1

States, firms and legitimacy of regulation: insoluble issues?

This book aims to answer a simple empirical question in a complex environment. Is Internet regulation a paradigm of constitutionally responsive co-regulation? Within the question, I unpack first what forms of regulation are present in the governance of the Internet, based on case studies. I define and examine what responsive regulation, and specifically co-regulation, entails, and how it contributes to protecting constitutional rights within regulatory organizations.[1] Finally, I assess the extent to which Internet co-regulation is a paradigm of such forms of regulation,[2] as compared to, for instance, financial[3] or environmental regulation.[4]

The book sets out to achieve these objectives with the following structure, based on two multi-year studies for the EC conducted in 2001–4 and 2006–8.[5] This opening chapter identifies how regulation is changing and explains in brief, for the general reader, via mapping, how the Internet has been perceived as being regulated, in terms of self-, co- and state regulation, outlining the methodology adopted, and the substantive case studies.[6] In Chapter 2, I identify more fully what co-regulation is, focusing on its application in European law and regulation. In Chapter 3, I begin with the first of four substantive case study chapters, which both analyze and update the work outlined in Chapter 2, examining self-organizational forms in which organizations establish their own governance form without reference to a wider corporate forum or government involvement. I consider paradigms of emerging regulation including self-organization by social

[1] See Klang and Murray (2005); Tambini *et al.* (2008).
[2] For earlier more theoretical attempts to undertake the same task, see Lessig (1999); Marsden (ed.) (2000b); Murray (2006).
[3] See Black (2009).
[4] Boyle and D'Souza (1992); Hulme and Ong (in press).
[5] Marsden *et al.* (2008), building on Tambini *et al.* (2008).
[6] Haddadi *et al.* (2009) at p. 12 state that they 'observe a move away from a preferential attachment, tree-like disassortative network, toward a network that is flatter, highly-interconnected, and assortative'.

networks. In Chapter 4, I identify the paradigms of technical self-regulation in governing the Internet, a form of relatively pure self-regulation not often encountered in other industries.[7] In Chapter 5, I consider paradigms of content co-regulation in the Internet environment, describing a move towards a form I describe as 'medium law'. In Chapter 6, I explore filtering and removal of content, privatized censorship and co-regulation. In Chapter 7, I summarize the case studies and explore the contribution these exemplars can make towards our understanding of Internet regulation. I summarize the substantive findings, analyze the directions of travel apparent in the case studies over the period 2007–10, and make cross-cutting comparisons with wider regulatory analysis in this period, described as the 'Age of Crises' in both environmental and financial regulation,[8] but also more broadly in advanced market economies subject to the emerging 'long depression' in growth as compared with the earlier 'Golden Age' of regulation in 1982–2007. In Chapter 8, I conclude by examining the prospects for co-regulation to become a more substantial regulatory technique, including via its analysis in Impact Assessment (IA) by government, and for the lessons of Internet co-regulation to be adopted more widely across government. The general heading of 'Better Regulation' lays particular emphasis on the need to assess impacts of proposed changes and specific guidance relating to evaluation and IA.[9] Key aspects are the need to: perform holistic *ex ante* assessment of impacts; consider relevant alternatives; take into account a range of potential impacts (costs, benefits, distributional impacts, administrative requirements); and measure and, where possible, monetize such impacts on the basis of sound data and analytic methods. These general principles are not reflected fully in the state of the art: alternatives are rarely identified, the range of impacts considered is often narrow, and measurement and monetization remain underdeveloped, especially in relation to self- and co-regulatory organizations (henceforth SROs).[10] Thus there is a need to develop further the implications of self- and co-regulation, and to identify clear and consistent principles and practices which can be implemented.

[7] See Price and Verhulst (2000, 2005).
[8] See Campbell (1999), pp. 712–772; Short and Toffel (2007), pp. 1–16; Weiser (2001), pp. 822–846; Kahan (2002), p. 281; Archon Fung, et al. (2004) The Political Economy of Transparency: What Makes Disclosure Policies Effective? Ash Institute for Democratic Governance and Innovation John F. Kennedy School of Government Harvard University OP-03-04, pp. 1-49; Michael (1995), pp. 171–178; CFA Institute (2007); Ofcom (2007); Federal Trade Commission (2007); Pitofsky (1998).
[9] Examples include the EC (2002).
[10] Jacobs (2005, 2006).

