Commissioner Jon Leibowitz
Competition in the Information Society
Uncorked and Unplugged
Remarks before the 2005 Global Forum
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Good morning. It is a true pleasure to be here with you today in this spectacular palace, and I thank Dr. Sylviane Toporkoff and Professor Miriam Sapiro for inviting me to participate in the Global Forum. I am honored to be before you: government officials and industry experts who are lighting the path toward a fairer, safer, more efficient information society.

Before I begin my remarks, I need to offer the Federal Trade Commission's standard disclaimer that the views expressed here today are my own, and do not necessarily reflect those of the Commission or of any other individual Commissioner.

For those of you who are unfamiliar with the Federal Trade Commission, I'll begin by explaining a bit about who we are. Next, I'd like to spend some time discussing an issue that should be of interest to you and has a significant impact on competitiveness in our global Information society: state barriers to competition, and to e-commerce in particular, in the United States.

The FTC is an independent agency with a broad consumer protection and antitrust enforcement mandate. When I say independent, I mean that we are a creation of Congress; not the executive branch. We don't work for the President.

The Commission consists of five members, nominated by the President and confirmed by the Senate. Commissioners serve staggered terms, which offers the benefit of both continuity of expertise and incremental policymaking. Additionally, by statute, no more than three Commissioners may be from any one political party. This ensures diversity of opinion. Our agency is a small one, comprised of just over 1000 attorneys, economists, and other staff.

With respect to our consumer protection mandate, our priorities remain anchored in fighting "traditional" consumer fraud, but they have been changing in the past decade as the nature of commerce -- especially e-commerce -- has changed. Recently, we have centered our efforts on areas such as cyber-fraud, focusing on spam, spyware, phishing, spoofing, and other abuses of cyberspace that threaten to undermine the promise of the Internet. In fact, I spent the latter part of last week in London participating in a conference on global spam enforcement. We have also focused recently on computer fraud and identify theft; recognizing that privacy and data security have become increasingly important, especially in light of recent high profile security breaches like Choicepoint, and Citibank.

With respect to our competition mission, investigating and challenging mergers and anticompetitive conduct, such as price-fixing and agreements among competitors that restrict competition, make up the vast bulk of the antitrust caseload. We are an agency with general jurisdiction, so you'll see us in a variety of markets; however, we have frequent business in certain economic sectors, such as:

– oil and gas,

– industrial chemicals,

– food and retail,

– pharmaceuticals,

– physician and hospital markets,

– computer hardware and software, and

– the Internet.

Additionally, unlike our counterparts at the Antitrust Division of the Department of Justice, our charter grants us a policymaking function in addition to our enforcement mandate. In support of that mission, we have a specialized shop which assists the FTC in developing recommendations on a wide array of policy issues.

Part of this program includes advocacy efforts directed at state impediments to competition, an issue with which the EC has dealt for some time, recently in the form of sectoral inquiries into energy and gas, and financial services. I would like to spend some time today talking about the FTC's efforts to address state regulations that impede competition.

Specifically, I'd like to talk about an old world issue – wine – and a new world issue – municipal provision of broadband internet service, or "muni broadband," as we call it. You might wonder what these two things have in common. The short answer is, they both have faced, or are currently facing, regulatory barriers to competition within the United States, and these barriers would restrict the use or expansion of Internet technology.

Just as important, you might wonder why you should care. Here's why: the Internet is crucial to consumers. Barriers to e-commerce – whether erected by the state or around the state; west of the Atlantic, or on the Continent, locally, or across borders – have the potential to undermine the promise of the Internet that we as a global society have worked so hard to nurture, and that many of you here today have made a part of your work.

Let's begin with wine.

Commerce in the U.S.– and this includes the wine industry – is most often regulated at the state level, because business traditionally has been transacted on a local basis. States have a compelling interest in ensuring that transactions conducted within their borders are fair, that their consumers are protected from fraud and deception, and that consumers receive the best quality goods at competitive prices.

The advent of the Internet, however, has turned local commerce into a national – and often times international – affair. Consumers now have convenient access to a wide array of goods that are produced outside the borders of their home states – or countries. While this is unquestionably of great benefit to consumers, it has also amplified regulatory concerns – and concerns by local “bricks and mortar” retailers, who often feel “squeezed” by Internet-based competition.

Most wine in the United States is distributed through a complicated distribution network, which was developed after the repeal of Prohibition (a 13 year nationwide ban on consumption of alcohol in the U.S.) in 1933. Under this system, a wine producer must first obtain a permit from the federal government. The wine then must sold to a licensed wholesaler, who delivers the wine to a retailer. The retailer may then sell the wine directly to a consumer. Most states prohibit vertical integration among these three tiers.[1]

This is, according to some, the most expensive distribution system of any U.S. packaged goods industry by far.[2]

Several years ago, the FTC undertook a comprehensive study that addressed potential barriers to e-commerce in the wine industry.[3] Particularly troubling to the Commission were certain state regulations that either limited[4] or outright forbade direct shipments of wine and

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1 *Possible Anticompetitive Barriers to E-Commerce: Wine*, A Report from the Staff of the Federal Trade Commission, July 2003. (“Wine Report”) at 5 (citations omited).

