future growth of the Internet. Given this background, the examination of this issue by the Judiciary Committee is not only appropriate, but also critically important.

INDUSTRY STRUCTURE, COMPETITION AND THE PUBLIC INTEREST

More than the legal history and the antitrust laws counsel for a close look at this issue by the Judiciary Committee. The key arguments offered by those advocating abandonment of this principle are essentially claims about the extent of competition in the exchange access market and the incentives of an entity that is vertically integrated across markets with radically different levels of competition. In essence, these are the very same issues that were in play when the federal court imposed the conditions under the antitrust laws a quarter of a century ago.

In economics an expression to describe competition in markets is – "four is few, six is many." When there are fewer than the equivalent of roughly six, equal competitors, a market is considered highly concentrated because economic theory, empirical evidence and a century of practical experience show that markets that are this concentrated do not perform well. In highly concentrated markets, prices are set above costs and innovation declines. With so few competitors, it is easy to avoid vigorous, head-to-head competition, especially when each uses a different technology, specializes in a different service, or concentrates on a different geographic area or user sector.

This concern is heightened for communications facilities, which have characteristics of public goods and economies of scale (as well as other barriers to entry). This means that the number of competitors is likely to be very small. These facilities are also considered infrastructure, which means these industries support a wide range of activities and the external benefits they generate are large are indirect and diffuse. There are many complementary

activities and vertical linkages to other sectors in the economy. Communications is a network, which exhibits strong network economies. In contemporary terminology, they are called platforms. In short, competition at the core of these industries is very feeble, but their influence stretches far and wide. The risk of the abuse of market power is substantial and the harm it may cause is profound.

Public policy must carefully assess where competition can be sufficient to provide the dynamic benefits that we expect from it and where it will not be sufficient to protect the public and promote dynamic innovation. This is precisely what the Court did 24 years ago. This is the balance that the FCC failed to preserve in its 2005 decision to eliminate the obligation of nondiscrimination in broadband.

The fact that the network operators are vertically integrated and seeking the right to discriminate poses a special concern for competition in the complementary markets – Internet services, applications and content – that rely on the network to reach the consumer. The potential to leverage market power in last-mile facilities to favor affiliates and advantage partners at the expense of competitors is very real. Of course, that was the core of the case against AT&T.

More importantly, the Baby Bells seem to have inherited their mother's tendency and inclination to leverage their market power to prevent competition and extend their reach. During the decade of failure to create competition in the local market, they consistently sought to undermine entry of local competitors. As a result, they were fined billions for failing to treat competitors fairly. In broadband, given their ability to discriminate and exclude access to the last mile, network owners have a strong incentive to raise costs for competing service providers and tie more competitive services to less competitive offerings. If the obligation of nondiscrimination is lifted, the behavior will only get worse, but the fines to police the behavior will no longer be available.

THE PERSISTENT PROBLEM OF MARKET POWER IN NETWORK FACILITIES

In the emerging, converging world of 21st century communications, prospects for vigorous competition in the local segment of the industry are not good. At present, there are only two local, last mile communications networks that can provide a fully functional broadband network to the residential consumer – the incumbent local telephone companies and the incumbent cable operators. Two is not a sufficient number to ensure vigorous competition, and both sets of incumbents have a troubling record of anticompetitive, anti-consumer behavior.

The best hopes for a third, last mile alternative were undercut when regulators allowed the most likely candidate – wireless – to be captured by dominant wireline firms through ownership or joint ventures. It stretches credible expectation to assume that a wireless provider owned by an incumbent Bell company, or in partnership with a cable giant, will market a wireless broadband product that directly competes with its wired product. They will offer premium, supplementary services to be sure—but it will not be a true third broadband competitor. Hope and hype surrounding other technologies cannot discipline anticompetitive and anti-consumer behavior where no real alternatives exist. Mergers such as that proposed by

AT&T and BellSouth will only make matters worse. No company with sufficient market power to set monopoly rents will fail to do so absent proper public policy protections. On the current trajectory, consumers are falling into the grip of a “cozy duopoly” of cable and telephone giants that will abuse its market power, abandon its social responsibility and retard the development of our 21st century information economy.

The danger of relying on a “cozy duopoly” is already apparent. The harm has already been done, and its impact is severe. America has fallen behind in the global race to the broadband future, not because there is inadequate incentive to invest or because we are less densely populated than other nations, but because there is inadequate competition to push the “cozy duopoly” to deploy attractively priced services and unleash the Internet economy to develop consumer-friendly services.

If future prospects are determined by our success in the broadband market (which few analysts deny), our current position is untenable. We are now 16th in the world in broadband penetration. Virtually none of our broadband lines can sustain even 1 megabit per second of speed in both directions—up and down the network. We pay \$15-\$20 per megabit for download speed—20 times more than the global leaders. The current jostling to attract upscale consumers with big bundles of services leaves the majority of Americans behind. On a per megabit basis Americans pay five to twenty times as much for high-speed services as consumers in many other nations. Is there any doubt that the primary cause of the broadband digital divide is price? Now, after leaving the American consumer in a serious predicament, the network giants are insisting on the right to discriminate against content, applications, and services on the Internet, as blackmail for building broadband networks.

REINSTITUTING THE PRINCIPLES OF THE MODIFIED FINAL JUDGMENT

The evidence overwhelmingly supports the proposition that the court got it right in the MFJ and that Congress never contemplated that a principle as vital as network neutrality would be abandoned through an administrative back door that rest on agency discretion, not a proper evaluation of the public policy merits.

The Judiciary Committee should restore the balance the federal court sought under the antitrust laws by adopting H.R. 5417:

SEC. 28. (a) It shall be unlawful for any broadband network provider—

(1) to fail to provide its broadband network services on reasonable and nondiscriminatory terms and conditions such that any person can offer or provide content, applications, or services to or over the network in a manner that is at least equal to the manner in which the provider or its affiliates offer content, applications, and services, free of any surcharge on the basis of the content, application, or service;

(2) to refuse to interconnect its facilities with the facilities of another provider of broadband network services on reasonable and nondiscriminatory terms or conditions;

- (3)(A) to block, to impair, to discriminate against, or to interfere with the ability of any person to use a broadband network service to access, to use, to send, to receive, or to offer lawful content, applications or services over the Internet; or
- (B) to impose an additional charge to avoid any conduct that is prohibited by this subsection;
- (4) to prohibit a user from attaching or using a device on the provider's network that does not physically damage or materially degrade other users' utilization of the network; or
- (5) to fail to clearly and conspicuously disclose to users, in plain language, accurate information concerning any terms, conditions, or limitations on the broadband network service.

The direct link between the MFJ language and this legislative proposal is clear. The MFJ made it illegal to discriminate in interconnection and access. That was the correct policy a quarter of a century ago. It is the correct policy today. It exercises the traditional function of antitrust policy to promote competition, where feasible, as the best form of consumer protection. And in this case, it will also guarantee the free flow of ideas, applications and services that has characterized the dynamic Internet economy.

The explicit dual jurisdiction – antitrust and communications law – that applies to the communications industry, and has applied for almost a century, reflects the nature of the industry. It is not vigorously competitive, nor is it likely to become so, and there are numerous complementary activities that are touched by the network. The original AT&T antitrust case served the purpose of fencing off the market power in the core of the network from the potentially competitive sectors that build upon it. The vigorous competition in interexchange and information is testimony to the wisdom of network neutrality. The court did not eliminate the need for regulation of the network functions, but it drew an important line where regulation should stop. Congress preserved that line in the 1996 Act. The FCC has incorrectly erased it. The House and Senate Judiciary Committees can and should restore the balance.