The word 'constitutional' is used in two senses in this book. First, it refers to a general adherence to principles of administrative justice, notably fair trial, due process, independence of regulator from regulated, participation by all interested parties, and transparency. Second, it specifically refers to the types of fundamental rights that may be affected by Internet regulation as it affects the specific communications medium,[11] notably the rights to privacy and free expression[12] that may be enhanced or infringed by Internet-based activities. This latter form of constitutional oversight is vital in this context, as Internet regulation affects both economic and social rights to participate in society and economy, but also these more fundamental constitutional rights.[13] It therefore straddles different forms of rights, in much the same manner as environmental regulation.

Much recent scholarship has focused on human rights and the Internet, in three different forms. First, the possibilities the Internet offers for self-publishing has made its use by those seeking more transparency and criticism of governments widespread, through websites such as Wikileaks and IndyMedia. In this sense, the Internet is considered a tool for human rights activists, as the 'world's biggest photocopier'. Second, and associated with the first, much scholarship has focussed on individual and group rights exercised by Internet users against those who offer them services without respecting their constitutional rights, especially concerning censorship of users' speech, and invasions of others' personal privacy, by both the state and private corporations. In this sense, it is the Internet Service Providers' (ISPs') often murky common carrier status which is in question, and the roles of ISP as publisher and user as author. Third, the idea that access to the Internet is a human right in and of itself has emerged, in part from the right to receive and impart communications enshrined in Article XIX of the Universal Declaration of Human Rights 1948.[14] It also stems in part from the ubiquity of the Internet as a means for communications between government and citizen, notably for the conduct of government

[11] See Lessig (1999).
[12] For differing US and European conceptions of free speech, see Boyle (2001), pp. 487–521.
[13] On the connection between human security and human rights, notably on the extent to which both can be aligned under what Franklin Roosevelt called the 'Four Freedoms' – freedom of speech and religion, freedom from want and fear – see Boyle and Simonsen (2004).
[14] Also see *International Covenant on Civil and Political Rights* of 16 December 1966; *Rome Statute of the International Criminal Court* of 17 July 1998; *European Convention on Human Rights and Fundamental Freedoms* 1950; *Framework Convention for the Protection of National Minorities* of 1 February 1995; *Council of Europe Convention on Cybercrime* of 23 November 2001 and its *Additional Protocol* of 28 January 2003.

and especially electoral and tax affairs. In this final sense from a rights perspective, the Internet has supplemented universality of telecoms and postal services for communications between individual and state.

These three, often intertwined, senses in which Internet access creates or conveys or transfers human rights are an important element in discussions, especially those surrounding state and private censorship of the Internet. Thus, the right to access the Internet has become an important part of the discussions around network neutrality and the revision of states' telecoms universal service commitments in Europe, with Finland becoming in mid 2010 the first country in the world to enshrine broadband Internet access as a universal human right for its citizens, no matter where they live.[15] Furthermore, the US State Department has set up a unit dealing with innovation,[16] and Secretary Hillary Clinton has given speeches condemning China for its censorship of (notably US-based multinational) ISPs and denying access to the open Internet to Chinese citizens, stating that restrictions on citizens' Internet access and speech:

> contravene the Universal Declaration on Human Rights, which tells us that all people have the right 'to seek, receive and impart information and ideas through any media and regardless of frontiers'. With the spread of these restrictive practices, a new information curtain is descending across much of the world.[17]

The European Parliament has included human rights within its discussions of granting users access to the Internet in legislative amendments to the Electronic Communications Package in 2009.[18] The European Commissioner responsible for fundamental rights has also spoken of Internet access in these terms.

The constitutional position of Internet co-regulation is therefore well established in the fundamental rights debate. Less well established is the basic procedural legitimacy of such arrangements. One could argue that placing the rights principles before the mechanisms to achieve them is a cart-before-horse manner of achieving those ends, but it is inevitable given the paucity of procedural legitimacy in much of the ad hoc governance of the Internet. The case studies will supply plenty of evidence of such policy-making and indeed forum-creation 'on the hoof', and much less evidence of administrative law standards of due process. In making this criticism, one should be careful to distinguish regulatory activities from SROs, and especially so to condemn governments for 'outsourcing'

[15] Catacchio (2010). [16] See Ross (2009). [17] Clinton (2010).
[18] Directives 2009/136/EC and 2009/140/EC.

activities to an ill-prepared private sector, while avoiding an inappropriate and unsuitably legalistic and governmental approach towards entrepreneurial activities that were never designed to meet formal regulatory procedural standards in the first place.

