

# The **Unintended Consequences** of Internet Regulation



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# The Unintended Consequences of Internet Regulation

Over the last few years, there has been an increasing drumbeat for greater internet regulation. But even the most well-intended policy approaches may have completely unexpected negative consequences that may outweigh the benefits sought by the regulation in the first place. Those benefits can be difficult to achieve and difficult to measure, while this paper finds that such regulations frequently have a negative impact on investment in covered internet companies, with declines ranging from 15% to 73%.

## Germany

The "Network Enforcement Act" or NetzDG, which compels large websites to remove content on short timelines, appears to have significantly reduced investment in social media companies compared to similar markets like the UK and France.

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## Pakistan

A 2021 set of regulations requiring rapid content removal by websites has sparked serious concerns about censorship as well as the impact on global investment in Pakistani companies, contradicting the government's other efforts to promote growth.

## China

A government crackdown on "celebrity" internet CEOs, executed in part via new laws and regulations ostensibly focused on issues like antitrust and privacy, appears to have resulted in a drastic reduction of investment in internet companies.

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## Australia

A reversal of fortune for the once-growing tech sector coincides with a series of court decisions that allowed plaintiffs to hold websites liable for third-party content. In the years since, funding of internet startups has quickly and steadily declined.

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## United States

2018's FOSTA-SESTA law amended the intermediary liability protections offered by Section 230. It was followed by a noticeable decline in late-stage investment in social media, while also failing to achieve its stated objectives.

## India

Rather than causing a reduction in social media investment, India's 2021 rules related to online intermediaries became a protectionist tool, and correlated with surging investment in government-friendly platforms such as the Twitter-like Koo.

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## Indonesia

Following a series of laws that have already been called out for abuse and censorship, the government recently issued several regulations that enable content removals and the blocking of entire websites. The full effect of these rules remains to be seen.

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A world map with several regions highlighted in a dark purple color. The highlighted regions include the United States, Canada, the United Kingdom, India, China, Indonesia, and Australia. The rest of the world is shown in a light grey color.

# 1. Executive Summary

**OVER THE LAST FEW YEARS**, there has been an increasing drumbeat for greater internet regulation. There is no question that the internet has grown to be more essential and more central to everyone’s lives over the last few decades. There has been significant global scrutiny on how internet companies act, and what they may enable. The explorations regarding regulations and the internet often fall into the category of intermediary or platform liability, but on the whole they all seem focused on either requiring or pressuring a few key companies to take more responsibility for content that is posted online.

Given how deeply the internet is now woven into our everyday lives, it is essential that policymakers take a careful, evidence-based approach to internet regulation. Small changes to the law can have a huge impact not just on the internet itself, but the billions of users and small businesses around the globe who now rely on the internet for important services, communications, information, commerce, and more. Even the most well-intended policy approaches may have completely unexpected negative consequences—consequences that may outweigh the benefits sought by the regulation in the first place.

Understanding the pros and cons to any particular policy should be top of mind for policymakers, understanding how to avoid the mistakes of the past, and how to create more effective regulations in the future.

The internet is not just “cyberspace.” It’s an ecosystem that is deeply, and inseparably, entwined with almost everything that people do these days, and policymakers need to be careful that attempts to regulate it don’t destroy competition, suppress freedom of expression, or dangerously limit investment and innovation. Even worse, policymakers must ensure that regulatory approaches aren’t simply a cover for governments to abuse their power to suppress civil liberties or rights.

The broad narrative that is often used to justify these regulations is that these companies are unwilling to take responsibility and need to be forced to take a more proactive role in managing the content connected to their services.

There has been much less attention given to exploring whether or not these efforts to put in place internet regulations are actually solving the problems they claim to be fixing, or the actual long term impacts of these regulations—especially with re-

gards to the unintended consequences of these laws, such as whether they harm innovation, free speech, or conflict with other policy goals by diminishing competition. These questions are only likely to become more important as a number of major new regulations touching on intermediary liability, such as a number of U.S. Congressional bills, the Digital Services Act in the EU, and the Online Safety Bill in the UK, move forward. Even as there is little evidence that previous attempts to regulate the internet in this manner have been successful, policymakers are already pushing to expand intermediary liability.

This report aims to explore those issues. Combining both our own data gathering and analysis (mostly on the investment front) with a meta analysis of other studies, we found that the studied regulations created significant unintended consequences. We reviewed a variety of different legal regime changes across many different countries and regions, focusing on the set of examples whose data was available at the time of drafting but was not yet available at the time we drafted our last report on this topic,<sup>1</sup> such that this report builds upon the existing body of research. The report also includes a series of illustrative case studies to highlight more specific ways in which these laws are impacting technology companies.

Generally speaking, this report finds that there is always a cost to such regulation, the benefits generally are hard to measure, and it is not apparent in data that intended benefits are being achieved. Overbreadth and poor targeting of many of these policies can both drive compliance costs up and make benefits hard to measure, especially when

many of the expected benefits were already being pursued by tech company firm policies, independent of legal requirements under the new policies.

The report looks specifically at the impact on changes to platform regulations such as intermediation standards in a variety of regions around the globe, including in the United States with the Fight Online Sex Trafficking Act (FOSTA), Australia with a series of court rulings putting more liability on websites, Germany with its Network Enforcement or NetzDG law, India with its Information Technology Rules (2021), and China with a series of legal changes supposedly to better control some of the largest internet companies in that country.

As a general conclusion, we find from these case studies that these regulations have also created many negative unintended consequences. These consequences tend to reduce innovation while creating barriers to new entrants in the regulated spaces. There were other consequences as well, including harm to speech, empowering governments to suppress critical speech, or to drive revenue and users to local companies over foreign competitors.

Throughout the research that went into this report, we found repeated examples of companies diverting resources away from product development and innovation, and often directed at compliance and legal costs that showed little to no benefit for users.<sup>2</sup> For example, one firm needed to increase total staff by over 2% to comply with the strict requirements of one such policy, NetzDG. Firms responding to NetzDG often saw only a tiny increase in content removals/blocks due to the policy relative to their

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measure*

baseline - for example, only about 1% at YouTube in most reporting periods - despite a large number of incremental complaints about content, suggesting that existing firm policies were already pursuing most of the intended benefits of the costly policy.<sup>3</sup> Moreover, the vast majority of the NetzDG complaints did not result in content removals/blocks, suggesting that a major impact of the policy was an increase in false positive reports.<sup>4</sup> Similarly, some regulations have resulted in expensive lawsuits, where even when the companies ultimately prove successful, the risk of criminal liability is far too great. The data and case studies show that this effort has often decreased profits and the ability of competition to grow, while simultaneously enabling the few companies at the top of the market to entrench their position.

Among the key findings in the report, we found:

**Decrease in investment and innovation:** A main focus of this report is to add to the literature data and analysis on the impact on investment in the wider startup ecosystem following major changes in platform regulation around the globe, particularly those that weakened intermediary liability protections. We found that these regulations decreased investment in covered startups by between 15.2% and 73.4% in the jurisdictions we examined.<sup>5</sup> This suggests that investors took the news of greater platform regulation as a sign to decrease their support for companies in the space, likely recognizing that such rules made it more difficult to succeed, and where more of the investment funds would likely be used on compliance or litigation costs, rather than innovation. Reduced startup funding results in fewer innovators and disruptors entering markets to compete with established firms, and fewer new and innovative ideas being tested in the market.

The literature strongly supports a positive association between startup funding and innovation, across numerous decades, countries, and industries, with a highly plausible causal mechanism: investment in startups funds innovation. A paper studying panel data of 17 European Union countries from 2000-2009 found robust empirical support

for a positive impact of venture capital on innovation even after controlling for the potential endogenous relationship between venture capital and innovation.<sup>6</sup> Another paper analyzing a firm-level dataset in China ranging from 1998 and 2007 found that venture capital-backed firms outperform non-venture capital ones in terms of both technological and commercialized innovation in China; and that the outperformance of venture capital-backed firms in innovation is driven by both the ex-ante project selection and ex-post monitoring efforts of venture capital firms.<sup>7</sup> The overwhelming consensus of research papers on this topic likewise found a positive relationship between startup funding and innovation consistent with a causal relationship.<sup>8</sup>

Moreover, in all of the areas that we researched, there was only one country example that didn't show a decrease in investment associated with the implementation of an adverse policy: India. And as the report details, the difference there appeared to be a significant investment in a local Twitter clone that has close ties to government officials behind the policy change who were upset with Twitter.

Our previous research<sup>9</sup> used cross-regional comparisons to explore the actual impact of different levels of intermediary liability protection and how it impacts investment in innovation. Our research found that in countries or regions with strong laws and standards that protect intermediaries from liability, there was much greater investment into innovative companies, while taking away those protections had a significant negative impact on investment and innovation. A primary cross-regional comparison in our research was between U.S. and EU intermediary liability protections.

Other studies have also found that reduced protections against liability harm investment in innovative startups, and increased protections increase investment: An economic microsimulation found that an intermediary liability regime with clearly defined protections and requirements for compliance and low associated compliance costs could increase startup success rates for intermediaries in studied countries by between 4% and 24%, with clear implications

for the attractiveness of intermediary startups to venture capital and similar investors.<sup>10</sup> One study directly analyzing intermediary liability found that an expansion of intermediary liability or reduction in protections would reduce the formation of internet intermediary startups, as well as generally decrease internet investment, as 71% of investors polled responded they would be uncomfortable investing in intermediaries if the protections were weakened.<sup>11</sup> An economic analysis of broader regulatory requirements creating liability risk for internet intermediaries in Europe found a clear negative association between increased intermediary liability and investment in new technology ventures and startups.<sup>12</sup> An analysis of European venture capital following the 2002 EU e-Privacy Directive found that European venture capital funding for internet startups slowed relative to the United States, likely due to increased regulatory uncertainty and associated liability risk for intermediaries reducing the attractiveness of such firms to venture capital investors.<sup>13</sup> Multiple surveys of global investors found that a supermajority of investors expressed strong reservations about investing in intermediaries without policy protections against intermediary liability, often referencing uncertainty and the potential for large legal costs/damages.<sup>14</sup> Other investor surveys and analysis have found that internet intermediary liability regimes have a strong effect on investor attractiveness and likely investment even when the scope of analysis is limited to intellectual property-related liability.<sup>15</sup>

In the U.S., the general policy limiting intermediary liability is Section 230 of the Telecommunications Act, which

created strong protections from intermediary liability in most circumstances. Section 230 was enacted in 1996 but faced significant legal uncertainty until 1998, when the rest of the Communications Decency Act was struck down, and the Digital Millennium Copyright Act was also enacted, which also contains important intermediary protections. In terms of impact on market activity, strong U.S. intermediary liability protections effectively began in 1998.

The EU E-Commerce Directive, which established the standards on liability protection that all EU member states must abide by, was agreed to in 2000 and member states had to have their laws in agreement by 2002. Under this directive, platforms do not get blanket immunity, but must comply with conditions like responding to reasonable notices of rights infringing activity by taking down the content, while also lacking “actual knowledge” of such activity prior to notice. The intermediary liability protections under the EU E-Commerce Directive are weaker than those in the U.S., and became

effective several years later than U.S. intermediary liability protections.

The different effective dates and relative strength of intermediary liability protections in the U.S. and EU created an opportunity to look at the impact of such protections on investment in innovation. We previously found that the broad protections offered by Section 230 likely resulted in somewhere between two to three times greater total investment in internet platforms in the U.S. as compared to the more limited protections offered in the EU under the E-Commerce Directive.

*Surveys and analysis have found that intermediary liability regimes have a strong effect on investor attractiveness and likely investment*



In Germany, intermediary liability protections were weakened further with the NetzDG policy. Following the implementation of the NetzDG law targeting social media companies, late-stage investment in such companies in Germany effectively went to zero (while such investment continued in nearby countries like France and the UK). In the U.S., late-stage investment in social media significantly declined after FOSTA went into effect and weakened Section 230 protections for intermediaries. The same was true in Australia, where investing in internet companies dropped precipitously as the country's courts began to pile on more regulatory burdens for web platforms. In China, to effectuate a crackdown on internet companies, the government used western platform regulation laws as justification for its own efforts to stymie domestic internet companies. Not surprisingly, almost immediately after those laws were put in place, investment in such internet companies dropped to merely a small fraction of what they were prior to the crackdown.

We also highlight case studies where the impact of this is clearly felt, with companies finding it more difficult to survive and compete in the market under these regulations. Or in some cases, such as the case study we have on Veoh, we show how a company that was vindicated after six years of litigation, winning every important ruling in its case, still had to shut down its business operations halfway through the lawsuit, as the cost of fighting the lawsuits bankrupted the company, and no investors were willing to provide the funding to continue, knowing much of it was going to lawyers—even for a legal fight the company would

eventually win.

The decline in investment was also associated with tremendous evidence of a negative impact on innovation itself. This was seen throughout the report, especially in highlighting the impact on startups and investment, and how often these laws appeared to negatively impact the local ecosystem for internet companies and innovation.

Most clearly this is seen in the case study on Australia's tech policy changes, where nominal "success story" Atlasian admitted that the compliance demands of various global platform regulations had destroyed product release timelines, massively ratcheted up the costs of compliance globally, and even had a role in having the company officially move its headquarters out of Australia.

