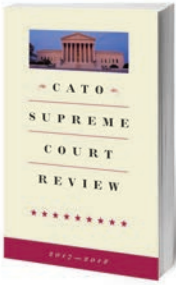

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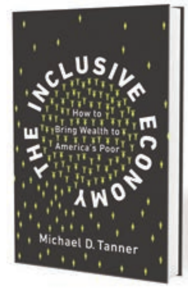

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Cato Policy Report

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Seeking Intervention Backfired on Silicon Valley

BY DREW CLARK

"For whatsoever a man soweth, that shall he also reap."

For nearly 30 years now, Silicon Valley has been an American success story and one of the biggest drivers of the nation's economic growth. America's head start on the information revolution has done more to cement America's dominant position in global affairs than a dozen aircraft carriers. The underlying factor was a kind of benign-neglect regulatory approach that left digital content companies largely free to do as they pleased, shielded from liability and operating under the guarantees of the First Amendment. The companies spawned by this revolution have grown to become some of the most valuable enterprises on the planet as they reshaped the modern world. Corporations like Twitter, Facebook, and Alphabet (better known by its flagship product Google) have made massive profits in an almost perfectly free-market environment.

That success has brought with it a familiar temptation: turning to the government to secure advantages in the marketplace. In so doing, these tech titans have played with fire, and now they see policies they initially supported being turned on them in ways they hadn't imagined were possible. First, in the 1990s with the antitrust case against Microsoft, and again more recently in the battle with internet service providers over net neutrality, Silicon Valley looked to Washington. With that fateful decision, they entangled the federal government in their industry in ways that are now coming back to haunt them.

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Washington Post columnist GEORGE WILL delivers the annual B. Kenneth Simon Lecture at Cato's Constitution Day symposium. In his lecture, Will addressed the role of political philosophy and counter-majoritarianism in American constitutional law.

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NET NEUTRALITY

On its face, the principle of net neutrality seems unobjectionable: internet service providers (ISPs) such as AT&T, Verizon, and Comcast should enable access to all content and applications regardless of the source, without favoring or blocking particular products or websites. This approach has always been a norm under which the internet has operated since its inception. The question for today is whether the government needs to enforce this norm via regulation or let market participants test different ways to improve the delivery of content over the internet.

The regulation of telecommunications services has always been an ungainly mess. From the 1910s until its breakup in the 1980s, AT&T's monopoly on telephone service was regulated first by the Interstate Commerce Commission (ICC) and then by the Federal Communications Commission (FCC) after its establishment during the New Deal era. Telephones were placed under Title II of the 1934 Communications Act, which had its origin in the ICC's regulation of railroad common carriers. Title III governs frequencies used by radio and television broadcasters. Other sections regulate cable TV and satellites and set rules for the auction of airwaves for wireless cellular services.

When the term "net neutrality" emerged in the public discussion in 2004, it was in response to entrepreneur Jeff Pulver's creating a Voice-over-Internet-Protocol (VoIP) company. Pulver wanted to be free to develop software for internet telephone calls. Traditional telephone companies argued that internet telephony should be regulated just like they were. But then FCC chair Michael Powell articulated what he called the "four freedoms" of the internet: (a) freedom to access content, (b) freedom to use applications—like Jeff Pulver's Free World Dialup VoIP, (c) freedom to attach personal devices to the network, and (d) freedom to obtain information about their ISP plans and policies. The Pulver Order, released within days of Powell's "Preserving Internet Freedom" speech, said that VoIP was an information service. And information services, unlike telecommunications services, would not be regulated under the stricter regime of Title II.

> "The regulation of telecommunications services has always been an ungainly mess."

The 1996 Telecommunications Act left it to the FCC to decide whether or how to regulate broadband internet access from cable modems, digital subscriber lines (and later fiber optics), and wireless transmission. The approach under the administrations of Bill Clinton and George W. Bush was to put everything possible into Title I, which governed the agency's "ancillary authority," and to call them "information services." Doing so avoided the common-carrier rules that require neutrality and nondiscrimination in the delivery of content. At the same time, the cable and telecom and wireless companies were investing and building more broadband connections. They too wanted to get out from under the regulatory regime. In their view, the internet worked so well because government regulated it so little.

Barack Obama had a much more pro-regulation worldview. He and his allies believed that the internet's convention of allowing innovators to launch new products and services without seeking permission from media gatekeepers was threatened by the big communications companies. The cable industry operated by bundling content distribution with pay-television services. These vertically integrated cable system operators had the power to thwart new entrants from launching new channels. That dynamic is absent from the internet, but progressives feared that the internet was in danger of becoming like cable TV.