The incoming tide of Internet co-regulation

The incoming tide of co-regulation is spreading from Europe into the UK. As described by Lord Denning,[19] the supremacy of European law means that the UK is largely a rule-taker not a rule-maker (except as one vote in twenty-seven members of the Council of Ministers). This tide has had several ebbs and flows, notably an ebb as Thatcherite privatization and regulation flowed out throughout especially Eastern Europe in the late 1980s, a tide of regulation under the Single European Market in the lead-up to 1992, and further ebbs and flows under various mantras, notably 'Better Regulation' (which was supposed to be deregulation) in the 2000s. Now with market failure and sovereignty seen on as spectacular a scale as in 1929, the entire regulatory state is at question.[20] As Sunstein explains, this leads to new regulatory techniques: 'the strongest arguments for cost-benefit balancing are based not only on neoclassical economics, but also on an understanding of human cognition, on democratic considerations, and on an assessment of the real-world record of such balancing' noting that cost-benefit analysis 'can protect democratic processes' from interest groups that are 'pressing for regulation when the argument on its behalf is fragile'.[21] Writing in 2010, I would suggest that IA is also useful to present the benefits of auditing self-regulation where industry players claim that it is more efficient.

This book aims to examine one area in which the excesses of deregulation were sponsored and supported by the UK Government, exposed to the rest of Europe as a best practice, but are unravelling and being re-regulated both due to their manifest failings and the tide of European regulation.[22] Previously, regulation of communications was seen as a subfield of either mass media or utilities, depending on whether the issue was content (particularly professional content for broadcast or print media)

[19] *H.P. Bulmer Ltd* v. *J. Bollinger* S.A. [1974] Ch 401 at p. 418.
[20] See Coglianese and Kagan (2007).
[21] Sunstein (2002a), p. 9.
[22] Recent examples of legal analysis grappling with the role of the EU and the nation state in the face of globalized markets and regulatory networks, include: Baldwin and Black (2007); Craig (2009).

or carriage (notably telecommunications, radio, satellite and cable networks). Since approximately 1995, however, communications has seen a convergence between content and carriage, fostered by digitalization and particularly the Internet, on which we make Skype telephone calls, read *The Times* (behind its paywall), listen to BBC radio and watch some video. Furthermore, communications infrastructures are so critical to the knowledge-based economy that this field has grown remarkably in economic importance as well as social pre-eminence. As intellectual property and financial transactions have become 0s and 1s of binary code cut into packets and fired around the Internet (the amorphous but convenient geographically metaphorical 'cyberspace' is often used), people appear locked to their desktop and laptop and mobile smartphone computers almost all their waking hours. Security, freedom, openness and safety of this space are seriously important.

There is often a founders' myth associated with 1990s Internet SROs, which holds that cyberspace would be an anarchic but functional space.[23] There was just enough truth in that to maintain the fiction that governments could not enforce their old rules, and normative claims were established that governments should not enforce such rules, as well as the practical claim that the technology was so alien, anonymizing and globalizing that national rule-sets were both damaging to the legitimacy of nation states that attempted their enforcement and futile in the face of the technology.[24] This vacuum of rule-enforcing gave space to the development of the myth of Internet self-organization, a space for social entrepreneurship that did not even admit of self-regulation, let alone government regulation. However, a flood of private law also surged into the vacuum, from copyright claims to terms of use for ISPs and websites, that were absurdly slanted in favour of the large corporate interests that rapidly emerged as the Internet commercialized in the mid 1990s.

A historical accident, that of unmetered local telephony, meant that US consumers went online long before Europeans, who were charged by the minute for access to narrowband Internet services.[25] As a result, it was the deregulated and aggressively commercial tactics of US ISPs and websites that predominated, adopted rapidly by the UK market, which was the first

[23] Johnson and Post (1996), pp. 1367–1402.
[24] See the critique by Mosco (2004).
[25] The US achieved ten million consumer Internet users about five years before the European Union, 1994 versus 1999. See Tambini *et al.* (2008), p. 12.

major European Internet adopter,[26] and shortly thereafter by European joint ventures between US and local companies, such as Terra Networks and AOL-Deutschland. The growth, by acquisition, of WorldCom, a US-based ISP that acquired over forty companies in the late 1990s including MCI (second-largest telephony competitor in the US) and UUNet (a pioneering ISP across Europe), led to further infiltration of US regulatory policies into European Internet policy. (I acknowledge that a thumbnail description of consumer Internet access such as this runs twin dangers, that of conflating consumer Internet use with the far more transformative use of the Internet Protocol for business communication, transactions and supply chain management, and of conflating the World Wide Web with other aspects of Internet Protocol-based communication.)

