

# Net Neutrality and Online Content

December 2008

**“Net neutrality” is often bandied about as a catch-all term to capture a range of perceived online problems. It’s important to analyse carefully the underlying granular issues: they’re relevant for incumbent and other Telcos/ISPs, and content providers such as TV broadcasters. Unadulterated “net neutrality” is unlikely to be the correct outcome. Sooner or later, following the lead in the US, net neutrality will attract regulatory attention in most jurisdictions. Stakeholders should plan for this, whichever side of the debate applies to them.**

## Introduction

There is concern – justified or not – that telecoms incumbents will seek to misuse market power, in a manner that requires “Net neutrality”. For example, President Obama, in his presidential campaign, promised to pass legislation implementing Net neutrality. A Net Neutrality bill has been introduced in the US House of Representatives.

There is often unclear commentary about what net neutrality means, and the need for Net neutrality. For example, unadulterated application of net neutrality – as put forward by some net neutrality advocates – flies in the face of economic principle and consumer welfare.

That’s not to say that there isn’t an argument for some minimum net neutrality requirement, such as, just like a universal phone service requirement (USO), minimum obligations on Telcos.

Net neutrality is relevant in a number of areas: those areas include online content and online line TV (IPTV and Web TV<sup>1</sup>). Particularly as Telco IPTV models develop, regulators and governments will be increasingly concerned to ensure there is net neutrality. Yet such IPTV models can be economically efficient where they provide services not available elsewhere.

## A key step in the Net neutrality story

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<sup>1</sup> For our purposes, Web TV is TV delivered over the general Internet and IPTV is TV delivered over dedicated circuits by, usually, Telcos and ISPs: there is usually a difference in quality of service. IPTV is often bundled with other telecoms services.

The debate took a heated step forward when Ed Whitacre made his highly publicised statement:

*Now what [Google, MSN, Vonage, and others] would like to do is use my pipes for 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!*

## What is net neutrality?

The best and most comprehensive summary we have seen of the underlying multi-dimensional issues is in the December 2008 WIK-Consult Report, Net Neutrality: Implications for Europe. Here we just touch the surface.

Net neutrality is used as a catch-all concept to reflect various incumbent behaviours that are said to be anti-competitive.

The concept indicates that all online traffic should be treated largely equally, to avoid the prospect of incumbents inappropriately discriminating treatment of IP packets as between its own packets and those of others.

Examples of such claimed discrimination include where the incumbent/ISP<sup>2</sup>:

- offers better performance to some sites and sources of content, ahead of others;
- allows access to certain affiliated sites or sources of content to particular users such as the incumbent's customers and not allowing others to access it;
- provides superior and prioritised access to certain sites and content to certain users (such as the incumbent's users); or
- "...erects "tollgates" in order to collect unwarranted charges from unaffiliated content providers who need to reach the integrated ISP's customers."<sup>3</sup>

It can be seen, for example, that the following may, rightly or wrongly, attract the interest of regulators and governments:

- incumbents establishing walled garden IPTV and triple/quad play bundles for their customers, which are unavailable to competitors' customers and to non-customers of the incumbents; and
- as noted elsewhere, ISPs arguably have a termination monopoly in relation to traffic to their customers. Often, most content traffic is injected on the network in the direction of the incumbents' end user customers. This raises concerns as to whether the incumbent will, for example, impose excessive charges on ISPs and Telcos injecting content-rich packets towards the incumbent's end-user customers.

### **Fallacy: Full "net neutrality" is economically efficient**

Many net neutrality advocates say that all users and suppliers should get equal treatment: that all packets should be carried with the same priority, quality of service, accessibility, etc.

That conclusion is incorrect and economically inefficient. It discourages innovation.

<sup>2</sup> See WIK-Consult, Net Neutrality: Implications for Europe at pages 1 and 2

<sup>3</sup> WIK-Consult at Page 2

Service and price differentiation (discrimination) is not anti-competitive per se. To the contrary. To use an analogy, airline passengers pay different fares for different levels of service: economy, business and first class. Often the retail fares are not aligned with the underlying cost of producing that service (e.g. typically the cost of providing the business class service will be much less, in relative terms than the comparable cost of the economy class fare). Moreover, fares in the same class vary greatly (for example, the businessman, who bought his ticket that morning, sitting next to the holidaymaker who booked weeks before).