We also found studies<sup>16</sup> regarding such policies suggesting that the most well-known companies—who were often described as the primary targets justifying these regulations—often would be harmed less by these new rules than smaller

competitors. Our own analysis supports this finding—for example, the relatively small company SoundCloud required six to seven staffers to comply with NetzDG – a more than 2% increase in total headcount<sup>17</sup> – while YouTube, which is several orders of magnitude larger, only required a single order of magnitude more staff to comply with NetzDG, at 77.<sup>18</sup> These results are consistent with economic models of internet regulation, which find that regulation imposes costs on all firms, but small firms and new firms are most adversely affected, especially where the price mechanism does not mediate the effect, such as the advertising-sup-

*We highlight case studies where the impact of this is clearly felt, with companies finding it more difficult to survive and compete in the market*

ported internet.<sup>19</sup> Likewise, economic models of innovation and startup formation imply that higher regulatory compliance costs for startups would be expected to be associated with lower startup formation.<sup>20</sup> While such rules did increase compliance costs for leading firms, a significant portion of those costs were fixed rather than variable costs, benefitting larger firms, and the total costs, while large, often appeared to be manageable for those firms (many of whom were already largely doing the very things the law demanded).<sup>21</sup> The impact on smaller companies, and especially upstart competitors with limited capital runway, on the other hand, was much more significant.<sup>22</sup> The impact of compliance costs was much higher and much more debilitating for smaller firms, and created a barrier to entry for new firms. The ability to raise investment decreased, as investors shied away from markets where the costs were increasing.

Similarly, the impact of size thresholds within these laws appeared to have some impact on competition. For example, Germany's NetzDG

law only applies to companies with over 2 million users, creating compliance cost cliffs for small startups that are pre-monetization and have limited capital "runway."

At the same time, the evidence showed that there was greater consolidation in markets with new rules, both with the most prominent companies (often who had been discussed as the main targets of the legislation) able to grow market share as smaller companies faded away.

#### **Failed to achieve the stated goals of the regulations:**

Throughout this report, we found evidence highlighting

how the stated goals of these platform regulations were not actually met. Perhaps most notable among the areas studied in this report was FOSTA, in the U.S., which was promoted with claims of how it was necessary to help stop the horrific crime of sex trafficking. However, multiple analyses since then, including analysis by the U.S. Government Accountability Office, found instead that the law made the job significantly more difficult for law enforcement, taking the activity away from companies that worked closely with law enforcement, and mostly sending it overseas. At the same time, that report found that law enforcement appeared to believe it already had the tools it needed to fight sex trafficking prior to FOSTA becoming law.

The analysis also found tremendous harm caused by FOSTA, most notably in putting those in and around the sex worker community at serious risk, but also leading to questionable and costly litigation, while also limiting access to cultural artifacts and historical documents.

While perhaps not as stark, other laws faced similar issues.

With Germany's NetzDG law, the evidence suggests that the very premise of the law—that companies supposedly needed extra incentive to remove illegal content upon notification—appears to have been wrong. When proposed, lawmakers predicted that there would be hundreds of fines issued to companies not removing content. Those failed to materialize, as the evidence suggests that the companies were already removing that sort of content when they became aware of it, and have continued to do so since. Instead, the data suggests that NetzDG has encour-

*The impact of compliance costs was much higher and much more debilitating for smaller firms, and created a barrier to entry for new firms*

aged companies to overblock legitimate content, claiming that it violates their terms, as a way to avoid even the risk of massive NetzDG fines. At the same time, there remains evidence that hate speech (what the law was designed to target) still exists on these platforms, but is not reported, such that the platforms remain unaware of it, and cannot take action on it.

The end result, then, is that the companies have much greater compliance costs and risks, for little benefit, and the only major change has been a more aggressive approach to taking down content that does not, in fact, violate the law.

We found that while governments put forth clear rationales for these new platform regulations, there is little evidence that the regulations actually live up to those promises—or that policymakers have much interest in revisiting why these laws failed to achieve the promised results.

**Harms to speech and expression:** A key function of the internet is to enable speech and communications. However, the evidence repeatedly shows that many of these laws end up having a negative impact on freedom of expression. While some might argue that this would be acceptable if these regulations ended up limiting egregious, abusive, or harassing speech, the evidence we found does not support that contention — instead, in cases like with NetzDG, the evidence points to overblocking of non-problematic speech and a chilling of discourse.

We discuss a few examples of speech suppression, as companies afraid of the liability risk chose to proactively block perfectly reasonable content that might still put them at risk of a lawsuit or regulatory fine. A notable example here is with the U.S.’s FOSTA law, in which many companies chose to alter terms of service regarding what content they were willing to host, including eBay removing all sorts of content it classified as “adult” content, but which actually included historical documentation of LGBTQ+ culture, and was becoming more and more difficult for researchers, historians, and archivists to find.

**Providing a roadmap for regimes to favor local companies and suppress speech via copycat laws:** Perhaps one of the most troubling of all the findings in this report is how more authoritarian governments were using these types of laws for their own ends. Multiple authoritarian regimes, in fact, modeled laws requiring the suppression of speech on Germany’s NetzDG law, enabling them to suppress speech critical of the government. Both Pakistan and Indonesia have recently implemented laws that appear quite similar to Germany’s NetzDG, using similar language around protecting society from the harms of online speech, and having similar requirements regarding rapid suppression of speech in response to government demands. The willingness to mimic intermediary liability laws from elsewhere in pursuit of suppression of criticism of the government is deeply concerning.

Equally troubling is the case study of the Indian government ratcheting up its intermediary liability laws in a direct attempt to pressure Twitter to suppress speech that was critical of the government. In that case, we found that while venture capital investment in social media in the country actually (perhaps surprisingly, given the findings elsewhere) increased after that change, it was notable that a key beneficiary of a significant amount of that funding was a local copycat microblogging service of Twitter, called Koo, which had close ties to the Indian government. In other words, these kinds of regulatory changes enabled the government to put in place protectionist policies that favored local companies, who were more willing to obey government demands to suppress speech and also to integrate with the government’s own biometric identification system, raising concerns about privacy.

China implemented multiple laws claiming to be about “data protection” and privacy in trying to limit the power of successful internet companies in that country (while increasing the government’s own surveillance powers). As our report shows, China’s claims around passing these new laws for “cybersecurity” and “antitrust” reasons were a thin smokescreen for actual plans to retain greater control over these successful internet companies and how they oper-

ate. China often justified these bills using the same talking points as western nations passing internet regulations and antitrust laws, which in turn should raise questions about how the west's passing of these regulations ultimately provides justification for greater governmental control and power in other parts of the world.

Repeatedly, this report found that these regulatory changes ostensibly designed to “rein in Big Tech” not only failed to do so, but that they also had dangerous and problematic consequences.

This report should hopefully lead policymakers to take a more careful and nuanced view of various platform and internet regulations, and especially their impact on the wider innovation ecosystem. What are these laws actually intended to do, and how can the public be assured that the laws will actually accomplish those goals? At the same time, what safeguards are there that these laws won't dan-

gerously limit competition and innovation, won't suppress free expression and investment, and won't be used to justify authoritarian goals?

As this report shows, the end result of all of these regulatory changes does not appear to be an “improved” internet where there is greater “responsibility” by larger internet companies, but one in which there is less competition, less innovation, and more ability by governments to abuse their power over these companies to damage speech and privacy interests. That also means an internet that is less in the public's interest and benefit. As governments around the world rush forward with major new internet regulations, which could have even more sweeping impact than the laws discussed in this report, it is imperative that policymakers do more to understand the impact of these laws on a variety of different areas, and take care in rushing to implement new and unproven policies.

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## Notes & Sources

<sup>1</sup> The Copia Institute. *Don't Shoot The Message Board* (2019) <https://copia.is/library/dont-shoot-the-message-board/>

<sup>2</sup> Note that many dollar figures in this report are based on exchange rates at the time the relevant data was collected for each section, generally in late 2022.

<sup>3</sup> For example, see: Google. *Removals under the Network Enforcement Law*. [https://transparencyreport.google.com/netzdg/youtube?hl=en&items\\_by\\_reason=period:2020H2&lu=community\\_guidelines\\_enforcement&verified\\_reporting\\_agencies=period:2021H1&community\\_guidelines\\_enforcement=period:2022H2](https://transparencyreport.google.com/netzdg/youtube?hl=en&items_by_reason=period:2020H2&lu=community_guidelines_enforcement&verified_reporting_agencies=period:2021H1&community_guidelines_enforcement=period:2022H2)

<sup>4</sup> For example, see: Google. *Removals under the Network Enforcement Law*. [https://transparencyreport.google.com/netzdg/youtube?hl=en&items\\_by\\_reason=period:2020H2&lu=community\\_guidelines\\_enforcement&verified\\_reporting\\_agencies=period:2021H1&community\\_guidelines\\_enforcement=period:2022H2](https://transparencyreport.google.com/netzdg/youtube?hl=en&items_by_reason=period:2020H2&lu=community_guidelines_enforcement&verified_reporting_agencies=period:2021H1&community_guidelines_enforcement=period:2022H2)

See also: Facebook. *NetzDG Transparency Report*. <https://about.fb.com/de/wp-content/uploads/sites/10/2022/07/Facebook-NetzDG-Transparency-Report-July-2022.pdf>

<sup>5</sup> A single outlier, India, is discussed in more detail in two paragraphs.

<sup>6</sup> Faria, A.P. and Barbosa, N. *Does Venture Capital Really Foster Innovation?* *Economic Letters*, 122 (2): 129-131, (2014) [http://www.ne.su.se/polopoly\\_fs/1.255624.1447241701!/menu/standard/file/140118\\_paper\\_1.pdf](http://www.ne.su.se/polopoly_fs/1.255624.1447241701!/menu/standard/file/140118_paper_1.pdf)

<sup>7</sup> Di Guo, Kun Jiang. *Venture capital investment, intellectual property rights protection and firm innovation: evidence from China*, *Entrepreneurship & Regional Development*, 10.1080/08985626.2022.2062618, 34, 5-6, (434-470), (2022) <https://www.tandfonline.com/doi/epub/10.1080/08985626.2022.2062618>

<sup>8</sup> Much of this literature uses patent counts as a proxy for innovation. This is an imperfect measure. Patents are of widely varying quality and value even within a single region, and may vary even more widely when compared across regions or industries or over time. Further, not all innovation is patentable. See:

Abrams, David S., Akcigit, Ufuk & Grennan, Jillian. *Patent Value And Citations: Creative Destruction Or Strategic Disruption?* [https://www.nber.org/system/files/working\\_papers/w19647/w19647.pdf](https://www.nber.org/system/files/working_papers/w19647/w19647.pdf)

Although limited by the imperfect nature of the data, the literature consistently shows a correlation between investment and patent-count based measures of innovation. For example, one paper studying the United States found that increases in venture capital activity in an industry are associated with significantly higher patenting rates, and venture capital may have accounted for 8% of all industrial innovations between 1983-1992. See:

Kortum, S., & Lerner, J. *Assessing the Contribution of Venture Capital to Innovation*. The RAND Journal of Economics, 31(4), 674–692. (2000) <https://doi.org/10.2307/2696354>, <https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=f117fed8fcd6566d01afee799792b9b3ed634a>

Another paper conducting a 41-country cross-country analysis between 2006 to 2016 found that higher venture capital investment in a country was associated with higher patent generation.

Nawab Khan, Haitao Qu, Jing Qu, ChunMiao Wei, and Shihao Wang. *Does Venture Capital Investment Spur Innovation? A Cross-Countries Analysis*, SAGE Open (2021) <https://journals.sagepub.com/doi/10.1177/21582440211003087>

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The pattern continues with other papers studying the relationship between investment in startups and/or venture capital and innovation:

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Samila, Sampsa and Sorenson, Olav. *Venture Capital, Entrepreneurship, and Regional Economic Growth* (July 6, 2009) <https://ssrn.com/abstract=1183576>, <http://dx.doi.org/10.2139/ssrn.1183576>

<sup>9</sup> The Copia Institute. *Don't Shoot The Message Board* (2019) <https://copia.is/library/dont-shoot-the-message-board/>

<sup>10</sup> Oxera. *The economic impact of safe harbours on internet intermediary start-ups* (2015) <https://www.oxera.com/wp-content/uploads/2018/07/The-economic-impact-of-safe-harbours-on-Internet-intermediary-start-ups-1.pdf-1.pdf>

<sup>11</sup> Chris Dippon. *Economic Value of Internet Intermediaries and the Role of Liability Protections*. NERA Economic Consulting (June 5, 2017) <https://archiveia.org/wp-content/uploads/2017/06/Economic-Value-of-Internet-Intermediaries-the-Role-of-Liability-Protections.pdf>

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## 2. Germany & NetzDG

**BEFORE GERMANY PASSED ITS** “Network Enforcement Act” or NetzDG in 2017, the EU established the EU E-Commerce Directive in 2000. Our previous research<sup>1</sup> compared this EU intermediary liability protection to stronger U.S. intermediary liability protection under Section 230 by looking at cross-regional differences in investment in web platforms that rely on intermediary laws. Over 15 years, we looked at social media, e-commerce and cloud computing companies that were formed after January 1st, 2000 up until the end of 2014 in the U.S. and Europe. The data showed differences between the regions: there were 12,381 companies in Europe, while there were 27,538 companies in the United States. Additionally, only 24 companies in Europe had received more than \$100 million in funding, while 410 U.S. companies received more than \$100 million in funding. Meaning that while Europe has about half as many internet companies, roughly 1/10th received over \$100 million in funding. When looking at companies that received \$10+ million in funding, our study found that 2,680 U.S. internet platforms received at least that much funding, compared to just 466 such internet platforms in Europe.

