



The Impact of Data Caps and Other Forms of Usage-Based Pricing for Broadband Access

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INTRODUCTION

Usage-based pricing has rapidly become one of the most controversial topics in Internet policy. Over the past two years, both wired and wireless broadband providers have been migrating from all-you-can-eat, flat-rate pricing to a variety of consumption-based pricing models.

This trend has been most prominent in the wireless broadband sector, where monthly data limits were an almost-inevitable solution to the surge in data demand unleashed by the smartphone revolution. Some fixed-line broadband providers have adopted much larger data caps for residential broadband use as well.

Some consumer groups have viewed the change to usage-based pricing with skepticism, fearing it will usher in an era of

- higher prices, deteriorating service, and increasingly anti-competitive conduct;
- anti-competitive tools with which broadband providers can protect their legacy cable affiliates from upstarts such as Netflix and Hulu; and
- capacity constraints to create artificial scarcity and pad profits, while avoiding necessary network upgrades.

RESPONSES TO USAGE-BASED PRICING CRITIQUES

- *Usage-based broadband pricing is not inherently anti-consumer or anti-competitive.* Rather, it reflects a cluster of pricing strategies through which a broadband company might recover its costs from its customer base and fund future investment. By aligning costs with broadband use, usage-based pricing shifts more network costs onto those who use the network the most and encourages more efficient Internet use. While anti-competitive risks exist, regulators should step in only when a firm exploits market power in a way that harms consumers.
- *Usage-based broadband pricing means lighter users don't subsidize heavier users.* Under a flat-rate system, all users pay the same amount to cover network costs. But heavier users, such as online video gamers and those who stream movies from Netflix and other online sources, consume significantly more of the network's total bandwidth each month. This means that light users pay a higher effective rate for broadband service, cross-subsidizing the activities of those who spend more time online. With usage-based pricing, those who use more bandwidth contribute more toward the cost of building and maintaining broadband networks.
- *Price experimentation may make broadband more affordable and accessible.* Data caps and other forms of usage-based pricing are examples of what economists call price discrimination. Although

the term may sound sinister, price discrimination is a common and often socially beneficial way for a company to spread its costs across its customer base. By pricing broadband service based upon the customer's willingness to pay, the firm can spread its costs efficiently across its customer base and may lead companies to extend service at a lower rate to light users who are unable or unwilling to pay the unlimited flat rate.

According to a 2010 FCC study, 65 percent of Americans have broadband access and those without access are generally "older, poorer, less educated, more likely to be a racial or ethnic minority, and more likely to have a disability" than those with broadband in the home. Allowing ISPs to experiment with different prices may aid in increasing accessibility among those disadvantaged groups.

- *Usage-based pricing may also help alleviate network congestion.* Unlimited flat-rate pricing encourages overconsumption of network resources because customers pay no additional charge for consuming additional bandwidth. This dynamic can create network congestion during peak online periods (a phenomenon that wireless consumers in particular are too familiar with).

By charging consumers for each additional unit of bandwidth consumed, usage-based pricing leads customers to internalize the costs that additional Internet use places on the network. This, in turn, could lead customers to demand that Internet content application and providers deliver content more efficiently to consumers.

- *Regulators should step in only when there is clear harm to consumers.* Skeptics may be correct that cable and Internet companies use data caps to protect their legacy cable businesses from Internet-based competitors such as Netflix. But the U.S. Supreme Court reminds us that antitrust law protects competition, not competitors. Netflix may not like the effects of data caps, but antitrust law should intervene only if the broadband provider has market power and is using that market power in a way that harms consumers.

Regulators should remain vigilant with regard to potentially anticompetitive conduct, but they should also heed antitrust law's lesson that many vertical restraints are pro-competitive. Absent market power, consumers can punish those that are not, without help from the Justice Department.

CONCLUSION

To reap the benefits of usage-based pricing and alleviate skeptics' concerns, broadband providers should be completely transparent about their pricing practices and give consumers tools to estimate their monthly data use. If successful, usage-based pricing can allow a company to differentiate itself from its competitors and allow consumers to choose the broadband plan that best fits their individualized needs.

Only through experimentation and empirical measurement will providers find the optimal pricing solution—which, by network, may vary dramatically. Thus far, regulators have correctly rejected the call to interfere with this pricing flexibility, absent a demonstration of market failure and consumer harm. This study shows why they would be wise to continue doing so.

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