Federal Trade Commission

PREPARED STATEMENT OF

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ON

NET NEUTRALITY: IS ANTITRUST LAW MORE EFFECTIVE THAN REGULATION IN PROTECTING CONSUMERS AND INNOVATION?

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL AND ANTITRUST LAW

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* The views stated here are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.

I. Introduction

Chairman Bachus, Ranking Member Johnson, and Members of the Subcommittee, thank you for the opportunity to appear before you today. My name is Joshua Wright and I am a Commissioner at the Federal Trade Commission. I am pleased to join you to discuss competition and regulation in the broadband sector and, more specifically, the issues highlighted by the on-going debate surrounding net neutrality. I should make clear at the outset that the views I express today are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.

Today I will focus my comments upon competition policy and regulation in broadband markets from a consumer welfare perspective. Consumer welfare is the lodestar of competition policy and antitrust, and it guides decision-making at the FTC. The consumer welfare approach harnesses the power of rigorous economic analyses to inform competition policy and antitrust. This emphasis on consumer welfare makes antitrust particularly well suited for tackling complex questions related to broadband competition and addressing the important issues raised in the net neutrality debate.[1]

[1] For additional discussion about antitrust, broadband competition, and net neutrality, see Joshua D. Wright, Comm'r, Fed. Trade Comm'n, Broadband Policy & Consumer Welfare: The Case for an Antirust Approach to Net Neutrality Issues, Remarks at the Information Economy Project's Conference on US Broadband Markets in 2013 (Apr. 19, 2013); Thomas W. Hazlett & Joshua D. Wright, *The Law and Economics of Network Neutrality*, 45 IND. L. REV. 767 (2012); Jonathan E. Nuechterlein, *Antitrust Oversight of An Antitrust Dispute: An Institutional Perspective on the Net Neutrality Debate*, 7 J. ON TELECOMM. & HIGH TECH. L. 20 (2009); Howard A. Shelanski, *Network Neutrality: Regulating With More Questions Than Answers*, 6 J. TELECOMM. & HIGH TECH. L. 23 (2007).

More specifically, the "rule of reason" analytical framework that lies at the core of antitrust analysis can be deployed effectively to analyze business practices in the broadband sector to separate socially beneficial conduct—conduct that increases consumer welfare—from business practices that are likely to result in the acquisition or maintenance of market power and harm consumers.

II. Net Neutrality From an Economic Perspective

I would like to begin by discussing net neutrality from an economic perspective. At its heart, the net neutrality debate concerns the competitive effects of vertical contractual arrangements between broadband providers and content providers. Put another way, net neutrality is about the fear that broadband providers will enter into business arrangements that disadvantage certain content providers, harm competition, and thereby leave consumers worse off. For example, a broadband provider could enter into an exclusive contract with an online video site to foreclose a rival video site's access to the broadband provider's subscriber. This type of competitive concern is grounded in antitrust economics, and more specifically, in the "raising rivals costs" literature familiar to students of antitrust that outlines the conditions that must hold in real world markets for this theoretical concern to give rise to a serious risk that a monopolist will disadvantage rivals, reduce competition, and harm consumers.[2]

[2] *See, e.g.*, Steven C. Salop & Thomas Krattenmaker, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L. J. 214 (1986).

Proponents of net neutrality traditionally have responded to these concerns by favoring a rigid, categorical ban or other significant restrictions upon broadband providers' ability to enter into vertical contractual relationships. Fearing that any network discrimination by broadband providers creates undue risk of competitive harm, they often have argued for a one-size-fits-all approach prohibiting such arrangements. This approach however fails to recognize the fundamental economic point that most vertical relationships benefit consumers. Indeed, although it is well accepted that vertical contracts occasionally can lead to anticompetitive foreclosure under certain specific conditions, it is equally clear that such arrangements often are part of the regular competitive process and can generate significant efficiencies.

The economic literature documents that vertical contracts can create efficiencies by reducing double marginalization, preventing free riding on manufacturer-supplied investments, and aligning manufacturers and distributors' incentives. Consumers benefit because these efficiencies are at least partially passed on to them in the form of lower prices, increased output, higher quality, and greater innovation. Moreover, considerable empirical evidence further supports the view that vertical contracts are more often than not procompetitive.[3] The empirical studies cut sharply against the idea

[3] For a comprehensive survey of the economics of vertical restraints, see Dan P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, *in* REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 40, Konkurrensverket, Swedish Competition Authority (2008); James C. Cooper, Luke M. Froeb, Dan P. O'Brien & Michael Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy* (Sept. 2005) (unpublished paper).

that broadband providers necessarily will use such arrangements in a way that harms competition. The marketplace experience also demonstrates that "non-neutral" business models deployed by providers have proven highly efficient.[4] For instance, in 2002, a fledging Google was able to strategically achieve economies of scale by beating out its competition in a bid to become the default search engine on AOL, then the country's leading Internet service provider, by offering a substantial financial guarantee.[5]

To be clear, the economic literature and empirical evidence does not claim that vertical contracts never create competitive concerns. The correct regulatory question—from an economic perspective focused upon consumer welfare—is not whether vertical contracts and related business practices employed by broadband providers can ever harm consumers. The better question is "what regulatory structure and legal rules best promote consumer welfare?" Any economically coherent answer to that question must begin with the fundamental observation and market experience that the business practices at the heart of the net neutrality debate are generally procompetitive.

III. The Advantages of Antitrust

In light of the economic evidence, in my view, antitrust offers a superior analytical framework—one that focuses upon consumer welfare and adopts the best

[4] *See* Hazlett & Wright, *supra* note 1, at 785-796 (exploring the widespread use of non-neutral business practices among Internet service providers).

[5] *Id.*

available economic tools—to address potential anticompetitive conduct in the broadband sector. Over the past century, antitrust jurisprudence has evolved a highly sophisticated "rule of reason" balancing approach for investigating whether vertical arrangements are anticompetitive. The "rule of reason" requires that vertical arrangement are assessed on a case-by-case basis by marshalling the available economic literature and empirical studies to evaluate evidence of actual competitive harm based on the specific circumstances of the case. The "rule of reason" framework is a flexible one that allows consumers to benefit from the vast number of vertical agreements that are procompetitive while also creating a means, grounded in sound economics and empirical evidence, for identifying those vertical contracts that harm consumers. A regulatory regime that prohibits all vertical arrangements or imposes significant restrictions upon their use is only in consumers' best interests if vertical agreements are overwhelmingly anticompetitive. As discussed, the vast body of economic theory and empirical evidence demonstrates that such conditions do not hold in the case of the business arrangements and contracts at the heart of the net neutrality debate.

IV. Conclusion

In closing, it is my belief that antitrust offers a superior approach to addressing anticompetitive business conduct in broadband markets in a manner that achieves the best result for consumers. I am happy to answer any questions.