Due to the implementation of weaker intermediary liability protections in the EU than the U.S., there was a major funding gap in Europe compared to the U.S., especially at the high end. Our research suggests that between 2000 and 2014, a U.S.-based company, under the protections set forth by Section 230, was 5 times as likely to secure investment over \$10 million and nearly 10 times as likely to receive investments over \$100 million and nearly 10 times as likely to receive investments over \$100 million when compared to internet companies in the EU that were under the more limited protections of the E-Commerce Directive. This research confirms that internet platforms built under the stronger intermediary liability protections of the Section 230 regime were more likely to receive the significant investment necessary to grow and succeed.

Despite this cross-regional disparity in investment driven by weaker EU protections for intermediaries, Germany further weakened intermediary protections when it passed its “Network Enforcement Act” or NetzDG, which compels large websites to remove “clearly illegal” content within 24 hours and other illegal content within a week or face significant fines. Despite

the law being in place for over three years, there are few indications that it has worked to achieve its main goal of stopping abuse, harassment, or hate speech online. To the extent that it has been shown to have changed the behavior of large websites, the only indications are that it caused them to overblock content that might not otherwise have been blocked, but in a manner that has not meaningfully decreased abuse, harassment or hate speech. The data actually suggests that the companies have been, and continue to be, quite adept at removing harmful content as soon as they are made aware of it, and the premise behind NetzDG (that companies needed stronger incentives here) was misplaced.

In other words, while it may have resulted in the removal of more content, it suggests those removals were likely for content that was legitimate and should not have been removed, while the law has created new costs for companies, without leading to the expected corresponding benefits.

It certainly did not stop people from posting hate speech and harassment. In 2021, the New York Times noted that NetzDG did little to stop hate speech flowing online in the run-up to the German election.<sup>2</sup>

*Harassment and abuse are all too common on the modern internet. Yet it was supposed to be different in Germany. In 2017, the country enacted one of the world's toughest laws against online hate speech. It requires Facebook, Twitter and YouTube to remove illegal comments, pictures or videos within 24 hours of being notified about them or risk fines of up to 50 million euros, or \$59 million. Supporters hailed it as a watershed moment for internet regulation and a model for other countries.*

*But an influx of hate speech and harassment in the run-up to the German election, in which the country will choose a new leader to replace Angela Merkel, its longtime chancellor, has exposed some of the law's weaknesses. Much of the toxic speech, researchers say, has come from far-right groups and is aimed at intimidating female candidates like Ms. Dornheim.*

While this article suggests the hate speech found online exposed “weaknesses” in the law, the evidence actually suggests that it’s the very premise of the law that is the weakness, not how the law itself works. The data shows that the companies have been, and continued to be, aggressive in removing this content as soon as they become aware of it, and the only major addition of NetzDG is to encourage companies to be less cautious about making sure the content actually violates the law before removing it.

Separately, academic attempts to analyze whether NetzDG accomplished what its backers promised found it lacking. A paper by researchers working with Dr. Marc Liesching in Germany, entitled “The NetzDG in Practical Application”<sup>3</sup> found multiple areas that suggested the law did not live up to the promises made by its supporters.

*In 2017, the NetzDG legislator assumed that there would be 500 substantiated fine proceedings against social networks each year in the area of complaints management, which would require a personnel expenditure of 39.5 positions with personnel and additional costs totalling approximately 4 million euros per year. In fact, in the period from 2018 to 2020, the responsible authority of the Federal Office of Justice (Bundesamt für Justiz) did not issue any penalty notices in the area of complaint management. This also indicates a rather marginal practical significance of the Network Enforcement Act, which is geared exclusively toward fine notices in terms of legal consequences.*

Indeed, this suggests that the entire law was put forth based on a faulty assumption: that companies were choosing not to remove such hate speech and harassment when the companies were alerted to such content. The results actually indicate that the companies remain aggressive in pulling down such content when alerted to it on their sites.

That same report highlights that of the companies it studied, nearly all of the removed content was done as violation of site “terms,” rather than as required under the law. The report also suggests that companies may be much more willing to determine that content violates its



own terms to avoid having to judge the content against the NetzDG requirements — and notes that it's quite likely this leads to overblocking.

For instance, the report highlights that there is significant circumstantial evidence pointing to overblocking as a result of the NetzDG, while criticizing the German government for failing to do the work necessary to determine if overblocking had actually occurred:

*However, a precise investigation is made more difficult by the fact that the evaluation of the NetzDG commissioned by the federal government did not include an empirical investigation into the existence of “overblocking”, and the three monitoring reports commissioned by the Federal Office of Justice within the meaning of Section 3 (5) of the NetzDG are based upon an inadequately explained methodology and an insufficient number of cases.*

The report highlights, again, the fact that companies claimed to take things down as violations of their own terms of service, rather than as required by NetzDG. But, it also shows that this focus on removing content as violation of terms has almost certainly resulted in overblocking. That's because the decision to take down so much content, combined with classifying those takedowns as terms violations, is strongly incentivized by the nature of the law and its large fines for missing content that must be taken down under the law. But by classifying it as a terms violation, the companies are able to “minimize” the risk of fines. It also allows the companies to remove the content on a global basis, rather than having to rely on geofencing different results inside and outside of Germany.

That said, there is substantial qualitative evidence that NetzDG has had a negative impact on speech online. Some of that is anecdotal, including when right after the law went into effect, *Titanic*, a satirical magazine in Germany, had its Twitter account blocked under the new law for parodying an extremist German politician.<sup>4</sup>

Combined, this suggests that the law was mistargeted, since the companies already aggressively removed prob-

lematic or illegal content when they were aware of it, and the only actual impact of the law has been to pressure companies to pull down more content than necessary to avoid the risk of potential fines associated with leaving up any problematic content after learning about it.

While the few attempts to statistically analyze the impact of the NetzDG law on speech<sup>5</sup> have been inconclusive, this is likely due to the classifications as terms violations, rather than NetzDG violations (making it more difficult to directly attribute the results to the law). However, since the law incentivizes this behavior, it also makes it much more difficult to explore the extent of the overblocking that is occurring.

There are also some problems comparing different companies in terms of how they've complied with NetzDG. For example, Facebook reported significantly fewer (orders of magnitude fewer) NetzDG reports received than Google, Twitter, and YouTube. It is believed that this was because Facebook set up a separate (apparently difficult to find) form for submitting such reports,<sup>6</sup> whereas the other companies included a NetzDG reporting option with their regular reporting interfaces.

Indeed, it appears that the only actual fine under NetzDG was against Facebook,<sup>7</sup> claiming that the company underreported the number of NetzDG reports it had received. Just recently, a complaint was lodged against Twitter under NetzDG, but focused on an alleged failure to provide details on its procedure for counter notices, which the complaint says violated the law.<sup>8</sup>

Perhaps because of the failings of the NetzDG to achieve its goals, in 2021, the law was amended<sup>9</sup> in part to standardize some of the reporting from the companies, and to make sure that their implementation is done in a similar way (most likely targeted at Facebook's very different form of compliance). It was also amended to force services to hand over more information about users (including names, home address, and IP address) directly to the federal police when being alerted to certain content, raising questions regarding privacy. This created an outcry in Germany, leading the President, Frank-Walter Steinmeier, to use a rarely

used procedure to block the law from coming into effect, until that section was changed.<sup>10</sup>

That section was then modified slightly, but various internet companies challenged it in court, where an administrative court has already ruled it violates EU law.<sup>11</sup>

There have been fewer (if any) attempts to look at how it impacted other areas of German society, such as the usage of social media or the willingness of social media companies to expand in Germany and investors to invest in such companies.

One useful feature of the NetzDG law is that it requires some level of transparency reporting from companies impacted by the law (nearly all companies impacted already did some form of transparency reporting, but the law added some specific transparency requirements beyond what was already happening). This has created ongoing reporting from a number of companies, which has been used in other studies to explore the number of takedown demands

in various categories, and how they are handled by various companies. For example, you can find NetzDG transparency reporting from a variety of websites including Google<sup>12</sup>, Facebook<sup>13</sup>, Twitch<sup>14</sup>, Pinterest<sup>15</sup>, Twitter<sup>16</sup>, Reddit<sup>17</sup>, TikTok<sup>18</sup> and more.

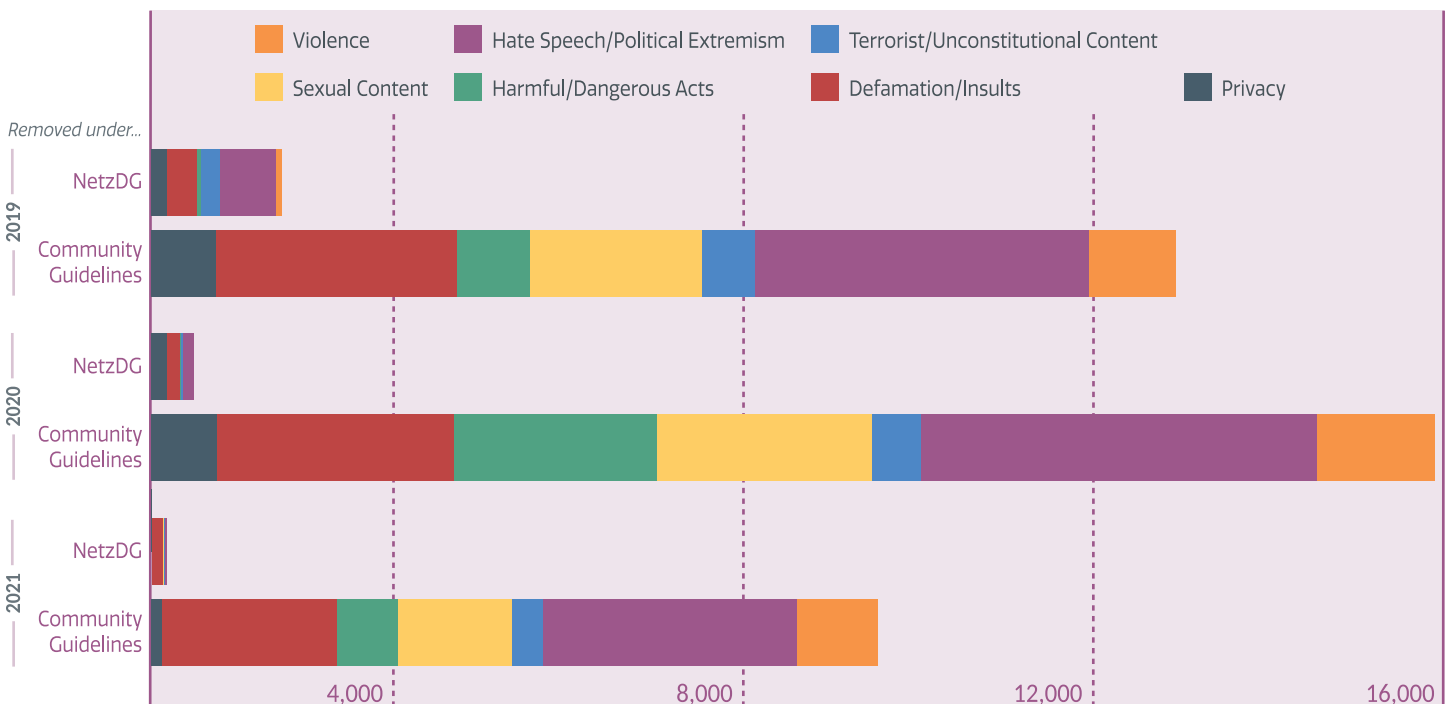
Some of these transparency reports reveal some interesting points about the impact of NetzDG — such as the aforementioned tendency for companies to first judge (and remove) content based upon their own terms of service, rather than against the requirements of the NetzDG law.

For instance, while this could be done with many companies, it's instructive to look at Google's transparency reporting regarding NetzDG, showing how each year, the vast majority of removals are due to a recognition of a policy violation, rather than because of the NetzDG requirements.