All that is accepted as being economically desirable and efficient.

Take the comparison between TV delivered on IPTV (that is, a dedicated online service with high QoS) as opposed to Web TV (the same content but delivered over the public Internet, so, lower QoS). The consumer can choose to pay less (or nothing) and take the poorer quality Web TV service. Or she can buy (maybe as part of a bundle) the higher QoS IPTV product. (Often the online service is ad-funded and so there is a two-sided market at play, just like the funding model for free-to-air TV, and no-one argues that such a commercial model is economically inefficient per se).

On the face of it, the consumer is getting choices, and that is a good thing.

Yet, ardent net neutrality advocates would argue against that differentiation, even though it provides customer choice and economic efficiency.

The story extends out when it is seen, for example, that many will pay to prioritise video on demand (VOD) packets (which are time sensitive) ahead of email packets. This is economically efficient and regulation that has the effect of stopping all such prioritisation could be anti-competitive.

Lots of other examples can be given.

So, it is not anti-competitive per se to differentiate price and service quality for particular services, contrary to the views of some hardline Net neutrality supporters. To

the contrary, it can be pro-competitive per se and fosters innovation and consumer welfare.

It is important to look at the detail of what is happening, across various dimensions, rather than bandying about a general concern about Net neutrality.

### **Where do genuine issues arise as to Net neutrality?**

Regulators may consider that there are genuine issues over net neutrality where the Telco has significant market power (SMP) which enables them to act anti-competitively. This is the sort of situation that is more likely to attract reasoned (as opposed to irrational) regulatory attention. The examples given above can play out this way, but it is important to analyse the position carefully, in case this does not apply in the particular circumstances.

Incumbents typically have SMP over at least (a) "last mile" access (copper local loop and fibre to the premises (FTTP)) and (b) access to their often dominant ISPs (arguably there is a termination monopoly for termination with ISP's customers, just like mobile companies have a termination monopoly).

The ability to put together triple (and sometimes quad) play bundles is an illustration. Bundles such as this can be pro-competitive, but use of SMP might render them to be anti-competitive.

Regulators internationally will increasingly review the role of those with SMP in the online content value chain.

Further, regulators and legislators may not be satisfied that anti-trust (competition) law is adequate to deal with the issues.

There may also be some freedom of speech issues to handle as well, although query whether in reality this area is challenged.

### **Net neutrality arises in many different guises**

The WIK-Consult report is also valuable in outlining the diverse nature of Net neutrality issues which can affect many stakeholders, and not just those with whom the telco has a contractual relationship. There are vertical,

diagonal and horizontal issues, as the report notes.<sup>4</sup>

A good illustration, noted by WIK, is the US FCC's decision<sup>5</sup> to stop cable company, Comcast, from slowing down its customers' BitTorrent P2P traffic. (Degrading P2P traffic is something that many Telcos and ISPs do). This had impact not just on Comcast customers downloading P2P, but also, in view of the way P2P and BitTorrent operate, it stopped the customers of other ISPs accessing P2P content from Comcast customers. Therefore, this net neutrality breach negatively impacted not just the Comcast customers (although it positively benefitted Comcast customers who did not use P2P as their bandwidth was freed up). It also negatively impacted other ISPs (who got more P2P traffic in view of Comcast's action) plus their customers. There were vertical, horizontal and diagonal impacts.

### **Net neutrality: conclusion**

Contrary to what many net neutrality advocates say, rules for unadulterated net neutrality would not be consumer welfare-enhancing and economically efficient. Crafting a rational set of rules for net neutrality will be very difficult (as no doubt the Obama administration will find when they come to implement the election promises).

However, internationally, the wide array of issues posed by net neutrality will attract the attention of regulators and/or governments. Telcos (incumbents and challengers) and content providers such as broadcasters should have strategies in this area to optimise their positions and minimise risk, given there could be a "calm before the storm".

Our experience is that a tipping point can be reached from which a stakeholder could find it difficult to return unscathed. A rational regulator will focus mainly on areas where a stakeholder has significant market power.

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<sup>4</sup> See pages 18 and 19

<sup>5</sup> Under appeal as at August 2009

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