INTERNET FREEDOM

In 1994, the Internet began to take off among U.S. consumers eager to use the platform's first "killer app"—the World Wide Web. By the late 1990s, the Internet had transformed global commerce and communications. In the United States, most companies that own the networks that compose the Internet and the applications that use it have avoided heavy-handed regulation. But a renewed push from self-styled consumer advocates urging federal regulators to impose network neutrality regulation on Internet service providers would upset that dynamic. Similarly, federal law has largely prevented states and localities from imposing onerous, discriminatory taxes on Internet access and online commerce—but existing protections against such taxes will expire if Congress fails to renew them.

Telecommunications

Congress should:

- Explicitly define the provision of broadband Internet access—both wireless and wireline—as an information service under the Communications Act.
- Deny the Federal Communications Commission (FCC) the authority to regulate any provider of any future data transmission medium, or any service operated over such a future medium, as a common carrier.
- Clarify that Section 706 of the Telecommunications Act (47 USC § 1302) confers on the FCC no independent source of regulatory authority, reversing the D.C. Circuit's contrary holding in *Verizon v. FCC*, 740 F.3d 623, 637–40 (D.C. Cir. 2014).

When Congress last overhauled the Communications Act of 1934, it passed the Telecommunications Act of 1996 (the 1996 Act), which made barely any mention of the Internet (Public Law 104-104, 110 Stat. 56; codified as amended in scattered sections of 47 USC). In the intervening 18 years, therefore, the Federal Communications Commission has operated with limited congressional guidance about how to regulate the Internet (see, for example, 47 USC § 151). Although the 1996 Act grants the FCC no express authority to regulate "information services" (47 USC § 153[24]), it does not specify whether providing Internet access is an "information service" or a "telecommunications service"—the latter of which is subject to stringent FCC regulation as a common carrier, including mandatory interconnection and rate regulation. (See Federal-State Joint Board on Universal Service, "Report to Congress," 13 FCC Rcd 11501, 11534–35, para. 69 and n.140, 1998.)

Soon after the 1996 Act's passage, the FCC encountered the question of how to treat the broadband Internet service that a growing number of cable companies were offering. In a rulemaking process commenced under Democratic FCC Chair William Kennard and completed under Republican FCC Chair Michael Powell, the FCC determined in 2002 that it would treat cable broadband as an information service—not a telecommunications service. (In 2005, the U.S. Supreme Court upheld the FCC's decision as a permissible construction of the 1996 Act.)

Meanwhile, the FCC was also considering how to treat broadband service offered by the incumbent telephone companies—also known as "Baby Bells," the firms that AT&T divested in 1984. Those legacy phone companies had long been regulated as common carriers under Title II of the Communications Act. Moreover, Section 251 of the 1996 Act required the Baby Bells to make their last-mile facilities available, at government-regulated rates, to their competitors—many of whom, like the Baby Bells, had started offering broadband Internet access over telephone wires using a technology known as the digital subscriber line (DSL) (47 USC § 251[c]). In 2005, observing the rapid growth of facilities-based wireline broadband competition, the FCC decided to deregulate the broadband component of *all* wireline facilities. That move not only freed phone companies from common-carrier regulation of their broadband offerings but also meant that they no longer had to share their lines with DSL competitors.

Since that time, wireline broadband providers have operated under a light-touch framework, enjoying similar freedom as companies that offer services and applications over the Internet, such as Amazon, Google, and Netflix. Under that regime, the Internet has flourished as a platform for free expression, innovation, and experimentation. That trend shows no signs of slowing down, as carriers continue to deploy more robust networks, while companies at the "edge" of the Internet—including Amazon, Google, and Netflix—make similarly significant investments.

Yet the FCC has long sought to promulgate rules to codify a concept known as "net neutrality," which entails barring broadband providers from offering paid prioritization to time-sensitive Internet traffic—such as videoconferencing and telemedicine—either at the behest of broadband subscribers or companies at the "edge" of the network.