It is also notable how often Google refused to take down reported content, suggesting that beyond the concerns for overblocking laid out above, the vast majority of the re-

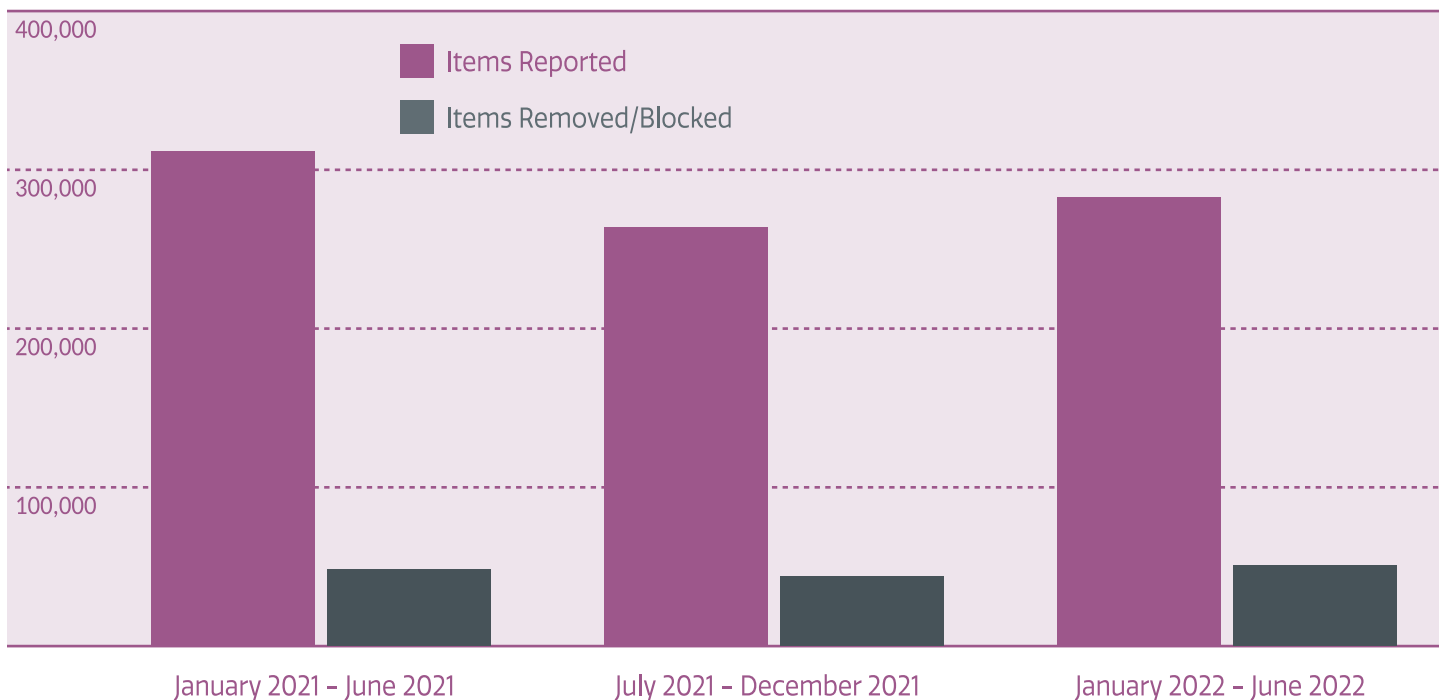
## Google content removals under Community Guidelines v. NetzDG

» Source: *Google Transparency Reports, 2019–2021*



# Google content reports v. removals under NetzDG

» Over last 3 cycles. Source: *Google Transparency Reports, 2021-2022*



ports are of questionable validity, and are likely not achieving the intended benefits of the policy.

From these transparency reports, you can see that just 17.93% of reported content was removed in the most recent report, with similar results in 2021. With such a low reporting-to-removal rate, combined with the lack of any of the expected fines (suggesting there is no evidence of Google failing to take down reported content that violates the law), it appears that improper reports are flooding the companies.

Looking at Twitter’s transparency reports, we see similar results. From January through June of 2022, Twitter reported receiving 829,370 complaints from both users and agencies, and only took action on 118,938 of them, or 14.3%. Reddit’s report shows many fewer reports overall, and a somewhat higher rate of taking action. In the same period, the company received 1,010 reports (all from users), and took action on 428 of them. However, all but 12 of those were determined to violate the company’s content

guidelines, and only the remaining 12 were determined to be specific to NetzDG.

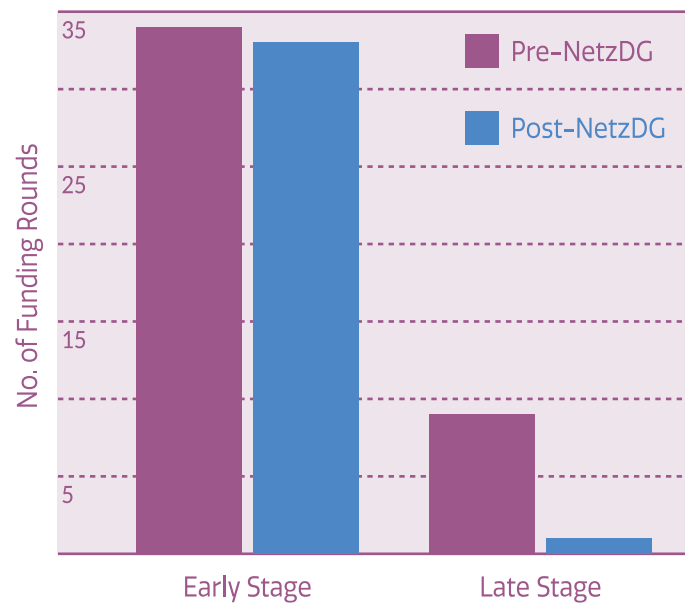
All together, these reports suggest that the companies are receiving a large number of questionable reports that require a significant amount of time and effort to review, to see if they are actually violating either the content guidelines on the sites, or the specifics of the NetzDG law. With so much of the reporting leading to no action, it calls into question whether this is a productive use of resources for the companies.

That said, there is one other significant concern raised by Germany’s touting of the NetzDG law as a way to stop “hate speech” and “fake news” online. Many other countries, often with authoritarian-minded leadership, have adopted laws with similar framing, and using similar language, often saying that they are modeled on Germany’s NetzDG. An analysis by Jacob Mchangama at Justitia noted that this was showing how “Germany created a prototype for global online censorship.”<sup>19</sup> As Mchangama wrote in his report:

While experts have paid close attention to the consequences of NetzDG on online freedom in Germany, less focus has been paid to global cross-fertilization of censorship norms by the NetzDG matrix. Yet less than two years after the NetzDG law went into effect, several states have been directly or indirectly inspired by the German efforts to tighten intermediary liability. Several of these states are flawed democracies or authoritarian states that, unlike Germany, do not have the same robust protection of the rule of law, lacking for example independent courts enforcing constitutional and human rights protections of freedom of expression. It should be emphasized that several of these countries had already adopted draconian restrictions of online freedom of expression and information, and could have tightened laws and regulations irrespective of the NetzDG. Yet, the NetzDG seems to have provided several states with both the justification and the basic model for swift and decisive action. This raises the question of whether Europe's most influential democracy has contributed to the further erosion of global Internet freedom by developing and legitimizing a prototype of online censorship by proxy that can readily be adapted to serve the ends of authoritarian states.

## Investment in German social media, Pre- and Post-NetzDG

» Source: Crunchbase (3 years prior to NetzDG & 3 years after NetzDG)



The report found around three quarters of countries who appeared to be modeling laws on NetzDG were in countries ranked “not free” or only “partly free” by Freedom House’s rankings.

Thus there remain concerns that even if one could argue that the law could be deemed as working in Germany (which is not evident from the data discussed above), that it might still be inspiring and justifying attacks on free expression elsewhere.

Looking at questions around investment, however, we do see a fairly noticeable impact on investment in social media by investors before and after NetzDG. Using the Crunchbase database to look at investments into German social media and web hosting companies in the three years before and the three years after NetzDG became law, we see a few distinct changes in the composition of invest-

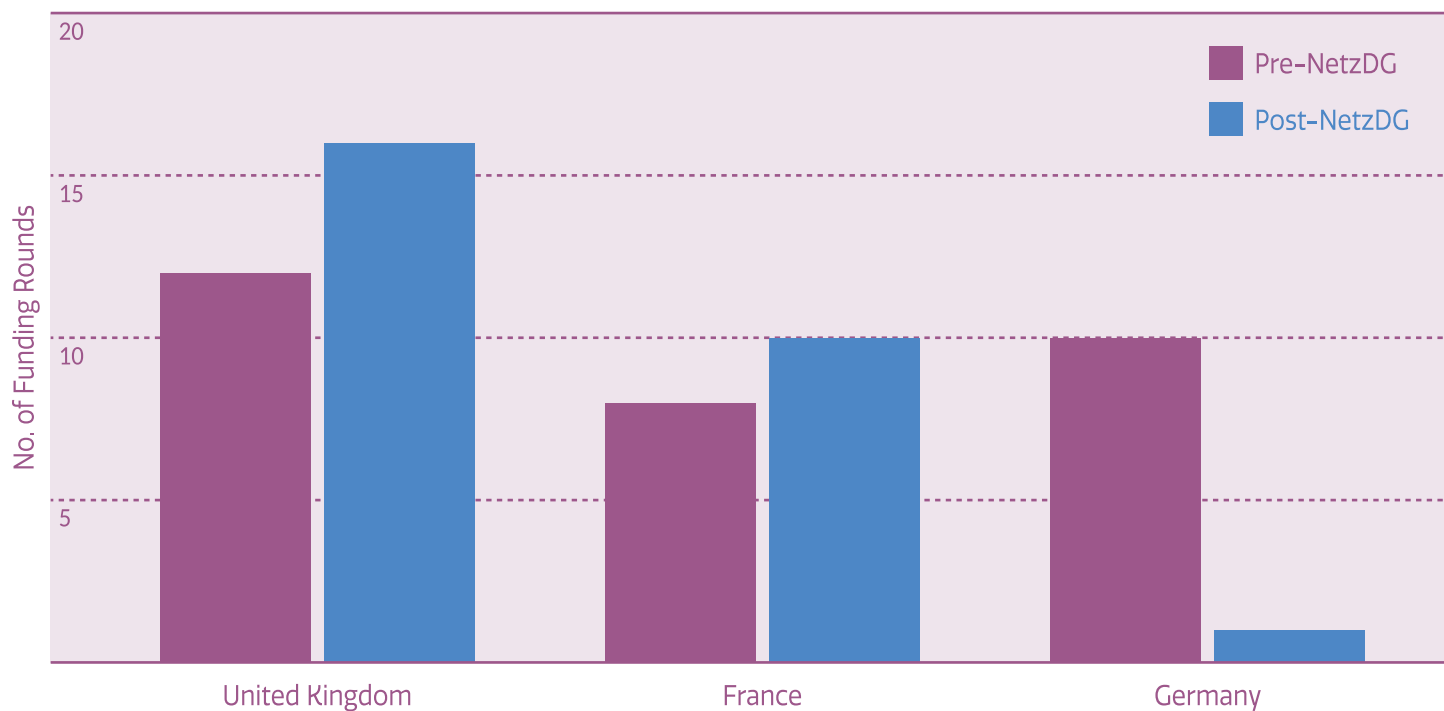
ment types. There were a slightly smaller number of equity investment rounds but, more importantly, the types of investment changed noticeably.

Prior to NetzDG, approximately 79% of the investment rounds in German social media companies were at a very early-stage (angel, pre-seed, or seed), with 21% being venture, or later, stage rounds. The amount of venture rounds can act as a useful proxy for whether or not new innovative enterprises are actually successful and growing, finding traction in the market, which is the point that venture investment tends to come in.

After NetzDG, however, while there remained significant early-stage investment activity in the space, the later-stage investment effectively disappeared. Out of 33 equity investment rounds in German social media companies, there was not a single venture round, and just one private equity round (an alternative to venture capital), an investment in BaxBeauty, which claims to be a social media app for fashion, though there is extraordinarily little public in-

## Late stage investment in social media, Pre- and Post-NetzDG

» Source: Crunchbase (3 years prior to NetzDG & 3 years after NetzDG)



formation about it (it does not appear in either the iOS App Store or Android’s Google Play at the time of this report, and neither Apptopia nor Data.ai appear to have any info on it in their databases — suggesting, if anything, that this is also a very early-stage company).

Prior to NetzDG there seemed to be at least a noticeable market for social media companies in Germany, to the point that they raised over \$85 million in those three years prior to NetzDG. However, in the three years after NetzDG went into effect, the complete lack of later-stage venture rounds stands out as notable, and is driven home by the fact that less than \$30 million was raised for German social media companies during that era.

It’s possible that the overall market for social media companies was in decline over that time, so as a control, we ran the identical Crunchbase queries for the same time periods in France and the UK, as both are European countries who position themselves as hubs for tech entrepreneurship.

In the three years after NetzDG went into effect in Germany, while the later-stage rounds effectively disappeared from Germany, they remained in both France and the UK, and even increased slightly in both countries.

In other words, while late-stage investment rates in local social media were similar in Germany, France, and the UK before NetzDG came into effect, they shifted noticeably in the years after, with later-stage investment in local social media effectively drying up in Germany in the years after NetzDG, while remaining in France and the UK. This suggests that NetzDG may have significantly limited the ability of innovative companies and services to grow and succeed.

Interestingly, in July of 2020, France’s own version of NetzDG, called the “Avia” law (named after its author, Laetitia Avia) went into effect.<sup>29</sup> Notably, the final bill has been considered “watered down” from its original premise (which was similar to NetzDG), with the biggest part — requiring websites to remove “hate speech” within 24 hours

— deemed unconstitutional just before the law was set to go into effect.<sup>21</sup>

This does not give us nearly as much data to work with, but looking at the data for a single year after the Avia law went into effect suggests there may be a similar decline in late-stage funding. In France in the year after

the Avia law went into effect, there were only two late-stage funding rounds in the social media space (and five early stage rounds). For comparison's sake, in Germany, there were zero late-stage funding rounds yet again, while the UK had four such rounds, which is consistent with earlier years.

## CASE STUDY

# SoundCloud & The High Cost of Compliance

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**SUMMARY:** Discussions about the compliance costs of NetzDG have focused almost exclusively on large companies. However, the experience of SoundCloud is instructive in understanding how the law is both costly and risky for smaller and mid-sized companies. As SoundCloud's transparency reports have shown, it had to staff up to deal with NetzDG complaints, hiring and training multiple employees with a focus on responding to those complaints. Perhaps even more notable is the extreme variability with which reports came in, requiring an analysis and response within 24 hours. Some months no reports were made, whereas some months, over 50 reports could come in, and SoundCloud had to be prepared for either scenario.

