



# Net neutrality and the open Internet

Comments – prepared for ACCC/AER Regulatory Conference

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August 2015

# Net neutrality

- A polarised debate in the United States
  - Even within the FCC...

*Our decision today—once and for all—puts into place strong, sustainable rules, grounded in multiple sources of our legal authority, to ensure that Americans reap the economic, social, and civic benefits of an open Internet today and into the future.*

Decision  
introduction

*In short, because this Order imposes intrusive government regulations that won't work to solve a problem that doesn't exist using legal authority the FCC doesn't have, I dissent.*

Commissioner  
Pai dissent

- Not a big issue in Australia...yet

# Overview

- Comments on Professor Brennan's presentation
- Myths and reality of net neutrality in Australia
- Is it worth taking further?

# Four main points arise from Dr Brennan's presentation

1. Australia now seems like an outlier on net neutrality
2. Net neutrality rules are complex to write and do not resolve all uncertainty
3. The (economic) justifications put forward by the FCC in favour of net neutrality seem incomplete
4. Rule change proposals are occurring in the context of significant changes in the use of the Internet

# 1. Australia now seems an outlier

## United States

- ❑ “We adopt carefully-tailored rules that would prevent specific practices we know are harmful to Internet openness—blocking, throttling and paid prioritization—as well as a strong standard of conduct design to prevent the deployment of new practices that would harm Internet openness.”

*FCC, Protecting and Promoting the Open Internet, Feb 2015*

## EU

- ❑ The European Parliament, Council and Commission have reached an agreement on key elements for a single market in telecoms, introducing rules safeguarding the open Internet in the EU
- ❑ Rules enshrine the principle of net neutrality into EU law: no blocking or throttling of online content, applications and services.

*European Commission, Connected Continent legislative package*

## Australia

- ❑ No specific rules on net neutrality or ‘internet openness’
- ❑ Reliance on *ex post* competition laws
- ❑ Previous policy reviews have recommended limited action (e.g. Convergence Review)

## 2. US laws will not resolve all uncertainty...

- Gaps remain
  - Applies to traffic management by ISPs, but not interconnection practices (where congestion can also occur)
- Interpretation required
  - Exemptions for ‘reasonable network management’?
  - Exemptions for ‘non BIAS services’ (e.g. VoIP)?
  - No clear finding on certain practices, such as ‘zero rating’ of content (unmetered)
- Much *ex post* assessment required
- These problems also appear in recent EU proposals



Discrimination vs differentiation?

...and are narrower than you would think

### 3. How strong is the economic case?

- Title II is not based on market power assessment
- FCC does argue that ISPs have the ability and incentive to reduce openness
  - Ability: Weak ISP competition, high switching costs
  - Incentives: Favour affiliates to cut costs, charge higher prices
- Focuses on risk to content innovation
- Theoretical or empirical justification for harm?
  - Empirics seem weak, although FCC argues existing rules have had effect
  - Large and developing economic literature not really referred to
  - No cost-benefit analysis of rules
  - No analysis of benefits of 'non neutrality'

### 3. Economic case (cont)

- The economic literature on net neutrality focuses not just on anti-competitive / foreclosure motivations:
  - Two sided markets: prices used to balance investment incentives (Gans 2015, Lee & Wu 2009)
  - “Competitive bottlenecks” and terminating monopolies (switching costs) (Valetti 2015)
  - Externalities and network externalities (Economides & Tag 2012, Brennan 2010)
- ISPs are platforms in two-sided markets
  - Prices to both sides balance investment incentives
  - Neutrality (likely) imposes a zero price on content providers
  - Is this efficient? Maybe (Lee & Wu 2009), Maybe not.
    - Suppose costs \$1 to upgrade network, consumers only value at 90c. But this upgrade would also deliver 30c of incremental advertising revenue to content suppliers.
    - Surely a Pareto improving deal feasible? Prices can mediate.
  - Implies that focus should be how to get appropriate prices and investment incentives in content *and* delivery



## 4. Changes in the use of the Internet may change the cost-benefit calculus

- Historically, Internet used for wide variety of content
- The dominant traffic flow on the Internet is now OTT video – anecdotes suggest Netflix alone accounts for 25% or more of local traffic

