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Solutions for the Internet Neutrality Argument

Overview

Internet Neutrality is the foremost issue facing the media industries. It is also a paramount issue in the economic growth or slide of nations. With the premise of national debt being that countries will inflate the debt away with productivity growth, the right internet regulations are critical to the continued success of every sovereign.

Decades ago in the United States the policy decision was made to allow private enterprise to build its public network infrastructure. This is an important threshold decision because investors are motivated by a return on their investment. This is as opposed to the government funding nationwide public network infrastructure, in which case no one would have a property right in it. However, since it has been privately financed we must weigh private property rights against free speech.

Under the Obama administration former Federal Communications Commission ("FCC") Chairman Tom Wheeler promulgated comprehensive internet neutrality regulations classifying the internet under Title II of the Federal Communications Act of 1934 which enabled the internet to be regulated as a common carrier. This basically means all network providers must peer and not have any fast or slow lanes. Now under the Trump administration new FCC Chairman Ajit Pai appears to be rolling back Tom Wheeler's mandates in favor of private enterprise regulating itself with regard to internet connectivity. Here is an analysis of the pro's and con's related to the spectrum of internet neutrality regulatory positions and proposed solutions to balance free speech and private property rights.

Private Property Rights are Paramount and Counter Balance Free Speech

We live in an information economy. Our global competitiveness in commerce and in education depends on being competitive with our internet infrastructure. Case in point, Verizon spent about thirty billion dollars and ten years paving a nationwide network of fiber optic roads to the home. It brought blazing fast fiber all the way into the bedroom. I know - I oversaw a small part of Verizon's implementation in Santa Monica, CA.

When I started this letter I was sitting in a hotel room in Seoul, South Korea with 100mb internet. I was using a Lenovo laptop, a Samsung phone, and watching an LG television. Do you remember the days when RCA was an American company and actually made TV's? Do you remember when Lenovo laptops were IBM? When everyone had Motorola Razr phones? Verizon paved thousands of roads. Just like the toll roads we often drive on. The tolls pay back the bonds used to finance the construction of the road - with interest for a return on the investment. Would it be reasonable to allow all cars to drive on a toll road without paying a toll?

This is what Amazon, Google, Hulu, Netflix and any other over-the-top ("OTT") applications have historically done when they deliver content to the consumer at home. The application is the new



everything. It is the new TV channel, CD, and DVD. Companies like Verizon make approximately 2/3 of their revenue from selling the television bundle. When companies like those listed previously can deliver a content offer that serves as a substitute straight to the consumer's television on the internet side of the pipe without having the cost structure of building and maintaining the network infrastructure they can be more competitive price wise.

Production is risky. Most shows fail to find enough audience to justify production costs on their own. The secret of the television business model, which is the 120 billion dollar-a-year spine of the 250 billion plus dollar-a-year media industry in the United States is that through the mandatory TV channel bundle we all pay for the content we don't watch. Let me say that again, *we all pay for the content we don't watch*. ESPN gets over five dollars per month from every cable household in America regardless of whether some homes watch even one minute within the month. This guaranteed income allows ESPN to manage the risks of rights acquisition and production. It has a positive trickle-down effect on the revenues of rights-holders earlier in the value chain.

Without this risk shifting methodology and with networks delivered ala-carte the following would be the results: (i) a well known cable network that receives two dollars (\$2) per cable household at seventy million (70MM) households would make approximately \$1.68 billion dollars per year in revenue from which they can support their cost structure and make a return on their investors money. Now, assuming in an unbundled world that only 10% of cable households watch that network on a monthly basis, they would have to charge \$20 per month to generate the same revenue.

According to a 2013 PriceWaterhouseCoopers study presented at CES 2014, the average consumer watches thirteen channels per month. What is the result of ordering 13 channels in an ala carte paradigm where channels are \$10 to \$20 per month? The average consumer ends up spending \$130 to \$260 per month for thirteen channels of television content. Not only is this paradigm more expensive than the standard television bundle, but they have only 13 channels instead of 550! If they keep their current spend, they have around 5 channels.

So the consumer is worse off. They pay more and get less. There is less production of new content. With less demand for skilled labor, wages shrink. To boot, companies like Verizon and Comcast have little incentive to invest in more robust networks leading to our infrastructure falling behind the rest of the world. As a result commerce and education suffer throwing the country further into a negative feedback loop.

The counterpoint to this is that during the Obama administration proponents of pure internet neutrality like Netflix and Amazon began investing billions in original content which has caused the traditional media companies to have to compete. Likewise technology companies like Google have been developing internet access paradigms that have kept traditional telcos on their toes. Internet speeds anecdotally appear to continue to be increasing under the threat of pressure from the likes of Google Fiber.

Possible Solutions: Pervasive Federal Regulation to Open Up ISP Competition

Today there is often very little competition within a geographic market for internet service. When I lived in Orange County, CA I had one cable provider and one phone company. I surmise part of the reason



why is due to local municipal regulation of the infrastructure laid in that jurisdiction. For example, from a commoditized utility perspective doesn't make sense to have two competing telephone poles side by side or two cables of the same type run next to each other. Time Warner had a virtual monopoly from the city. So if I wanted cable television, I had to get it from Time Warner.

Now imagine a single clear and concise set of Federal regulations that leverage the commerce clause to pre-empt local regulations to open up the internet service market to competition. These Federal regulations would provide that internet service is to be a competitive market and that any fixed line or federally licensed wireless operator (think 5G) can use local easements to build infrastructure to the home - subject to local approval of where the pipes are laid on a most favored nations basis.

Further, to avoid unnecessary infrastructure duplication, produce competition, low prices, and world-class data transport local governments can implement street level dark fiber available at a fixed wholesale price to any approved retail provider of internet access. This infrastructure investment could be financed by private lending or government bonds. The important element is that the resulting network be a wholesale facility that any retail actor can use at a fair known cost.

We'd have multiple fixed line cable, telco, and fiber providers and likely high speed wireless providers. Local and regional companies could build last mile networks and then pay backhaul providers (including municipal wholesale fiber) to connect to the internet at large. The industry would balloon. Access speeds would increase. Competition would lower price to the consumer. More content would be produced.

In a Private Internet environment, Comcast would not have to allow Netflix to reach its consumers. However, if I want Netflix content I can drop Comcast and get it through another internet service provider. Chances are Comcast will carry Netflix. It will become a part of the bundle of TV channels and the two companies will work out an economic relationship. Everyone wins. The consumer gets vastly more and higher quality content, the cable and telco companies are incentivized to invest in infrastructure, the media companies maintain their revenues so they can continue to take risks on high quality programming, and the jobs created throughout the media value chain are maintained keeping our nation economically on track.

The little guys survive in this proposed environment as well. The industry or a government agency could set "pay by the drink" rates for data usage on the part of content senders (the platforms and applications) much like they have for mechanical and public performance royalties with music copyrights. With a consent decree the internet data equivalent of performing rights societies could be born to collectively bargain and set rates between data broadcasters and infrastructure owners. Alternatively a baseline rate, such as the mechanical reproduction rate for music compositions administered by the Copyright Royalty Board, could be set and reviewed from time to time by a committee.

If we keep an entirely neutral internet then the consumer will bear the brunt of the economic rent that network owners need to extract to build and maintain their networks while data and content suppliers ride for free. The bundle is good for consumers, media companies and network owners alike.