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To demonstrate the internal impact on tech companies, this report will focus on a smaller company: SoundCloud, a company that hosts user-uploaded music and other audio files. It has over 70 million registered users, but is generally a "smaller" online service. SoundCloud has filed NetzDG transparency reports for 2018, 2020, and 2021<sup>22</sup> and provides useful insights into how a smaller company needs to handle a regulation like NetzDG. Also, given that it stores almost entirely audio content,<sup>23</sup> it limits the kinds of content that is likely to be flagged and necessary to be reviewed under NetzDG.

Nevertheless, the company still received a fair number of NetzDG reports that it had to investigate. In 2018, the

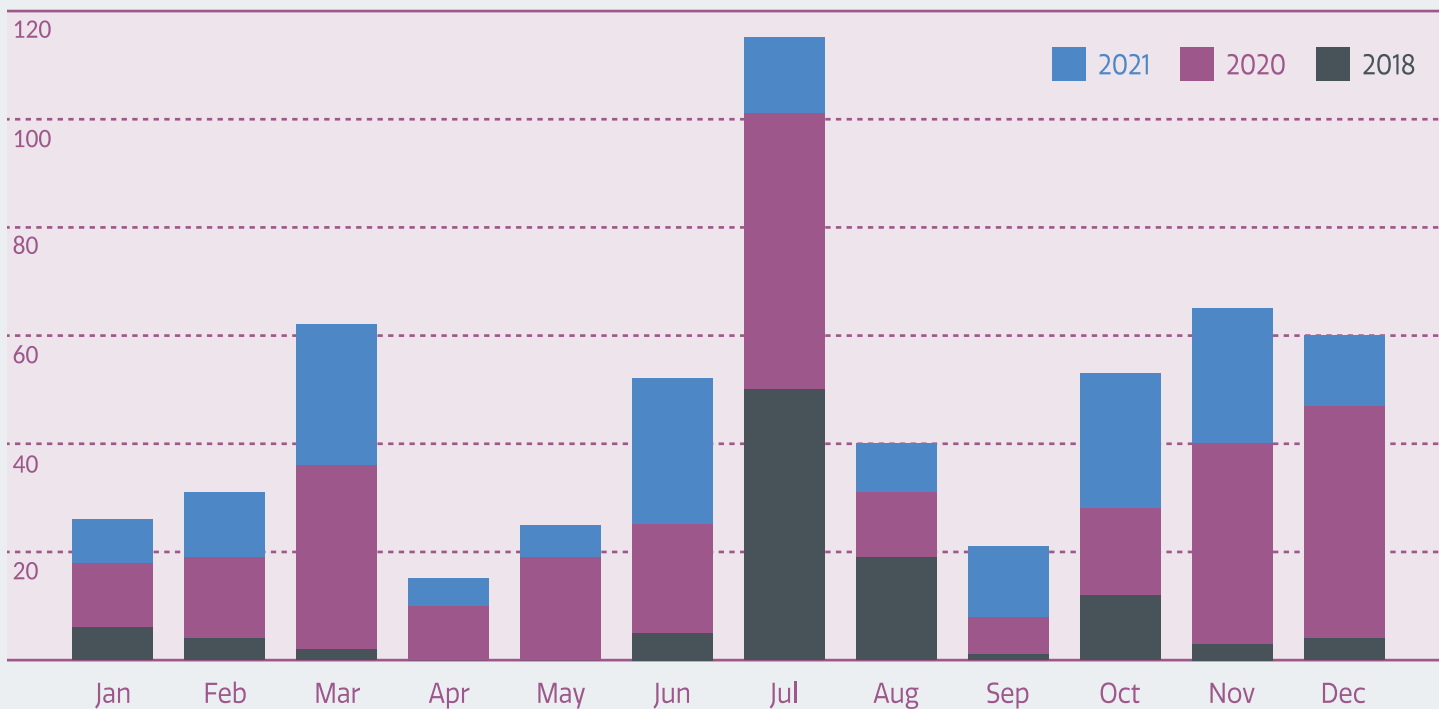
company dealt with 106 reports, a number that jumped to 276 in 2020, and then dropped to 183 in 2021. The vast majority of reports for SoundCloud came in two categories: "dissemination of propaganda material of unconstitutional organizations" under §86 of NetzDG and "incitement to hatred" under §130.

However, perhaps more interesting is that the rate of reporting was hardly standard or predictable. Some months had zero pieces of content reported, while others had around 50 pieces of content.

In other words, the workload is highly variable. Given that a key part of NetzDG's rules is that you must take certain illegal content down within 24 hours, any company

## Number of NetzDG reports to SoundCloud by month

» Source: *SoundCloud Transparency Reports*



has to be prepared to respond very quickly, even to a large number of reports demanding content be removed. For example, in 2018, SoundCloud received zero reports for both April and May, and only five in June, but in July it received 50 reports.

Making matters more confusing, all but one of the previous NetzDG reports, prior to July in 2018, had been under §86, related to propaganda from illegal organizations. However, the flood of reports in July included 47 that were under §130's rules against "incitement to hatred." Prior to that there had been only one previous such §130 report, back in February of that year.

For a company like SoundCloud, that means that the company needs to be staffed up and ready to handle an extremely unpredictable number of reports, but be able to respond within 24 hours in many cases.

SoundCloud reveals some of the staffing needs to carry this out. In each report, SoundCloud details the staff needed to deal with NetzDG reports. In 2018, it included four

employees, led by a Senior Trust & Safety Manager, a Trust & Safety Manager, and two Trust & Safety Specialists. Each of these positions required college degrees. Notably, the two Specialists were hired in August of 2018, or right after SoundCloud had a likely unexpected "flood" of 50 reports, after a three month prior total of five reports. The company also notes that this team is assisted by a "fully qualified German lawyer" who is on the Business and Legal Affairs team.

In the 2020 report, it appears that the two Specialists hired in 2018 had been promoted to Manager, while a new Specialist had been hired in September of 2020. In the 2021 report, the staff had grown to six employees, though with noticeable turnover and changes in staffing.

The company explains some of these changes in its 2021 report, including the need to hire people in different geographic locations in order to improve response times. It also noted that the company had to outsource some NetzDG management to a third party in order to meet the

NetzDG's response time requirements, adding additional support from seven outsourced agents.

*In early 2021 the Trust & Safety Team was expanded with an additional headcount of three Specialists. The team now has a total of six members. Two of our new recruits are based in New York City, providing us with increased time-zone coverage. At the time this report is written, one team member has left the team and we are actively recruiting for that position.*

*As of May 2021 and in order to keep our high standard of response time, the Trust & Safety Team also began working with a third party content moderator. At the time of publication, this has resulted in an additional headcount of seven agents/specialists dedicated to processing objectionable content reports.*

While six employees may not sound like a huge number, it is notable that SoundCloud is a relatively small company.

A search on LinkedIn shows that the company currently only has 280 employees in Germany, where the company is headquartered, suggesting the need to increase staff by over 2% just to meet the needs of this law. Indeed, when viewed in conjunction with the data showing that very, very few NetzDG reports are having an impact (many not actioned, many would be actioned under existing terms), it suggests a noticeable increase in cost, for nearly no benefit.

These reports clearly demonstrate some of the costs and challenges a site may have in dealing with NetzDG requirements. Even for a much smaller company than the larger platforms most people think about when discussing intermediary liability, SoundCloud has had to staff up around the globe, in addition to bringing on outsourced help, hiring qualified college graduate staff members (with some bit of turnover) all in order to be able to respond to NetzDG reports in a reasonable period of time.

For companies with other types of content, the demands and requirements may be significantly higher.

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### 3. United States & FOSTA

**IN 2018, THE UNITED STATES PASSED** what was called the FOSTA-SESTA package (a combination of two separate, but similar laws, SESTA: “Stop Enabling Sex Traffickers Act” and FOSTA: “Allow States and Victims to Fight Online Sex Trafficking Act”). Since then the law is generally referred to just as “FOSTA.” The bill was signed into law by then-President Donald Trump on April 11, 2018, becoming effective immediately.

While there were a variety of elements in the law, the main component was an amendment to what is traditionally known as Section 230, the 1996 law that, loosely speaking, says that websites hosting third-party user content are not liable for that content (the users posting the content, however, may remain liable, should the content violate any civil or criminal law). Section 230 acts as a procedural immunity for service providers who enable third-party speech, allowing them to get removed relatively quickly from any lawsuit brought against them over third-party content and editorial decisions regarding that third-party content.

FOSTA removed Section 230 immunity for interactive computer services for claims in a civil action, or any charge in a state criminal case, under certain sex trafficking laws (basically if the local law, civil or criminal, matched the elements of federal sex trafficking laws).

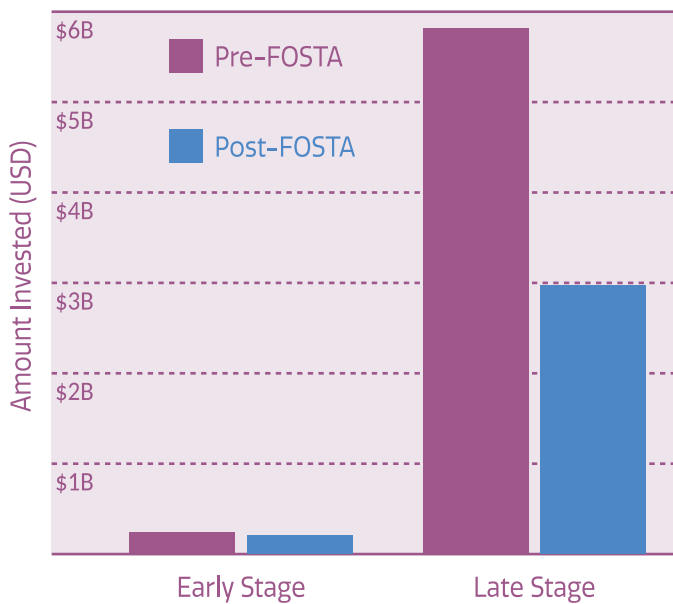
This was the first (and, as of this writing, only) amendment to Section 230. As there have been a relatively large number of recent proposals to otherwise amend Section 230, it also seemed worthwhile to explore the impact of such an amendment. Most of the current research has focused on issues related to users of the platform, with a particular focus on the harm to sex workers<sup>1</sup> and how FOSTA has made it more difficult for law enforcement to find those engaged in sex trafficking.<sup>2</sup>

For this report, we also wanted to look at its wider impact on the internet industry.

Using Crunchbase to analyze equity funding rounds, we found that in the two years prior to the enactment of FOSTA, there were 327 “early-stage” (angel, pre-seed, seed, and equity crowdfunding) investment rounds in social media companies based in

## Investment in US social media, Pre- and Post-FOSTA

» Source: *Crunchbase (2 years prior to FOSTA & 2 years after FOSTA)*



the United States, raising a total of \$243 million. In the two years after FOSTA passed, the number of early-stage funding rounds declined to 294, raising a total of \$206 million.

When looking at later-stage rounds (including post-IPO equity rounds), we found 202 such financing rounds for \$5.8 billion in the two years prior to FOSTA with a significant drop post-FOSTA to 142 such financing rounds for \$2.9 billion. In other words, at a time when you would expect more financing to be flowing into social media, especially the significant growth capital of later-stage investing, the opposite appears to be happening.

It is, of course, possible that investing in social media in general declined over the same period, unrelated to FOSTA. To control for this, we also ran identical searches on the EU as a comparison to the U.S. While overall investing in social media is lower outside of the U.S., if there was a similar percentage decline across the EU, it would indicate some other, non-U.S.-specific factor driving the decline.

Instead, however, we found that the investment rate

in late-stage rounds in EU social media stayed constant across this time frame. In the two years prior to FOSTA passing in the U.S., early-stage investing in social media in the EU showed there were 111 such rounds raising \$43 million. In the two years after FOSTA, those numbers were 81 rounds for \$28 million.

For late-stage venture rounds in EU social media, there were 57 such financing rounds in the two years prior to FOSTA passing in the U.S., raising \$245 million. In the two years after, it was a nearly identical 51 such financing rounds, for \$226 million.

The end result: while there was a similar decline in early-stage investing in the U.S. and the EU, the EU did not see a large decline in late-stage financing rounds like those seen on this side of the Atlantic.