In 2008 and again in 2010, the FCC tried and failed to create enforceable net neutrality regulation—first through adjudication, then through rulemaking. On both occasions, the U.S. Court of Appeals for the D.C. Circuit rejected the agency's efforts, concluding that both FCC actions exceeded the authority Congress had delegated to the agency. In the more recent ruling, *Verizon v. FCC*, the D.C. Circuit accepted the agency's argument that Section 706 of the 1996 Act is an independent source of authority for FCC regulation (740 F.3d at 635). But the court nonetheless vacated the agency's no-blocking and nondiscrimination rules as impermissible, finding that the rules failed to "leave sufficient 'room for individualized bargaining and discrimination in terms.'"

Since the court handed down *Verizon* in January 2014, the FCC has embarked on yet another effort to impose net neutrality regulation. This time, many net neutrality advocates and some of their allies in Congress are pushing the FCC to adopt a radical approach floated by the agency in its May 2014 notice of proposed rulemaking ("Protecting and Promoting the Open Internet, Notice of Proposed Rulemaking," 29 FCC Rcd 5561, 5564–65, para. 10, https://apps.fcc.gov/edocs_public/attachmatch/FCC-14-61A1_Rcd.pdf). They would have the agency reverse its longstanding decision to treat wireline broadband as a lightly regulated information service, rather than as a telecommunications service subject to strict common-carrier regulation under Title II of the Communications Act of 1934 (47 USC §§ 201–21). Reinterpreting broadband providers as common carriers, net neutrality supporters argue, represents the FCC's best hope of imposing enforceable net neutrality rules that withstand judicial scrutiny.

However, should the FCC decide that broadband providers are common carriers, the agency would gain not only the authority but also perhaps the *obligation* to impose myriad new regulations on broadband access. For instance, the FCC has a statutory duty to regulate the prices that common carriers charge for service, a practice known as "tariffing." The Act requires common carriers to file with the FCC detailed price schedules; the FCC, in turn, must ensure that those prices are "just and reasonable." Such price regulation, if imposed on broadband providers, would severely undercut their incentive to continue improving their networks, and it would spook investors, potentially depriving providers of access to the capital markets that finance most U.S. private-sector investment.

Net neutrality supporters dismiss those concerns, claiming that the FCC can and will exercise its statutory authority to "forbear" from tariffing and other especially onerous forms of common-carrier regulation. But it remains unclear whether the FCC is willing to broadly forbear from those rules—and, perhaps more importantly, *whether courts will permit the agency to do so*, given the agency's recent repudiation of its prior approach toward forbearance. The Internet's future is far too important to be gambled away by a risky bet on the FCC's willingness and ability to forbear from public utility-style regulations.

The FCC has suggested that it might pursue net neutrality without reinterpreting Title II of the Act to encompass broadband providers (29 FCC Rcd at 5610–12, paras. 142–47). That too would be a mistake. Even absent common-carriage mandates, net neutrality regulation is unnecessary and harmful on its own merits. Since the dawn of the net neutrality debate, American consumers have used myriad apps and services over myriad broadband providers—yet only two violations of net neutrality have been substantiated. In the more noteworthy instance, Comcast admitted to degrading some BitTorrent peer-to-peer traffic that it claimed was causing congestion for some of its other subscribers. That practice may have harmed Comcast's BitTorrent users, but what of the other subscribers whose experiences Comcast sought to improve? In the six years since it issued its Comcast order, the FCC has yet to conduct a real economic analysis of why an Internet service provider might manage its network such that certain traffic is prioritized—or degraded—relative to other data.

The virtues of paid prioritization by broadband providers are especially promising given the "two-sided" nature of the broadband market, wherein companies at the edge—for instance, Netflix—may have an incentive to help shoulder the costs that broadband providers bear in delivering Netflix traffic to consumers across the nation. Wireline broadband competition among two or more providers exists throughout the vast majority of U.S. markets, while wireless broadband is increasingly viable as a substitute to wireline service.

Experts: Ryan Radia, Wayne Crews

For Further Reading

Gary S. Becker, Dennis W. Carlton, and Hal S. Sider, "Net Neutrality and Consumer Welfare," *Journal of Competition Law and Economics*, Vol. 6, No. 3 (2010): 497519, http://faculty.chicagobooth.edu/dennis.carlton/research/pdfs/NetNeutralityConsumerWelfare.pdf.