But that's not likely to happen. A provider's blocking or throttling access to any websites or service has happened so rarely that it's laughable to characterize the possibility as any kind of problem. And yet strong passions have been stirred by the fear that big communications companies might mess with the consumer's expectation of net neutrality.

Obama's first FCC chair, Julius Genachowski, took a "light touch" regulatory approach as he attempted to put net neutrality into law. Genachowski kept wired internet access as an information service rather than a telecommunications service but added a narrow proscription against blocking and throttling. Verizon Communications sued and won, prompting the next FCC chair, Tom Wheeler, to try again. At first, this attempt appeared to be headed for the same defeat in court. But then Silicon Valley content giants, including Google, Facebook, Twitter, and Netflix, launched an all-out publicity war, enlisting celebrities and mobilizing young progressives to demand the adoption of net neutrality.

The companies that drove the engine of America's information technology machine essentially argued as follows: We provide the good stuff that you—the American consumer—want. You go to Google to get your searches answered. You want Facebook to keep up on posts from friends, families, and trusted content providers. Access to the content in the Apple iTunes store or to Amazon Prime streaming video subscriptions doesn't need to be regulated because we tech giants compete vigorously among ourselves. But Washington does need to step in and regulate the telecom market because of a lack of competition among ISPs. And the FCC agreed in 2015 with what was officially dubbed the Open Internet Order.

The argument for net neutrality might have served tech giants well under Obama, but it wasn't as well received by the Trump administration. And for incumbent telecom providers, the new administration has been a time for political payback. On December 14, 2017, the Obama-era approach to net neutrality was starkly reversed by the Federal Communications Commission under Chair Ajit Pai.

For years, many of the industry's leading lights pressed the hardest for Washington to rescue them from the always-unpopular ISPs. Now some of the same companies, like Apple, are themselves the target of a trust-busting zeal among resurgent progressives in the Democratic Party and Steve Bannon–style nationalist populists.

Major content companies like Google, Facebook, and Netflix feared that ISPs would seek to throttle their services as a way of extracting payment for prioritization. Particularly for data-intensive video- streaming services like Netflix and Google's YouTube, this concern had a certain economic logic, even as it remained hypothetical. Having long courted Silicon Valley as a key constituency and facing a highly visible public demand with enthusiastic grassroots support on the left, Obama complied.

The D.C. Circuit Court of Appeals upheld the new rules in June 2016, giving the FCC remarkably wide deference to do nearly whatever it wants with the internet. At first, it seemed like a major victory for progressives keen on heavier regulation. But with a change in administration, what the FCC now wants to do is very different from what it wanted to do just a few years ago.

FCC Chair Pai effectively eliminated all of these new internet rules with the exception of a 2010 transparency requirement. Under the 2017 decision adopted by the agency on December 14, broadband providers can prioritize traffic for a fee, or for affiliated companies, or to block access to any or all websites and services, so long as they disclose those practices. Enforcement will be turned over to the FTC, on the theory that this change is a matter of antitrust and competition law rather than technology regulation. It now takes the FCC completely out of the business of micromanaging disputes about broadband traffic between telecom and content companies.

Silicon Valley's regulations-for-thee-but-not-for-me attitude has come back to bite them. They want the strictest form of regulation for telecommunications providers but no scrutiny of themselves, and now the tables have been turned.

> "Their regulations-for-thee-but-not-for-me attitude has come back to bite them."

Pai has not hesitated to point out the hypocrisy as he has moved to undo the net neutrality rules. In a November 29 speech in the lead-up to his net neutrality rollback, he said that the tech giants are "part of the problem" of viewpoint discrimination. "Indeed, despite all the talk about the fear that broadband providers *could* decide what internet content consumers can see, recent experience shows that so-called edge providers *are in fact* deciding what content they see. These providers routinely block or discriminate against content they don't like."

As examples, Pai cited Twitter's blocking Rep. Marsha Blackburn (R-TN) from advertising her Senate campaign with a message about partial-birth abortion, Apple's blocking an app for cigar aficionados, Google–YouTube's demonetizing videos from conservative commentator Dennis Prager and his "Prager University," plus "algorithms that decide what content you see (or don't), but aren't disclosed themselves" and "online platforms secretly editing certain users' comments." Others have termed the need for clarity about algorithms as a form of "search neutrality." The next day, for good measure, Pai blasted Facebook and Twitter for contributing to the rise of incivility in public discourse and "the breakdown in human interaction."