2 Id. at 22. (citations omitted).

3 *Possible Anticompetitive Barriers to E-Commerce: Wine,* A Report from the Staff of the Federal Trade Commission, July 2003.

4 Some of these limitations include very low ceilings on annual purchases, bans on advertising from out-of-state suppliers, requirements that individuals purchase “‘connoisseurs’ permits,”, and requirements that delivery companies obtain a special individual license for every vehicle that might be used to deliver wine. Wine Report at 4.

other alcoholic beverages from out-of-state sellers to in-state customers. In many cases,[5] these laws erected a barrier to cross-border online wine sales that was all but insurmountable. More than half of the United States had some sort of regulations in place,[6] some of which were the subject of federal lawsuits that argued that these restrictions violated the U.S. constitution.[7]

Now this might not seem like a significant issue to many of you here in Western Europe, where a trip to the local corner store is likely to yield an array of wines richer than some of even the more specialized wine dealers in the U.S.. But in a country like the United States, where a consumer may be situated thousands of miles from her wine-producing region of choice, convenient access to out-of-state wines is a significant consumer issue. For example, under New York law – which has since been overturned – if a New York consumer wanted to order a Pinot Noir directly from a California vineyard,[8] she would be out of luck; likewise if she wanted to purchase an Italian Pinot Grigio directly from an out-of-state U.S. seller. Consumers in over two dozen other states would run into the same problem.

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5 Some states allow direct shipment of wine to the consumer, but only from an in-state supplier, which necessarily limits greatly the variety of wines available to the consumer.

6 Ben Lieberman, Internet Wine Sales: Old Monopolies Fight Against New Bottles, Competitive Enterprise Institute, August 14, 2002.

7 The Wine Report takes no position on the constitutional issue, which was subsequently resolved by the Supreme Court.

8 California, the hub of the U.S. wine industry, is the world's fourth largest wine producer, behind France, Italy, and Spain. See Michael Lear-Olimpi and Tony Mauro, *Supreme Court Clears the Way for Wine to Flow in and Out of States*; E Commerce Law and Strategy, June 2005.

The FTC took a close look at this issue and concluded in its Wine Report that bans on direct shipping of wine prevented consumers from saving as much as 21 percent.[9] Additionally, these regulations precluded convenient access to a multitude of popular wines – many of which were European imports -- and from literally thousands of smaller wineries. The Report thus concluded that states could significantly enhance consumer welfare by allowing the direct shipment of wine to consumers.

Many of those supporting the restrictions claimed that they are necessary to prevent underage drinkers (in the U.S., those under 21 years of age) from receiving direct shipments of wine.[10] However, these concerns could be addressed by simply requiring a signature from a qualified adult upon delivery. In fact, the Commission's study found that of the states that allowed direct shipping, most reported few or no problems with shipments to minors.

There is a happy turn to this story, or at least one we can raise our glasses to. Earlier this year, in an opinion that cited heavily to the Commission's Wine Report, the United States Supreme Court issued a ruling outlawing regulations in two states – New York and Michigan – that banned direct shipments of wine by out-of-state suppliers, but allowed in-state wine

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9 According to private estimates cited in the Report, a wholesaler typically marks up a bottle of wine by 18-25%. Wine Report at 22 (citations omitted)

10 Due to a magnitude of alcohol-related problems, the various United States prohibit consumption of alcohol by individuals under a certain age, which is in most instances, twenty-one One study, cited in the Wine Report, estimated that in 1996, the total costs of underage drinking – including traffic crashes, violent crime, burns, drowning, suicide attempts, fetal alcohol syndrome, alcohol poisoning, and treatment – was $52.8 billion. Wine Report at 11 (citations omitted).

suppliers to ship directly to customers.[11] (Interestingly, C. Boyden Gray, nominated to be the next U.S. ambassador to the EU, joined the fight on the side of the wine wholesalers, who sought to ban direct sales. Let's hope that his views will ripen with age....)

Though the Supreme Court's ruling was widely heralded as "the best day for [American] wine lovers since the invention of the corkscrew,"[12] there are clear limits to the high court's ruling. While the ruling struck down laws that favored in-state wine suppliers over out-of-state competitors, it does not outlaw the practice of banning direct shipping to consumers completely. Indeed, in the months since the Supreme Court's ruling, many states have proposed legislation that would prohibit direct shipping entirely. Additionally, the court's ruling leaves open the issue of how states may regulate direct shipments from European suppliers. Which way the wine flows from here remains to be seen.

Now that we've been uncorked, let's get unplugged.

It is almost universally acknowledged that Internet access is essential to economic growth and education. High speed access, particularly wireless access, benefits students, parents, small businesses, emergency workers and anyone else who values enhanced portability, flexibility and speed. In its most fundamental form, broadband is about consumer empowerment – giving users

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[11] Granholm v. Heald, 125 S. Ct. 1885 (May 16, 2005)

[12] Clint Bolick, strategic litigation counsel for the Institute for Justice, as cited in Michael Lear-Olimpi and Tony Mauro, *Supreme Court Clears the Way for Wine to Flow in and Out of States*; E Commerce Law and Strategy, June 2005.

access to and control of information.