Haley Sweetland Edwards, "Net Neutrality Campaign Claims Victory in 'Battle for the Net,'" *Time*, September 10, 2014, http://time.com/3319344/net-neutrality-congress-fcc/.

Robert Ellickson, *Order Without Law: How Neighbors Settle Disputes*, Cambridge, MA: Harvard University Press, 1994.

Daniel B. Klein, ed., *Reputation: Studies in the Voluntary Elicitation of Good Conduct*, Ann Arbor: University of Michigan Press, 1997.

Philip J. Weiser, "The Future of Internet Regulation," *UC Davis Law Review*, Vol. 43 (2009): 529–590.

For a comprehensive discussion of why forbearance is unlikely to avert pervasive Title II regulation of broadband providers, see "Comments of TechFreedom and International Center for Law and Economics on Protecting and Promoting the Open Internet," FCC GN Docket no. 14-28, July 17, 2014, 32–46, http://www.laweconcenter.org/images/articles/tf-icle_nn_legal_comments.pdf.

Taxation of Internet Access and E-Commerce

Congress should:

- Make the Internet Tax Freedom Act permanent.
- Reject the Marketplace Fairness Act.
- Enact legislation that bars states from requiring out-of-state online sellers to remit sales or use taxes on the basis of the remote seller's relationship with passive in-state affiliate websites.

Internet Tax Freedom Act. In 1998, Congress enacted the Internet Tax Freedom Act (ITFA), which bars states and their political subdivisions from imposing "[t]axes on Internet access" and "[m]ultiple or discriminatory taxes on electronic commerce" (Internet Tax Freedom Act, Public Law 105-277, div. C, Title XI, 112 Stat. 2681–719 [1998]; codified as amended at 47 USC § 151 note). ITFA allows states to tax online purchases—an option most states have exercised—but it bars states from imposing a higher tax rate on goods purchased online than on comparable goods purchased through other means. And ITFA bars states from imposing taxes on Internet access, except for Internet-access taxes already in force at the time of ITFA's enactment. ITFA was originally scheduled to sunset in 2001, in part because the Internet was still quite new to the public in 1998. Fortunately, Congress extended ITFA in 2001, 2004, 2007, and most recently during the 2014 lame-duck session—albeit only through October 2015.

If ITFA is allowed to expire on that date, many states will likely enact Internet-access taxes—which could cost U.S. consumers $14.7 billion annually, if existing state and local telecommunications taxes are merely applied to Internet access, according to estimates by William Rinehart of the American Action Forum. States might also respond to ITFA's expiration by imposing additional sales taxes on goods and services that their residents purchase online. Congress can prevent both of those harmful outcomes by passing the Permanent Internet Tax Freedom Act (H.R. 3086 in the 113th Congress), which would permanently codify ITFA, thus eliminating the political battle that occurs every few years when ITFA is about to expire.

Marketplace Fairness Act. Large brick-and-mortar retailers are urging Congress to pass the Marketplace Fairness Act (S. 743 in the 113th Congress), which the Senate passed in 2013, but which has stalled in the House. The bill would allow any state to force out-of-state domestic Internet retailers such as Overstock and Amazon to collect sales taxes on goods shipped to customers in that state.

The Marketplace Fairness Act would impose substantial new burdens on small and medium-sized businesses across the country, many of which employ few staffers and rely primarily on the Internet to sell goods across state lines. Those burdens would hurt the thriving e-commerce sector, which has benefited tremendously from low barriers to entry and minimal regulatory burdens. And it would enable many states to impose a de facto tax increase, as existing state laws that require residents to pay a "use tax" on goods they buy remotely for in-state consumption are rarely enforced.

Experts: Ryan Radia, Jessica Melugin, Wayne Crews

For Further Reading

Joseph Henchman, "The Marketplace Fairness Act: A Primer," Background Paper no. 69, Tax Foundation, 2014, http://taxfoundation.org/article/marketplace-fairness-act-primer.

"64 Days to a Tax Increase," editorial, *Wall Street Journal*, October 9, 2014, http://www.wsj.com/articles/64-days-to-a-tax-increase-1412810890.