The Internet Association, a lobbying group for content companies like Google, Facebook, and Twitter, served up the standard response: "Websites and apps operate in a competitive environment with low barriers to entry where choice and competition are a click away. This stands in stark contrast to ISPs, where more than 60 percent of Americans have no choice in high speed broadband provider." As the battle over regulating social media and search engines turns to Capitol Hill, we can expect legislators to vigorously debate whether consumers are better served by a "light touch" regulatory approach or by the truly free-market deregulation implemented by Pai.

But if regulation returns, the tables have turned such that Google and Facebook would likely be subject to any such rules that get passed. As AT&T CEO Randall Stephenson argued in a full-page advertisement in January, legislation "would provide consistent rules of the road for all internet companies across all websites, content, devices and applications." In other words, no more free ride for tech companies at the expense of the telecom players: neutrality regulation either applies to everyone or to no one.

ANTITRUST

Twenty years ago, the administration of Bill Clinton put forth an official government policy declaring that information technology industries—separate and apart from government treatment of telecommunications—should be effectively immune from government regulation. Republicans, opposed to practically everything else Clinton stood for, cheerfully agreed.

For Silicon Valley, that all seemed great—except when it came to Microsoft, the software giant from the north. Eric Schmidt, who would later become CEO of Google, played a crucial role in rallying Silicon Valley against Microsoft through his role as chief technology officer at Sun Microsystems, and then as CEO of networking company Novell. Apple also played a role. The Clinton Justice Department put forward a theory about how Microsoft improperly leveraged the monopoly it had earned in the market for computer operating systems into the market for so-called middleware software. Hence, Microsoft was the original example of a "platform monopoly."

Yet the allegations, even as proved, never

> "'What goes around comes around.'"

justified the demand for breakup. Once the D.C. Circuit Court of Appeals took that option off the table with a 2001 en banc decision, the Bush administration Justice Department settled the case in 2002 with a 10-year consent decree.

Both Microsoft's critics in Silicon Valley and its defenders among free-market economists acknowledged that the case needed to turn on the consumer welfare standard, per the appeals court: "To be condemned as exclusionary, a monopolist's act must have an 'anticompetitive effect.' That is, it must harm the competitive *process* and thereby harm consumers."

Law professors Geoffrey Manne and Joshua Wright—in a 2011 paper on Google and antitrust—summarized decades' worth of Supreme Court jurisprudence on Section 2 of the Sherman Act against attempted monopolization:

- Mere possession of monopoly power is not an antitrust offense.
- The mere exercise of lawful monopoly power in the form of higher prices is not an antitrust violation.
- Courts must be concerned with the social costs of antitrust errors, and the error-cost framework is a desirable approach to developing standards that incorporate these concerns.

This "error-cost framework" requires the plaintiff, often the government, to prove exclusionary conduct. The accused monopolist has the opportunity to introduce evidence of pro-competitive effects. Unrebutted positive effects are then weighed against the consumer harms of exclusionary effects.

Google appeared to be heading down the same path as Microsoft in the first Obama administration. Although estimates vary for market share in the United States, Google is undoubtedly dominant and currently has around 90 percent of global searches. The Justice Department imposed restrictions on Google's acquisition of ITA Software's airline flight-pricing information. And the Federal Trade Commission began a far more significant review of whether Google's search results favored its own products over those of competitors.

One of Microsoft's former attorneys thought that Google had crossed the line without offering sufficient justification. Summarizing Google's dilemma in the *Wall Street Journal* in September 2010, Charles "Rick" Rule wrote, "What goes around comes around." Taking his cue from Microsoft's experience, he said, "The last 10 years have shown that reasonable antitrust rules can be applied to prevent exclusionary conduct by dominant tech firms without destroying market forces."

Yet in January 2013, all five FTC commissioners held that Google provided more benefits than harms to competition. "The totality of the evidence indicates that, in the main, Google adopted the design changes that the Commission investigated to improve the quality of its search results, and that any negative impact on actual or potential competitors was incidental to that purpose," according to the official statement concluding the investigation. The rather modest changes agreed to by Google included not "scraping" the content of its rivals for specialized search results, as well as dropping contractual restrictions that made it harder for small businesses to advertise on competing search advertising platforms.

That FTC decision not to sue Google is increasingly under fire, by conservatives as well as progressives. In late August, Sen. Orrin Hatch (R-UT) asked that FTC Chair Joseph Simmons revisit Google's role in search and digital advertising. That request came after three days in which Trump went on the warpath against Google, and also Facebook and Amazon, saying that the companies may be in a "very antitrust situation."