The US Communications Decency Act (CDA) [27] was enacted as part of the Telecommunications Act 1996, but was overturned a year later in the landmark Supreme Court case of *American Civil Liberties Union* v. *Reno* (1997).[28] The Court decided that the virtually unanimous will of Congress to censor the Internet via mandatory filtering was unconstitutionally chilling of speech under the First Amendment to the US Constitution, and that technical filtering as a voluntary option for users was the less intrusive approach from the viewpoint of freedom of speech. This inspired standards experts to attempt to introduce a wide-ranging labelling scheme for Internet content, the PICS (Platform for Internet Content Selection).[29] We examine this connection between technical standards and content, services and applications in some depth in Chapter 4. CDA was then almost immediately replaced by the Child Online Protection Act 1998 (COPA 1998), which established the Commission on Child Online Protection (COPA Commission), whose 2000 COPA Commission report forms the basis for (Family Online Safety Institute) FOSI's educational approach

[26] Driven by what was known as the Freeserve model after the subsidiary of Dixons plc that first adopted a revenue-share interconnection model with the incumbent monopoly telephony provider British Telecommunications plc (BT). Freeserve grew rapidly in late 1998, then was absorbed by Wanadoo, a subsidiary of France Telecom, the French monopoly telephony provider. Another leading example was WorldOnline, a Dutch company that used the same business model.

[27] Title V of the Telecommunications Act of 1996, the amendment that became the CDA, was added to the Telecommunications Act in the Senate by an 84–16 vote on 14 June 1995.

[28] *American Civil Liberties Union* v. *Reno* [1997] 21 USC 844 Supreme Court case of 27 June 1997, No. 96–511 suspending parts of CDA by 7–2 majority, Rehnquist and O'Connor dissenting in part.

[29] See www.w3.org/TR/REC-PICS-labels-961031.

to child protection from harmful content.[30] COPA 1998 was suspended and overturned,[31] and the Government's last appeal was refused a hearing by the Supreme Court on 21 January 2009 at the culmination of the George W. Bush Presidency. *Reno* led directly to the Internet Content Rating Association (ICRA) which emerged in 1999 from PICS and the US RSAC system for computer games. ICRA is a not-for-profit company that has been government funded and supported with corporate members. In 2007, ICRA was absorbed into a relaunched advocacy organization for rating, FOSI. The lack of market adoption of ICRA until now has been attributed in part to lack of incentives for websites unless rating can interoperate with other standards, or more radically unless rating is made mandatory. It essentially retreated into becoming an advisory council on online safety after 2007. FOSI itself recently recognized the genesis of its approach.[32]

The collapse of the Internet start-up market in the infamous 'dot-com bubble' of 2000, followed by the technology and telecommunications markets in 2001–2, and finally the collapse of global accountants Arthur Andersen in the wake of the Enron and WorldCom frauds of 2001–2, did not fundamentally change the by-then entrenched self-organizational policies in Internet standards (as readers will appreciate, legislation that is passed in 2002 has its origin years earlier). Legal institutions had embedded the self-regulatory model as their standard for the Internet, in legislative acts such as the Electronic Commerce Directive 2000/31/EC, the European Electronic Communications Package ('ECP') of 2002,[33] the 'Television without Frontiers' Directive 1997 and the UK Communications Act 2003. It was only in 2007–10 that these laws were reviewed, reconsidered and in some cases amended to redress the over-zealous deregulatory intent of those giddy 1990s. As I write in autumn 2010, the E-Commerce Directive is being reviewed, the ECP was amended in November 2009, the Audiovisual Media Services (AVMS) Directive 2007 replaced the 'Television without Frontiers' Directive and was implemented in European Member States in 2009 (see Chapter 5: ATVOD), the Digital Economy Act 2010 amended UK legislation, while the Telecommunications Act 1996

[30] Commission on Child Online Protection (2000).
[31] *Ashcroft* v. *ACLU* [2004] 542 U.S. 656, of 29 June, confirming suspension of unconstitutionally broad Internet censorship in COPA, by a 5–4 majority, Rehnquist, Scalia, Breyer and O'Connor dissenting in part.
[32] FOSI (2010).
[33] Five Directives, a Recommendation and a Decision were included within this enormous legislative undertaking. See Marsden (2010), Chapter 6.

was reformed almost beyond recognition by its regulatory agency, the Federal Communications Commission (FCC), and the courts.