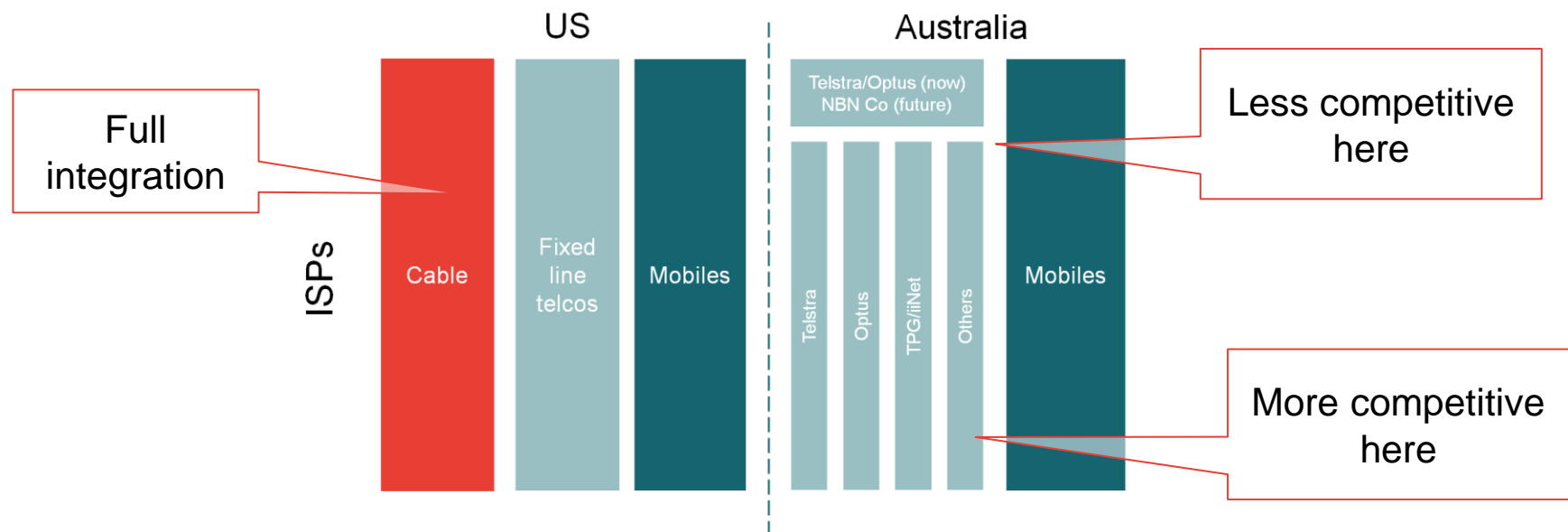


Roy Morgan's June figures estimate Netflix had increased to 1.42 million Australian subscribers in 559,000 homes.

- This trend:
  - Puts more pressure on upgrading of existing networks – and how this can be funded
  - Puts horizontal integration in pay TV more directly in frame
- Will the NBN lessen these concerns?

# Net neutrality in Australia

- The ISP market structure in Australia is quite different



- So is the regulatory framework
- However, differences do not mean net neutrality is irrelevant

# Australian net neutrality: myth or reality

- “Problems have been more prevalent in the US (or Europe)”
  - *Not really. There is not a lot of evidence of problems, and the rules appear precautionary.*
  - *Evidence suggests some prioritisation by ISPs of certain kinds of traffic. Throttling has—at least—been trialed.*
  - *Zero rating of some content example – see over.*
- “Australia’s “user pays” pricing model eliminates concerns with net neutrality”
  - *In contrast to the US, more traffic does increase revenue, so incentive not to block or favour.*
  - *But, no reason to think that it eliminates incentives to favour affiliated firms, or favour firms that pay for access.*
  - *Profits from these practices may outweigh losses.*

## Example: “Zero rating” or data cap exemptions

- Zero rating: service usage doesn't count against the user's data allowance.
- This certainly appears to be a form of prioritisation of traffic from one content provider – or is at least a lower implicit usage charge.
- Widespread in Australia, less so in the US.
- Does not directly contravene FCC rules. The FCC says:
  - “...we will look at and assess such practices under the no-unreasonable interference/disadvantage standard, based on the facts of each individual case, and take action as necessary.”
- Netflix has been caught in a bind on this issue
  - Bargaining position much stronger in Australia?
  - Or merely responding to competition?

## Myth or reality (2)

- “The establishment of structurally separated fixed access networks solves the competition and net non-neutrality problems”
  - *Strong ISP competition may reduce non-neutrality, if consumers have an effective choice of ISPs and knowledge about traffic management practices.*
  - *But what if competition between ISPs takes the form of offering preferential access to content?*
  - *What about mobiles?*
- “Australia’s regulatory regime is different from the US and problems can be more easily dealt with”
  - *We have an access regime (Part XIC) and special Part XIB powers against anti-competitive conduct.*
  - *Part XIC applies to inputs, not retail ISP services. XIB powers rarely used.*
  - *The 2012 Convergence Review noted that the ACCC’s existing powers may be too narrow to address network neutrality.*

# The policy questions

- Australia now appears to be an outlier relative to US and Europe
- But there is little impetus for action
  - Recent Australian reviews have either ignored or not been acted on
- Should Australia follow a similar path?
  - Do our structural reforms obviate the need for similar rules?
  - Are (any?) proposed rules workable?
  - Would a simpler set of rules be desirable (e.g. transparency on traffic management)?
  - Or should we sit back and learn from experience?

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