Google had argued that in search operations—unlike with broadband providers—the costs to switch remain minimal. "Internet platforms are not natural monopolies. Although some digital companies exhibit scale economies, they do not produce undifferentiated products and face relatively low costs of competitive entry," writes Glenn Manishin on the blog of the Computer and Communications Industry Association. "If digital platforms were natural monopolies, Google could not have dethroned Yahoo search, Myspace and Friendster would not have been surpassed by Facebook, and Amazon's small business e-commerce platform would not have been bested by the start-up Shopify."

Google's competitors and critics employed what is becoming a more common tactic: go to Europe to make charges. Indeed, the European Commission, the executive of the European Union, has taken an aggressively protectionist approach that has singled out American tech giants. In June 2017, it announced a fine of €2.4 billion , or $2.8 billion, against Google. It was for the same claims dismissed by the FTC. In July 2018, the EU lodged its second fine: €4.3 billion ($5.1 billion) over allegedly illegal restrictions on Android device makers and mobile network operators. (It's worth noting that Trump himself criticized the verdict in a tweet: "The European Union just slapped a Five Billion Dollar fine on one of our great companies, Google.") A third EU case involving Adsense has not yet concluded. It's still unclear whether American state attorneys general will also jump on board against Google, as they did in the Microsoft case—although the Justice Department and 14 state attorneys general did attend a meeting on September 25 to consider growing concerns about the power of social media giants.

Of course, the tech industry has never been exempt from laws of general applicability. But the once-unvarnished "success story" narrative has been scrapped for fashionable tech-bashing, as seen in popular books such as Jonathan Taplin's *Move Fast and Break Things: How Google, Facebook, and Amazon Cornered Culture and Undermined Democracy;* Franklin Foer's *World without Mind: The Existential*

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A new way to reach the public on the value of liberty

Art Exhibit at Cato: *Freedom: Art as the Messenger*

The Cato Institute has long been dedicated to spreading the ideas of freedom through books, studies, policy analysis, and research. Starting next spring, the Institute will launch a new way to explore the message of liberty. *Freedom: Art as the Messenger* will be Cato's first-ever art exhibit, as we open our doors to the general public and invite artists across all media to submit works for display at the Cato Institute's beautiful building on Massachusetts Avenue in Washington, D.C.

Artist's visualization of a banner which will be used on Cato's Massachusetts Avenue building.

Born of discussions with Harriet Lesser—an international exhibition artist, Strathmore curator, and longtime friend of Cato's—*Freedom: Art as the Messenger* will be a juried art exhibit on display from April 11 to June 14 of next year. Entries in all media are being accepted with a submission deadline of January 11.

The exhibit's Call to Entry succinctly explains the purpose of this project: "We are living in an era where people are finding their combative voice but having little conversation or dialogue. The goal of this exhibition is to provide a medium for that conversation. This exhibition invites all investigative points of view in all media; 2-D, 3-D, audio, and video. A full spectrum of interpretation is invited—whether personal, emotional, general, realistic or imagined, communal, or individual—addressing Freedom in all its manifestations through art."

Submissions will be considered through a blind jury process and will be juried on aesthetic value, mastery of craft, and relevance to the exhibition theme. Cash prizes will be awarded for Best in Show, Second Place, and Third Place at the opening reception. Honorable mentions will also be recognized. ■

FOR FURTHER DETAILS AND INSTRUCTIONS ON HOW TO SUBMIT WORKS FOR CONSIDERATION, SEE CATO.ORG/FREEDOM-ART-AS-THE-MESSENGER.

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Threat of Big Tech; and Tim Wu's *The Attention Merchants*.

Yet these now-criticized tech giants are all constantly pushing up against each other, and smaller companies, with innovative new offers. As tech journalist Scott Rosenberg writes: "One problem with today's charges of monopolistic behavior is that there are so many monopolists this time around. And they're all competing with one another!"

As to where the Trump administration comes down on antitrust, Washington is still trying to parse the meaning of the Antitrust Division's prosecution of AT&T's proposed merger with content company Time Warner, a $109 billion transaction—and its dubious decision to appeal U.S. District Court Judge Richard Leon's merger approval. The Obama administration had blocked AT&T's proposed acquisition of T-Mobile, a $39 billion transaction. But that was a "horizontal" merger proposal that would have lowered the number of nationwide cellular carriers from four to three. In a "vertical" merger of content and internet distribution, the better parallel is Comcast's acquisition of NBCUniversal, a $30 billion transaction approved by the Justice Department in 2011 with modest conditions.

Silicon Valley should take all this activity as a teachable moment. When the companies first went to the government in the 1990s to seek intervention against Microsoft, and when they pushed for FCC net neutrality rules more recently, they set a precedent that brought Washington into their industry. They took it for granted that regulators would never go after content platforms like their own, but now it is precisely those platforms that are squarely in the sights of many politicians. ■