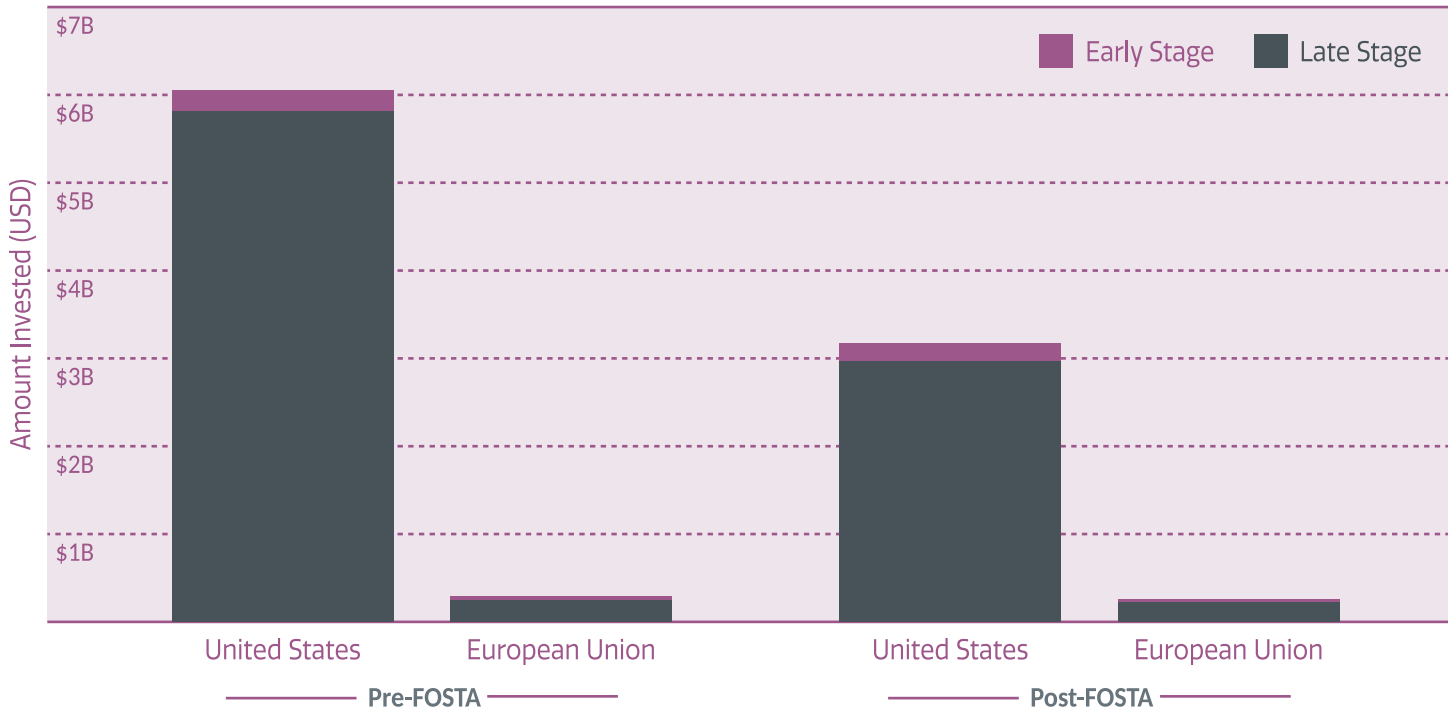
From this we can see that while early-stage investing in social media stayed relatively similar pre- and post-FOSTA, it declined noticeably post-FOSTA in the U.S., while there was no equivalent decline in the EU — suggesting that U.S. policy played a role in scaring off investors in the same time periods.

Considering the much lower base of investment in the EU, we also ran the same comparison against China, which has become a powerhouse of social media over the last half decade. The results there again suggested no other change pre- and post-FOSTA as was seen in the U.S. Given the impact we saw in the U.S. on later-stage financing, we focused on those same later-stage rounds of social media financing in China. In the two years prior to the U.S. passing FOSTA, there were 67 late-stage equity investment rounds in Chinese social media companies, with \$4.5 billion invested. In the two years after the U.S. had FOSTA in effect, there were 43 such rounds, for a total of \$4.3 billion.

While it should not be surprising that investment levels in social media in the EU and China would not be impacted by a U.S. policy, it is useful as a type of control. If there were other, more global factors, leading to a decline in investment for social media companies around the globe, then there would be less of a chance that it was related to the only significant U.S. policy change regarding social media.

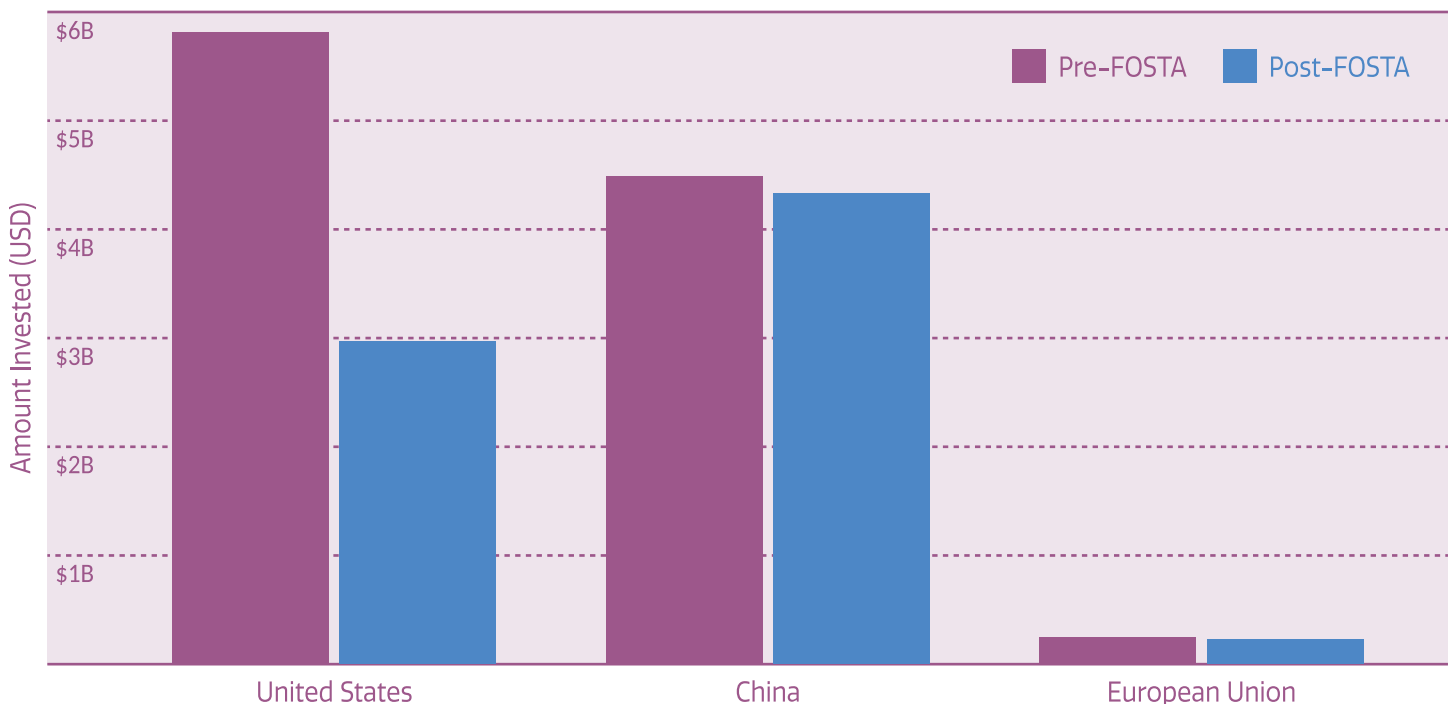
## Investment in social media, Pre- and Post-FOSTA

» Source: Crunchbase (2 years prior to FOSTA & 2 years after FOSTA)



## Late stage investment in social media, Pre- and Post-FOSTA

» Source: Crunchbase (2 years prior to FOSTA & 2 years after FOSTA)



Instead, this data suggests that FOSTA may have contributed to much greater hesitancy among investors to invest in U.S. social media companies.

Over the years since FOSTA has become law, there have been a variety of attempts to study the impact it has had, with most of the attention focused on the impact on sex workers<sup>3</sup> which has been studied and reported on multiple times.<sup>4</sup> It is still argued that more research is needed, and bills have been proposed in Congress to do just that.<sup>5</sup>

In 2021 the Government Accountability Office released a report, as required by the law, studying the impact of FOSTA, finding, among other things, that despite many claims in support of the law that it was necessary to provide law enforcement and users with the tools to prevent sex trafficking, it turned out that law enforcement had barely used the law at all.<sup>6</sup> That report also found, through interviews with law enforcement, that most felt they did not need the law, because “prosecutors have had success using other criminal statutes.”

The report also noted that the passage of FOSTA, likely combined with the criminal prosecution of the operators of Backpage.com (which occurred just five days prior to FOSTA becoming law), resulted in sex traffickers moving operations overseas, making them much more difficult for U.S. law enforcement to track down the perpetrators. As the GAO report noted:

*The relocation of platforms overseas makes it more difficult for law enforcement to gather tips and evidence. According to DOJ officials, successfully prosecuting those who control online platforms—whether their platforms are located domestically or abroad—requires gathering enough evidence to prove that they intended that their platforms be used to promote prostitution, and, in some cases, that they also acted in reckless disregard of the fact that their actions contributed to sex trafficking.*

*The evidence needed to prove such allegations may include documentation of communications, incorporation records, or financial transactions that demonstrate that*

*those who control these platforms had the intent to promote the prostitution of others or to conceal the nature of the material being posted on their platforms (if such material promoted the prostitution of others), according to DOJ officials. According to these officials, intensive evidentiary review and analysis is essential because the needed evidence may be contained in voluminous electronic communications and financial records. Further, officials said, these investigations are often national or international in scope, necessitating interviews in various locations, and requiring extensive computer and financial forensic expertise.*

*These existing challenges are heightened when those who control such platforms host servers abroad, reside abroad, use offshore bank accounts and financial institutions, or introduce third parties to attempt to obscure or distance themselves from the day-to-day operation of their platforms, according to DOJ officials. For instance, these officials said, following laundered money through shell companies based in corporate secrecy jurisdictions is significantly more difficult than following laundered money through U.S.-based financial institutions that are subject to U.S. laws. Such circumstances often require using mutual legal assistance requests to coordinate and obtain evidence from foreign jurisdictions. Officials said this can cause extensive delays in investigations and some countries’ extradition policies may further complicate prosecutions.*

*Separately, gathering evidence to bring cases against users of online platforms has also become more difficult. According to a 2019 FBI document, the FBI’s ability to identify and locate sex trafficking victims and perpetrators was significantly decreased following the takedown of backpage.com. According to FBI officials, this is largely because law enforcement was familiar with backpage.com, and backpage.com was generally responsive to legal requests for information. In contrast, officials said, law enforcement may be less familiar with platforms located overseas. Fur-*

*ther, obtaining evidence from entities overseas may be more cumbersome and time-intensive, as those who control such platforms may not voluntarily respond to legal process, and mutual legal assistance requests may take months, if not years, according to DOJ officials.*

Those reports suggest that FOSTA likely failed in its key objectives. It has made it more difficult, not less, for law enforcement to stop sex trafficking, while at the same time putting sex workers at significant risk.

Other research has shown strong evidence that efforts like FOSTA put women at serious risk. Research from Scott Cunningham, Gregory DeAngelo, and John Tripp found compelling evidence that when Craigslist allowed escort ads on its website, violence against women was lower. The research compared the homicide rate in different locations as Craigslist initially rolled out its escort ads at different times in different locations and found that the availability of those ads on Craigslist “reduced the female homicide rate by 10-17 percent... helping sex workers to screen out the most dangerous clients.”<sup>7</sup>

This seems especially notable, given that, while Craigslist, under pressure from state Attorneys General, closed down its escort ads business in 2010,<sup>8</sup> the passage of FOSTA made the company shut down all personal ads including those that had nothing to do with the escort business.<sup>9</sup>

Another concern regarding FOSTA, and other attempts at limiting liability protections for intermediaries, is the debilitating cost of litigation that companies face, even when it’s clear they have done nothing wrong. A study on the “impact of litigation on small providers” by the Chamber of Progress noted that the impact on smaller competitors is much bigger than on larger companies.<sup>10</sup> That report details the massive impact that even frivolous litigation can have on smaller companies.

*Even in an ideal scenario in which a defendant is successful in dismissing a case at an early stage, they’ve poten-*

*tially spent \$100,000 they will never recover. Cases that involve multiple motions, discovery, or appeals can easily run into hundreds of thousands of dollars or more in legal expenses. Successful defendants are not entitled to recover their attorney’s fees except in rare cases. While it’s worth noting that cost data on individual cases is scarce, there’s no doubt these costs are nontrivial for the average small business, not to mention other Section 230 defendants like individual hobbyists or nonprofit groups.*

*These costs can easily exceed the ability of an individual, nonprofit, or small business to pay. The tremendous cost of paying for a legal defense coupled with an uncertain outcome often leads defendants to settle lawsuits they would prefer to fight. When settling is not a viable option, legal costs can have devastating impacts since most small entities do not have liability insurance. Individuals and entities may have to shut their operations, lay off employees, and spend years paying down legal bills.*

*The risk of business-ending litigation also impacts the ability of startups to attract funding and the cost-benefit analysis for entities who want to offer an interactive forum but know it will not produce significant revenue.*

In the FOSTA context, we have already seen some such litigation against companies that clearly are not engaged in sex trafficking (the law’s intended target), including ongoing lawsuits against Salesforce and Mailchimp, with the argument being that the services of those companies (customer relationship management and mailing list software, respectively) were sometimes used by those engaged in trafficking, and therefore the companies themselves should be held liable.

The fear of such litigation, even if proven frivolous eventually, can have serious detrimental effects on smaller companies, as well as the willingness of investors to back and support new entrants in the market.

## CASE STUDY

# eBay & The Disappearance of Cultural Artifacts

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**SUMMARY:** The threat of litigation under FOSTA for activities only tenuously connected to sex trafficking has resulted in many internet companies deciding it was not worth the risk to host many kinds of adult content. This has had wider implications than just the attempted removal of adult content online. Artists, historians, and researchers have noted that policy changes from FOSTA on sites like eBay have been “erasing” artifacts of LGBTQ+ history, making it much more difficult to preserve and study the history of that culture from the mid-20th century.