Policy-makers retreated from that deregulatory high ground of 1995–2000 as the Internet became a ubiquitous broadband medium. Having recoiled from the futility of their original efforts to regulate, regulators regained their nerve partly because the extent of misuse was becoming so apparent in the early 2000s, partly because the 'dot-com bubble' had demonstrated that the golden goose had choked itself and that therefore there was no alchemy that regulators would disturb by their actions, and partly because Internet markets naturally evolved such that the thousands of early entrepreneurs rapidly consolidated into a few large companies. There was by 2005 a relatively stable constituency of Internet content providers (Yahoo!, Microsoft), of search engines (Google), of electronic commerce providers (Amazon, eBay), and of ISPs (the largest cable and telephone companies and few rivals). Commissioner Kroes has recently stated: 'The lower the costs of entry, the lower the risk to innovators, and the more innovators you get. A time such as this one characterized by a very dynamic environment and a high rate of innovation might not be the best time to close the door to experimentation and private initiative.'[34] The technical standards body, IETF (see Chapter 4), still maintained its original constitutional structure (constitutional in the sense of the basic ground norms and procedural approach), and the body of SROs that mushroomed in the late 1990s was embedded alongside the older telecommunications and electronic engineering SROs on which industry had previously relied.

Internet regulation has been a trailblazer for self-regulation in the 1990s, for re-regulation and state interest in the early 2000s, and now increasingly for co-regulation in the period since about 2005. This is not just because it has 'grown up' and regulators with it – it is obvious that in 1995, very few bureaucrats or politicians had a clue what the Internet would be and it may have appeared attractive to allow it to develop in somewhat of a legislative-regulatory vacuum with minimal enabling of e-commerce and extension of the principle that online behaviour could – with great difficulty – be prosecuted as in offline behaviour. It is certainly true that such Internet exceptionalism ended in the bursting of the post-Cold War deregulatory euphoria with the twin events of the collapse of the dot-com bubble in 2000–2 and the renewed vigour of state security in the period after the 11 September 2001. There is, however, a more important

[34] Kroes (2010). On Internet competition issues, see also Almunia (2010).

narrative than simply the end of the exceptional. Internet regulation has become a testing ground for new forms of regulation, some discarded as too idealistic or naïve in the late 1990s, others tested, adapted and adopted and fitted to new cultures and new practices. This book aims to unpick those practices to explore which have appeared successful – often simply through survival – and those of merit and capable of adoption in other regulatory fora and other industries. The book concludes by noting which practices are indeed 'best of breed' and capable of adoption by the wider regulatory academic and policy community.

Internet regulation was continually declared to be 'light touch' in the UK, notably by its 'super-regulator' Ofcom and sponsoring ministry (the many-named former Department of Trade and Industry), until the collapse of the OECD economies in 2008, after which regulation became briefly fashionable. This short period finished with the election of the deregulatory Conservative Government in May 2010,[35] and the renewed growth of those OECD economies in 2010. The crucible of innovation and enterprise was seen as one in which the alchemy of competition was most likely to produce a successful outcome. 'First do no evil' was the watchword of regulators in the UK, US and many other places. In this, they shared their intellectual inheritance with the Financial Services Authority and other guardians of the information economy. The crashing of financial markets worldwide in 2007–9 had much less effect on the Internet than on many more traditional sectors, not least because it depends on free cash flow for investment in the UK far more than multiples of earnings: the crash of the bubble in 2000–2 was literally a life-changing event for those in Internet industries. Partly through that crunch, partly through the market-concentrating network effects which are such a part of the Internet, much of the industry was very concentrated by 2007, with only two major UK wholesale Internet access providers (Virgin and British Telecom), one major search engine (Google), one UK-owned mobile network operator (Vodafone, the other four being foreign-owned by German, Spanish and French incumbents, and a Hong Kong company), and the largest online content operators being the government-owned BBC and Channel 4. To that extent, oligopoly ensured the survival of the industry, but largely because it had consolidated so rapidly in 2002–7. Social networking sites were US-owned, notably Facebook, MySpace and Bebo. The

[35] See Vaizey (2010), stating: 'This government is no fan of regulation, and we should only intervene when it is clearly necessary.' Though his Secretary of State is a Liberal Democrat, this is clearly government policy.