This is true in the U.S., in Europe, and around the globe.

In fact, in this day and age, access to broadband in the U.S. could be considered even more vital than some traditional government services because the Internet is both a repository of information, like a library, and a shared common space, like a park, to which the public should have access. To that end, local governments are beginning to step up in communities across the United States to meet the information and technology needs of their residents by offering high-speed wireless Internet access or broadband, as a public service. In other words, a growing number of U.S. municipalities are establishing broadband networks that potentially compete with commercial operators.

Take Philadelphia, for example. Beginning last year, the city undertook plans to offer wireless Internet access. The city's rationale was straightforward: many of its residents did not have access to broadband, and Wi-Fi service would spur economic development, improve education,[13] attract tourists, and benefit city agencies at lower cost than the current telecom

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[13] Philadelphia's chief information officer also stressed the importance of providing broadband for education – noting that while schools have heavily invested in their computer systems, only 58 percent of Philadelphia's students have Internet access at home. David Haskin, *Philly CIO: Public Wi-Fi Needed to Close Digital Divide,* MOBILEPIPELINE, January 25, 2005, *available at* www.mobilepipeline.com/57703505.

infrastructure.[14]

These plans, however, were almost terminated at their inception by the efforts of commercial operators pressing for state legislation prohibiting municipal wi-fi. But fortunately, after a public outcry, reason won out and today the city is moving forward with its plans.[15] Many additional U.S. cities – perhaps 300 in all – are considering or implementing broadband networks.

Municipal development of broadband may be the best option in some cities where many residents cannot afford the high prices of private Internet providers, or where Internet providers simply did not see enough economic incentive to provide universal coverage. It may be the only option in rural areas where phone and cable companies have not extended any service – often contending that it would be prohibitively expensive. Indeed, even the mere threat of local government entering the broadband market may entice phone and cable companies to compete in these low-income and low-density areas.

Although in Philadelphia, the city prevailed, many similar municipal initiatives are being challenged by the efforts of commercial incumbents who simply don't want the competition. To

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14 Peter Loftus, *Philadelphia Waits for Wi-Fi*, THE WALL STREET JOURNAL, March 3, 2005.

15 With respect to the construction of its network, it is interesting to note that Philadelphia is turning to two highly capable private-sector companies to potentially provide this service – undermining the position of some that cities cannot provide broadband competently and the position of others that this issue breaks down as a fight between the private sector and local government.

put this in context, imagine if Borders and Barnes & Noble – or Waterstone's, Thalia, or FNAC – claiming it was hurting their book sales, asked lawmakers to ban cities from building libraries. At the very least, this would be considered somewhat of a stretch. Yet so far, phone and cable companies have successfully pressured about a half dozen states to place some sort of restrictions on their books, and similar measures are being considered in many others.

To be certain, opponents of municipal broadband make several arguments that, at first blush, might seem persuasive. They assert that supplying access to the Internet simply is not a proper function for local government. They argue that municipal participation in the establishment of wi-fi networks would amount to "unfair competition" because municipalities have certain advantages over private providers, such as lower fixed costs and no need to pay for rights of way, an argument that seems to raise concerns similar to those embodied in the EC's proscription on state aid. And they claim that cities would be incompetent suppliers of broadband service.

Having said that, municipalities in the U.S. already provide their residents with many services that compete with private sector counterparts, such as libraries, schools, recreational centers, police, parking, subways and buses and, in some places, electricity. And it stands to reason that if the companies truly believed that municipalities would be incompetent broadband service providers, they wouldn't be spending tens of millions of dollars lobbying to prevent government-sponsored competition.

I raise these concerns today with the awareness that this issue has not gained as much momentum on this side of the Atlantic as it has in the U.S. But it might: municipal Wi-Fi could be coming soon to a city near you. One city in the UK has rolled out a Wi-Fi hotzone, and there are reportedly talks progressing about introducing municipal Wi-Fi in Birmingham.[16] It has likewise been reported that the city of Amsterdam is involved in supporting a fibre network to be built around the city.[17] I'm sure there are others.

I have asked the FTC's Office of Policy Planning to go on record as opposing attempts to restrict municipal broadband. But I would also hope for the involvement in this issue of our sister agency, the FCC. I count at least two FCC Commissioners as a supporter in this regard, and hope that others will share my concern.

The potential contributions that e-commerce can make to our world economy – and to the quality of our lives as consumers – are limited only by those forces that impede the competitive process. Whether you are a New Yorker ordering a Zinfandel directly from a California vineyard, a Philadelphia student learning French online in her backyard, or a London banker checking stock quotes from the Tube, you are among those whose lives have been enriched by the promise of the Internet. The Internet is a true global resource, accordingly, threats to its vitality are of global concern.

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16 Peter Judge, *Please Persecute Us, Cry Wi-Fi Suppliers*, Techworld, April 22, 2005.

17 Richard Handford, Broadband Debate Rages in the U.S., The Financial Times, June 29, 2005.

Thank you.   I've enjoyed being here.