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While the impact on sex workers and law enforcement has been researched, there are many other unintended consequences of FOSTA as well, that have impacted many different internet services. It was widely noted that both Tumblr and Facebook drastically cut back their willingness to host more adult-oriented content in response to FOSTA.<sup>11</sup>

These fears are not unfounded. While the GAO report found that law enforcement appeared uninterested in using FOSTA’s criminal provisions, multiple civil cases have appeared on the docket, almost all of which are targeting random services used by sex workers — including Salesforce<sup>12</sup> (a customer relationship management software) and Mailchimp<sup>13</sup> (an email marketing platform). Given the tangential relationship between these businesses and how they were being used, it is unsurprising that companies began distancing themselves from any sort of content that might give rise to a similar civil suit.

There were also reports of how it harmed artists. Two comic book creators, Erika Moen and Matthew Nolan, were advised by lawyers not to publish a comic book about sex work, fearing liability under FOSTA.<sup>14</sup> Similarly, a poet,

Rachel Rabbit White, whose poetry sometimes includes explicit discussions, found that she was removed from Instagram, in response to that company’s post-FOSTA rules adjustment.<sup>15</sup>

The impact of these kinds of policy and enforcement changes can be more widespread than people realize. In the years following the passage of FOSTA, advocates for the LGBTQ+ community began noticing that websites across the U.S. were silencing

them and their culture.<sup>16</sup>

The most notable example of this was eBay, who adjusted its “adult items policy”<sup>17</sup> soon after FOSTA passed, greatly limiting what was allowed to be sold on the auction site. The impact of this on LGBTQ+ culture became clear very

*The impact of these kinds of policy and enforcement changes can be more widespread than people realize*

quickly to scholars, filmmakers, and researchers, who decried how queer history was being hidden. A New Yorker article noted that “The Queer Past Gets Deleted on eBay”:<sup>18</sup> It highlighted the impact of this decision, while tying it directly to FOSTA:

*Drew Sawyer, a curator at the Brooklyn Museum, said that he has “often turned to eBay for printed matter, magazines, zines, and photographic reproductions” when preparing exhibitions. “Even if—if—they’re archived in libraries, they’re often easier to buy on eBay from logistical and registrarial perspectives. And also cost.” For an upcoming retrospective, Sawyer won a copy of the photographer Jimmy DeSana’s self-published 1979 monograph, “Submission: Selected Photographs.” It’s one of only a hundred or so copies ever made, and a crucial document of a moment when queer sexuality and conceptual art intermingled. “DeSana is an artist whose work would fall under this new policy,” Sawyer said.*

*In researching his book “Bound Together: Leather, Sex, Archives, and Contemporary Art,” Andy Campbell, an associate professor of critical studies at the Roski School of Art and Design, used both eBay and the Johnson/Carter Library, in addition to other archives around the country. “Bound Together” argues that queer archives are particularly precarious, as they often lack institutional support structures and their content is at odds with community guidelines. Yet, by making queer culture accessible, they also increase the likelihood of that more positive erasure: assimilation. The same kind of harness that once strained across a hairy chest in Tony DeBlase’s *DungeonMaster* magazine ends up, some four decades later, on Taylor*

*Swift in a paparazzi shot or Timothée Chalamet on the red carpet. Campbell can still trace those historical lines of sex, style, and commerce without eBay, but it’s more difficult. “When looking at an issue of the leather magazine *Drummer*, I think about all the coordinated efforts of so many writers, artists, readers, and editors to represent, month after month, their experiences in this community,” he told me, over e-mail. “With *DungeonMaster*, which was a near-solo labor of love for DeBlase, I think about the radical abilities of one extremely-driven person to educate and titillate his community. That either exists is a miracle.” When it comes to finding them, “It’s a bummer that eBay won’t be that platform any longer.”*

Other news organizations found even more examples, including *The Advocate*<sup>19</sup> and *Axios*<sup>20</sup> who quoted Cathy Renna, the communications director of the National LGBTQ Task Force:

*“We are talking about a part of queer history that is really hard to locate and is being saved by a small number of folks in the community. This change in policy will create a huge vacuum in anybody’s ability to access these things. They are really hard to find.”*

While eBay has not confirmed that the move was directly in response to FOSTA, the timing and the focus of the change has most commentators connecting the two. Indeed, one further consequence of FOSTA, and the nature of the civil suits filed under FOSTA is that it makes it more difficult to study the law’s impacts, as companies like eBay and others shy away from directly attributing moves like this to the law, out of fear of drawing a litigation target on their backs.



## CASE STUDY

# Veoh & Death by Litigation

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**SUMMARY:** Litigation can kill innovative companies, even if they didn't do anything wrong. Veoh was an online video platform, similar to YouTube, and launched at a similar time. Unlike YouTube, Veoh had support and buy-in from many entertainment industry insiders, including the former chairpersons of both Disney and Viacom. It also initially raised approximately ten times as much money as YouTube did from investors. However, Universal Music still sued the company. The case lasted for nearly six years, including multiple rulings at both the district court and appeals court levels, where Veoh won every ruling, with the courts noting that its service was protected by the DMCA's safe harbors. However, despite all of this, Veoh declared bankruptcy, and sought to liquidate the company's assets approximately halfway through the process, noting that the legal costs of fighting the case had become unbearable.

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With many regulatory regimes, supporters argue that the specific regulations are necessary to stop bad actors from abusing the system. However, time and time again, we find that the much larger impact is on good actors who are still punished with damaging litigation. Former Ninth Circuit Court of Appeals Chief Judge Alex Kozinski famously warned of "forcing websites to face death by ten thousand duck-bites, fighting off claims"<sup>21</sup> spurred on by laws that encourage litigation to hold platforms responsible for actions of their users.

While the FOSTA section of this report discusses questionable litigation under FOSTA against companies like Salesforce and Mailchimp, there is perhaps no better example of how "lawfare" enabled by regulations can destroy a company, than the story of Veoh.

It is less remembered in the present day, but Veoh was initially seen as one of the leading online video hosting websites. It was launched around the same time as YouTube, and was initially considered a formidable competitor to that site. Veoh launched with nearly 10x the funding of

YouTube, and had the backing of major players within the entertainment industry, including former Disney chair, Michael Eisner, who took a seat on Veoh's board.<sup>22</sup> Other investors included Time Warner, Goldman Sachs, and top Viacom executives.<sup>23</sup> While Veoh focused on user-generated content, it also was among the first (way before YouTube) to explore making professionally-produced content available via its service as well.<sup>24</sup>

Given all that, around 2006 and 2007, Veoh was positioned to not just be a strong competitor to YouTube, but one with deep links to the entertainment industry, leaving it well-situated to become a huge player in the space.

However in 2007, Veoh was sued by Universal Music, claiming that it had violated copyright law by allowing infringing works to be uploaded by users.<sup>25</sup> Veoh countered that it was protected by the DMCA's safe harbor rules, which protect internet companies from copyright liability for user-uploaded content, as long as the websites follow some specifically outlined steps. In 2009, the district court ruled in favor of Veoh's motion for summary judgment,<sup>26</sup>

agreeing that the company was protected by the DMCA's safe harbors. Universal appealed, and it took until 2013 for the appeals process to be exhausted, when the 9th Circuit ruled in favor of Veoh once again.<sup>27</sup>

The entire lawsuit took nearly six years, and despite the fact that Veoh won every decision by the court, the lawsuit effectively killed the company. Approximately halfway through the lawsuit, Veoh's founder announced that the company was bankrupt, in large part over legal fees, and would be liquidated.<sup>28</sup> While the assets of the company were purchased a few months later, the remaining entity

did continue to fight the lawsuit and win.

While this is, perhaps, an extreme case and example, it is instructive for how expensive and damaging litigation can be for startups.<sup>29</sup> As this report noted elsewhere, the expense of litigation is especially overwhelming for smaller companies, which is where the "death by ten thousand duck-bites" concern was targeted.<sup>30</sup> In this case, there was a death by a much larger duck-bite, but the point remains. Even mistargeted litigation regarding basic platform management can lead to the collapse of an otherwise well-positioned company.

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## 4. Australia's Laws & Cases

**THE 2010S LOOKED LIKE** a decade where Australia had a chance to position itself as a new global internet entrepreneurship hub. There were a large number of interesting and successful internet companies coming out of the country, finding success around the world. This included enterprise app providers like Atlassian, e-commerce powerhouses like RedBubble, and design tool leader Canva.

In fact, the rise of internet entrepreneurship in Australia made the country appear to be a true success story for a country building up a real internet hub outside of the United States.<sup>1</sup> Looking at the funding of non-financial internet startups<sup>2</sup> we see a rapid increase, and almost as rapidly a decline, with a peak in 2016.

While there is no one singular legal change tied to this, there were a series of court rulings, combined with one change to intermediary liability in the wake of a violent attack that, together, may have spooked investors away from what had been a rapidly growing market.

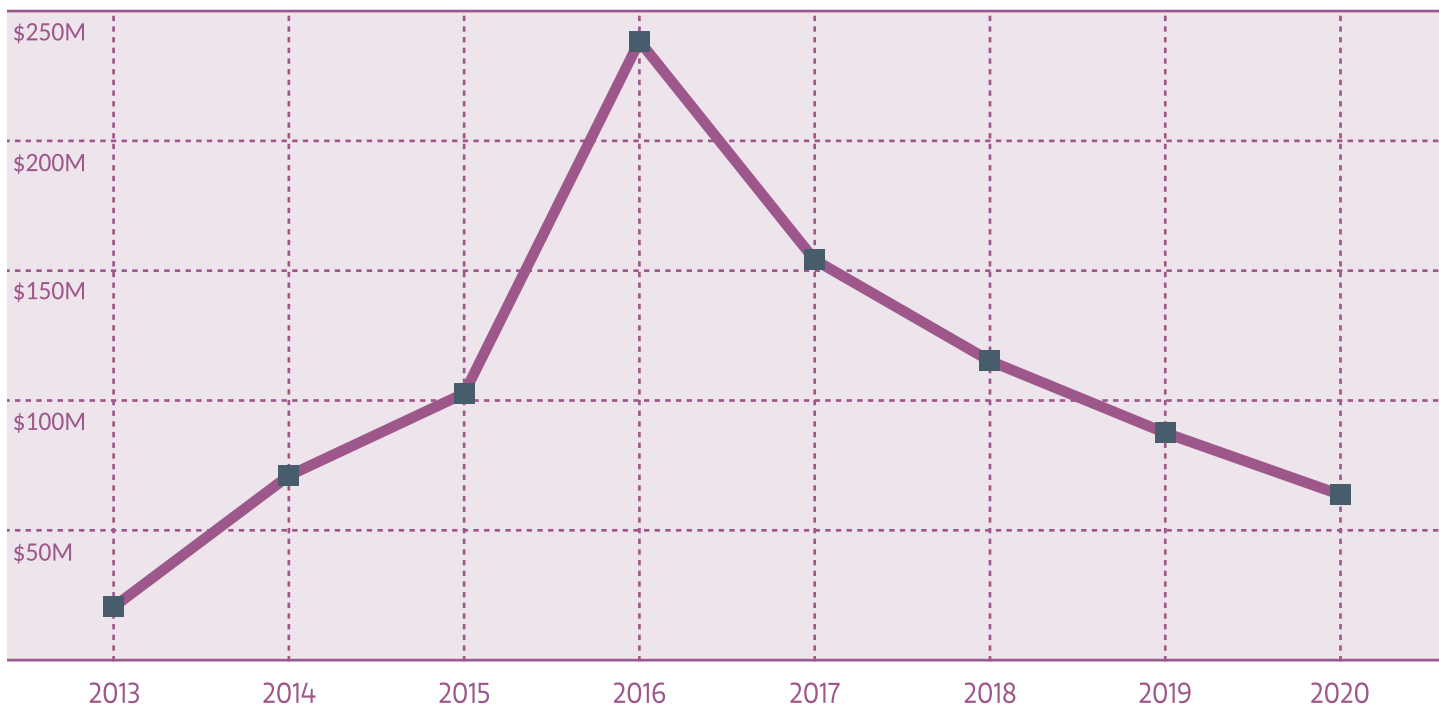
Throughout the time frame covered above, there were a series of cases taken to court that sought to hold websites liable for content posted by users. Initially, the trend appeared to be toward reduced intermediary liability: In the first couple of these cases, against Google Australia<sup>3</sup> and Google,<sup>4</sup> in 2013 and 2014 respectively, Google was held not liable for third-party speech (though the rulings were narrow and limited to some specifics in each of those cases). Funding of Australian internet startups rose during the period following these rulings limiting intermediary liability.

On the whole, it appeared that Australian jurisprudence on intermediary liability laws would be at least somewhat similar to the traditional intermediary liability framework found in the U.S. and the EU, where the intermediary is rarely, if ever, held liable for third-party speech.

However, that trend shifted very quickly, with a series of Australian Appeals Court and Supreme Court decisions, starting in 2016 and continuing throughout 2017 and 2018, saying that plaintiffs could hold websites liable for third party content.

## Funding of Australian internet startups

» Source: *Crunchbase*



These high profile cases included ones against Google<sup>5</sup> and Twitter.<sup>6</sup> Funding of Australian internet startups fell quickly after 2016, coinciding with the shift toward increased intermediary liability in legal rulings.

In other words, whereas earlier cases appeared to show Australian intermediary law would likely follow the U.S./EU model of mostly immunizing intermediaries from liability, the Australian courts shifted dramatically after 2016, at a time that matches almost identically the peak and the collapse of funding of internet companies in the country.

Australia also changed its intermediary laws in early 2019, in a rushed response to the horrific terrorist shootings in Christchurch, New Zealand, adjusting the country's

criminal code<sup>7</sup> to require intermediaries to remove "abhorrent violent material" or face large fines.

