

Special Review Memorandum

Re: Internet Access & Volume-Sensitive Pricing.

Foreword

Is the next logical step going to be lots more volume-sensitive pricing by Internet service providers (ISPs)? Recently, three Federal Communications Commission (FCC) commissioners opted for broad "network neutrality" requirements, didn't they? They said Comcast couldn't discriminate among customers using a file-sharing system called BitTorrent. Well, if facilities-based companies like Comcast can't "manage" demand on their own systems technically, aren't they likely to turn to price?

Isn't that what the U.S. Postal Service, Hilton Hotels, United Airlines, or Amazon.com do already? That is, if you want faster-than-usual service, or special handling, you're going to be charged more? So, what's so different here?

"It Was BitTorrent That Ate the Strawberries!"

An English computer expert compared the current ISP situation to four people being invited to tea, and discovering there are just four fancy creme cookies ("biscuits," to be correct). One of the guests, however, immediately eats three -- and, starts eyeing the fourth.

Demands which BitTorrent and other file-sharing systems place on networks are tremendous -- much more than simple email messages or routine web site searches. But those three FCC Commissioner basically said if one company and its customers want to "eat all the strawberries," the ISP's mess boys have to go along with the program, don't they? Again, do you think ISPs are just going to sit there and take it from these folks?

"Inflate My Tires? The Hell I Will!"

Back in 2005, you'll recall, SBC's CEO Ed Whitacre told Business Week he wasn't prepared to let every direct and potential competitor capitalize on SBC's broadband capabilities without paying, possibly lots. Whitacre spoke like a true capitalist, and that magazine commentary sparked a reaction in much of Washington.

Massachusetts Congressman Ed Markey lambasted Whitacre for refusing to give his shareowners assets away. Illinois Congressman Dick Durbin also said Whitacre was just being selfish. When Whitacre's lawyers and press agents were unable to control the fellow, moreover, Congressional (and, other) push-back mounted. Top Democrats on the House Commerce Committee pushed for "network neutrality" legislation, citing the ever-evil telephone companies -- but they lost twice in markup. But Democrats on the Senate Commerce Committee were luckier. Senators Dorgan, Kerry, etc., refused to let cable franchising legislation

happen in 2006 without addressing the "neutrality" topic. They prevailed.

The Ceaseless Search for Budget Support

Google, Amazon.com, and eBay back then had small, primordial Washington offices -- but staffers weren't stupid. They saw an issue which home offices could readily understand. A little creative budgeteering followed.

Soon, we had extravagant visions of SBC -- later renamed AT&T -- discriminating between Amazon.com and Barnes & Noble. Try and order a book on Amazon.com, their Washington counsel explained, and it might be harder than buying the same on a competing system. It'd soon be "curtains for America"!!

Major Internet users didn't mention that most big users already relied on Akamai and its global network of servers to get preferential treatment. They also didn't mention they were planning to start offering big, long video messages and services -- and, certainly didn't want to have to pay more.

But the pitch worked. Resources flowed from Santa Clara County. Online advocacy groups were enlisted -- Free Press, MoveOn.org, the "full catastrophe." Law firms started conducting conferences. As that fellow sang back in CB radio days, "We got ourselves a convoy!"

No Obligation to Subsidize Competitors

Now, there's a long U.S. regulatory tradition which holds that big, rich telephone companies must be required to share their bounty with small, "innovative" new entrants ("entrepreneurs"). But that tradition hasn't yet carried over to the predominant suppliers of Internet access service in this country, cable television companies.

Comcast, Charter Communications, etc., aren't that enthused about BitTorrent-enabled "file sharing" because this generates a video service directly competitive with Comcast's on-demand and similar video services. Cable companies also don't like to see one customer greedily eating all the creme-filled cookies.

So, we think it's almost certain the volume-sensitive Internet access pricing some cable and telephone companies are already "trialing" will be instituted nationwide. Some say the capacity of new systems -- the Verizon FiOS systems, for instance -- is so vast no one need limit any uses. But we expect phone companies -- and, cable companies -- still think a lot like good ol' Ed Whitacre. That is, as the song said, "It's my party and I'll restrict if I want to... ."

Will It Make Much Difference?

But assuming cable and phone companies start metering use of their broadband systems. Is that necessarily going to be, again, "curtains for America"?

Well, to begin with we're not sure volume-sensitive pricing will become truly "universal" because it's something of a hassle. Once upon a time, remember, all long-distance was sold on that basis, with elaborate "bands," clock times ("day-parts"), and so forth. Just the costs of billing, as AT&T showed, were significant. And, the great benefit of shifting to a "flat rate," Alaska's Ron Duncan explained, is "You can sell a lot of minutes they never actually use."

Over the next few years, holding onto customers and keeping them happy will be as commercially important for ISPs as growing the business. Pew Internet Project folks think we've pretty much tapped out in terms of high-speed market penetration. Remember, there are about 20% of the public best characterized as "aggressive non-adapters," and there are another 20% who live in households without children and who don't want all the Internet's "dazzling new electronic abundance." Email for them is mostly sufficient. Care-and-feeding of existing customers, in-short, will soon be a premium competitive value (the current stupidity of companies such as Time Warner and AOL notwithstanding).

If you're serving a longtime, happy customer who dutifully pays his or her monthly bills, do you want to risk that relationship by instituting some sort of cap on usage -- or, changing the pricing arrangement altogether? And, do you want to do that when your dutiful customer has available service options ranging from EarthLink to Covad to other competitors?

Wireless: The Wave of the Future

Ourselves, we think wireless high-speed Internet service is going to be the wave of the future -- and, that such services will be sold very simply. Most computers sold these days are laptops (note books). They all come with wireless (WiFi) connections -- and, Verizon, AT&T, and Sprint are also pushing their WiMax options.

True, wireless service currently is sold on the basis of message volume in some markets (e.g., Washington). At least one wireless carrier (AT&T) has said they're not going to allow peer-to-peer (P2P) file sharing. But we think limitations on these services will attenuate, as wireless connections continue to suck-up the business.

File Sharing: A Dicey Long-Term Proposition?

And, is file sharing all that "promising" a long-term service challenge, to begin with? Who knows?

Ourselves, we think the Motion Picture Association of America (MPAA) and the Recording Industry Association of America (RIAA) are soon going to be all over this practice like the proverbial Baltimore cheap suit. What would you guess? That better than 80% of the data files "shared" involve copyright infringement -- or, maybe pornography?

Huge data files which cable and phone company engineers say can gag their systems aren't likely to be "licit" stuff, are they? And, any time anyone tells you "these practices" can't be controlled, ask them to explain the RIAA "crusade." How many lawsuits have they filed -- it's over 10,000, isn't it? What's the typical settlement? Something like \$5,000?

Look at what colleges and universities are doing -- screening students's notebook computers on the ground they're seeking malicious viruses. Think any educators want to be nabbed for "contributory infringement"?¹

Conclusion

In conclusion, the FCC's decision to curb the "network management tools" ISPs can employ will probably result in more volume-sensitive pricing. But that's expensive, dashes some customer expectations, and may not be the best approach -- especially at a time when wireless options seem likely to take over.

And, is wanton, unconstrained file sharing likely to prevail in the end? Well, copyright folks and their limitless number of lawyers are on-to this case, aren't they? Just as they vanquished Napster, they ought to be able to address this latest challenge, too.

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¹ We think folks should also note that companies like Netflix have done a very good job competing against online services using the U.S. Mail. How many folks have dropped HBO service -- which at about \$20 a month is increasingly pricey -- in favor of signing up with Netflix? A lot, we'd expect.