Thus, over the course of just a few years, Australia went from fostering an environment for intermediary services to flourish, to holding them liable and imposing aggressive proactive takedown measures, and the rise and fall of internet startup funding in the country just happens to match the timing of that shift almost exactly. While it's likely that this rise and decline may have been impacted by many factors<sup>8</sup> including broadly changing policies towards tech and innovation in Australia, the timing of the decline matching with a changing view of intermediary liability is certainly worth calling out.

## CASE STUDY

# Atlassian & The Impact of Regulation on Innovation

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**SUMMARY:** While Atlassian has been highlighted as a true “Australian” internet success story, the company actually had to move its official headquarters to London in response to multiple regulatory hurdles put on its growth if it had remained headquartered in Australia. The company’s co-founder and co-CEO has explained how Australia’s very different regulatory landscape has been a huge challenge for the company, particularly in terms of the costs and complexity around compliance. He has argued that platform regulations have greatly slowed down innovation at the company, and taken the company’s focus away from building great products and focused it, instead, on complying with different global platform regulations.

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Undoubtedly one of the biggest internet success stories out of Australia is Atlassian, the enterprise focused internet company that was founded in Australia and grew to be valued over \$40 billion.<sup>9</sup> However, that one success story actually serves as a kind of “exception that proves the rule” example of the problems of the policy environment for internet companies in Australia.

A recent article in the Financial Review pointed to Atlassian as a “call to arms” for the country to recognize “Australia’s deficit of global technology companies.”<sup>10</sup> That article concludes that Australia does not have the right policies and regulatory settings in place to breed future Atlassians.

Atlassian’s own journey shows why Australia is a location that is fraught with risk for similar companies. Despite its founding and growth in Australia, the company felt the need to register as a UK business after it was determined that remaining as a purely Australian business would limit the company’s growth potential.<sup>11</sup> The company itself now claims that, while it is headquartered in the UK, it thinks of itself as “Australian-backed” rather than Australian.

Even more telling was a recent interview given by Atlassian’s founder and co-CEO Scott Farquhar, as he bemoaned how Australia had become the “test bed” for in-

ternet regulations that often made it more difficult for the company to operate.<sup>12</sup> Farquhar repeatedly notes that he, as an Australian who built an Australian tech success story, wants to help grow and improve the ecosystem for other Australian tech startups, but keeps pointing out how challenging it is to do so, and how the company needs to keep speaking out about policy choices in the country.

There are many useful points raised in the interview, but the most telling is just how much more expensive these different internet policy regimes make it for companies seeking to develop products for a global world:

*So we get to see a unique perspective of how that all plays out, and I would say from our vantage point, or my personal vantage point, the increasing parochialization of the web — or the splintering it into a Chinese web, a European web, a United States web, an Australian web — is not good for the world. These economies of scale that we used to get, where effectively 2,000 engineers could build a product that scales to the whole world, now we’re gonna need 20,000 engineers to build that same product 10 different times.*

*And that's not a really good use of resources, and so that worries me. And you know, if governments lose trust in each other's regulatory functions, because they have different approaches to data, security, privacy, then you're gonna see these roadblocks emerge.*

He later notes that this kind of approach creates a lot of dead weight loss for society.

*And like, you won't notice it to start with. It'll just be the number of employees dedicated to a country, or a particular jurisdiction, goes up. And that's sort of a dead weight loss for society, and probably the biggest worry is how it entrenches the incumbents.*

Notably, he also talks about the impact of other regulations around the world. This is in a section where he talks about how all the different policy fights mean he is much less able to focus on actually building products and building the company.

*As the CEO, I always wish I could spend more time on products. That's my love and my passion is building stuff*

*for our customers. Our customers don't buy our policy, our customers don't buy our packaging or our pricing. Our customers buy and use our products, and so that's where I want to spend most of my time. Our senior executive team, I would say that — let's say GDPR for example, it was named internally, something like the Generalized Destruction of Product Roadmaps.*

*That law came into place and every person in product had to stop whatever they were doing that they had on their roadmap to provide for customers globally, and instead had to pivot. We had hundreds of people building these data protection regimes, and for privacy it's a great thing. But it wasn't top of the list our customers were asking for.*

The end result, then, is that Atlassian, arguably Australia's biggest success story, admits that the policy environment in Australia is challenging, not just for itself as a company, but for the wider Australian technology ecosystem that the company's founders hoped to encourage and support.

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## 5. South & Southeast Asia

**MANY COUNTRIES HAVE BEEN** putting in place various laws and regulatory rules that seek to place liability on websites that host third-party content. These laws, in practice, sound quite similar to Germany's NetzDG, with requirements for sites to take down content upon government demands with extremely short turnaround time, little in the way of due process, and the threat of crippling fines (or even country-level blocks) for failing to follow through in the removal demands.

In some ways, these laws, and the limitations they put on internet companies, seem at odds with the publicly stated goals of the governments of these countries to build out an entrepreneurial digital startup ecosystem. Indeed, at the same time these laws are being put in place, the same countries are often setting up special economic zones, and removing other barriers for foreign investment in technology and media operations.

The full impact of these conflicting policies is yet to be fully understood. As we note below, in India, the impact on investment was surprising, and somewhat counterintuitive, though explainable if viewed through the lens of protectionism and nationalism: pumping up a local social media competitor with close ties to the government. Elsewhere, such as in Pakistan and Indonesia, there are concerns about these laws, which most people recognize as tools of government control over speech, and how they will impact policy changes designed to encourage investment in the internet sector.

### **India / Information Technology Rules 2021**

In one of our previous papers exploring some similar themes regarding intermediary liability regimes,<sup>1</sup> we looked at India and its Information Technology Act. Section 66A of the IT Act criminalized a variety of speech online, claiming that anything “grossly offensive” or messages that were designed to “cause annoyance” could be criminal and intermediaries would be held responsible for hosting that speech. An Indian Supreme Court ruling in early 2015, *Shreya Singhal v. Union of India*, declared that part of the law unconstitutional, and effectively made it clear that intermediaries should not be held liable for speech of its users.

Our research investigated if there was a sizable shift in startup investment three years before and three years after the Singhal ruling. We found that in the three years prior to the ruling, there were 1,642 investments into Indian startups, totaling \$15.4 billion. However, in the three years after the ruling, the numbers grew to 3,938 investments, which totaled \$46.9 billion. This was a massive increase in investing in internet startups in India, more than doubling the flow of money into startups in the immediate aftermath of the ruling. There was also a similar pattern when looking at startup exits or acquisitions over the same time period. We found a substantial increase in startup acquisitions in the two years post the Singhal ruling.

We did warn, however, that there were proposals in the Indian Parliament to effectively add more liability to intermediaries, and we worried that the positive impact seen in that paper might be cut off. While the proposals we highlighted at the time did not come to pass, there were a series of court decisions<sup>2</sup> in the interim that chipped away at the intermediary liability protections for internet companies.

The largest change, by far, was that in early 2021 the Ministry of Electronics and Information Technology released a new set of “intermediary guidelines and digital media ethics codes”;<sup>3</sup> which people immediately pointed out were significantly more stringent for intermediaries than earlier draft rules that had been proposed and discussed. The earlier rules had already raised significant concerns<sup>4</sup> among experts about the impact on speech and internet innovation. However, the final rules appeared to go much further

than the draft. The rules have caused tremendous concern about various technology companies operating in India, both those headquartered in the country<sup>5</sup> as well as those headquartered elsewhere. Most notably, the Meta-owned WhatsApp filed a legal challenge over the new rules<sup>6</sup> as did the Foundation for Independent Journalism.<sup>7</sup>

The new rules represented a significant reversal of the previous setup protecting intermediaries from liability. The rules created a complex structure for regulating internet

properties, including news organizations, and allowed the government to impose significant obligations on any intermediary. This included significant requirements for tracking and surveilling users of messaging services, strong filtering requirements, and a “grievance redressal mechanism.”

Given all of this, we expected to see a noticeable decline in investments following the imposition of these rules. Since the rules only went into effect in May of 2021, we only have approximately one year of post-rule data. Surprisingly, the data did not fully show

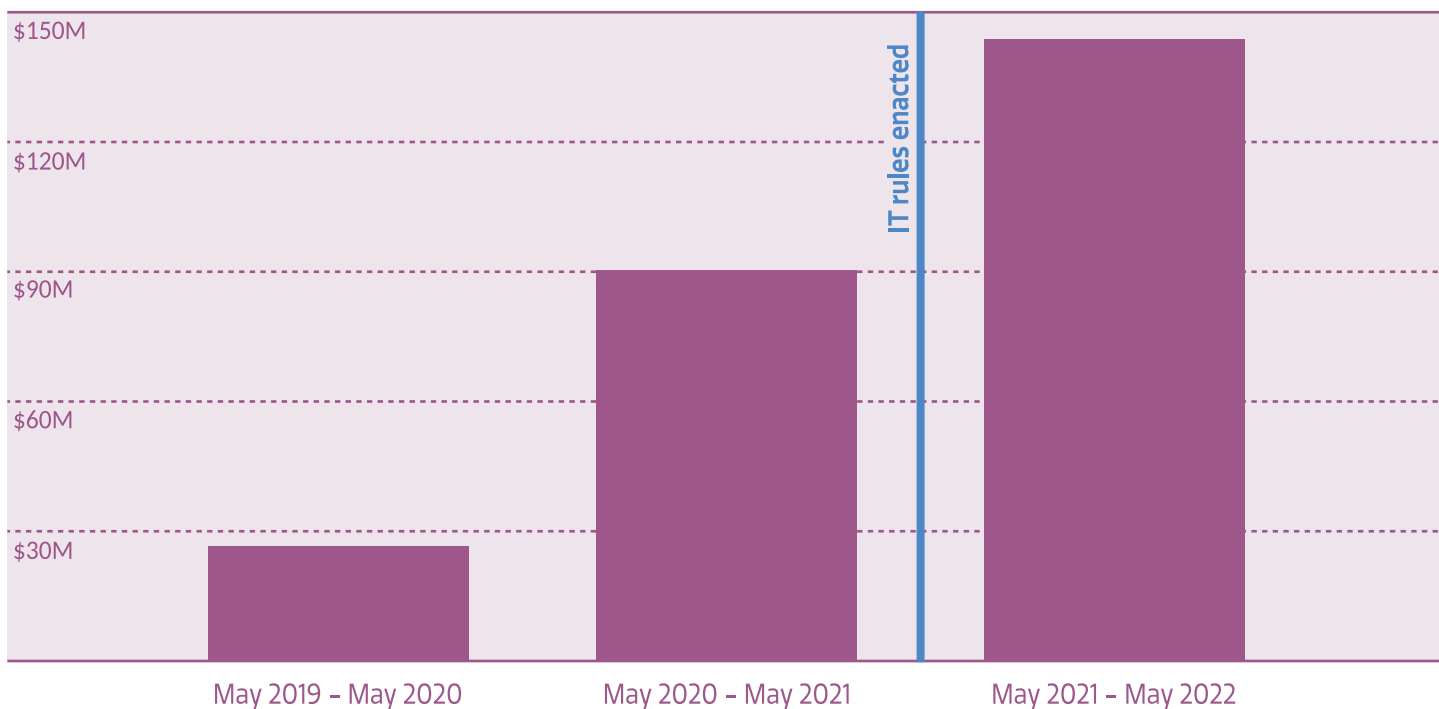
the expected decrease in funding, but certainly did raise some concerns about the impact of the new rules and the consequences created.

To examine the impact on early-stage investment, we look at the types of companies most impacted by the new rules: social media/networking and video/audio streaming (we removed a few funding rounds focused on the gaming market, as that industry was not impacted). Perhaps surprisingly, such early-stage investing actually increased in the lead-up to the new rules and in the immediate aftermath of them (again, it is worth highlighting that given the

*The rules created a complex structure for regulating internet properties, and allowed the government to impose significant obligations*

## Early stage investment in social media & OTT around 2021 IT Rules

» Source: *Crunchbase*



recency of the rules going into effect, there is only one year of data for investment after the rule has gone into effect, and it is possible the data is less complete).

Either way, it was surprising to see investment increase, even after such strict laws impacting those industries, and that caused us to look more closely at why the investment story played out this way, which is further explained in our case study.

Specifically, in digging into the data, it appears that while these legal changes did increase, rather than decrease funding, it actually did so as a type of protectionist

move, in that one of the largest beneficiaries was a relatively new startup that was a clear clone of Twitter, and with close ties to the Indian government. As detailed in the associated case study, Koo, a direct clone of Twitter, raised \$38 million soon after the law went into effect, representing approximately 70% of the increase in funding. That is, it is quite possible to see these new laws as not just reining in internet companies, but also playing favorites with certain internet companies who have a close relationship with the current Indian government.

## CASE STUDY

# Koo & How Governments Use Platform Regulation as a Form of Protectionism

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**SUMMARY:** Unlike other platform regulations, when India vastly changed its intermediary liability rules in 2021, we actually saw investment increase in social media startups. However, much of that seemed to be based on the protectionist nature of the rules, and how they were designed to help only small, local Indian companies. The most notable example of this was Koo, a very obvious Twitter clone (including using a bird as a logo), based in India, that cultivated a close relationship with the current government leadership, including embracing India's controversial Aadhaar biometric identification system as a form of user verification. Koo was able to raise quite a large sum of money just as the new rules went into effect, and just as the Indian government started attacking Twitter (including raiding its offices, and threatening to arrest Twitter employees). At the same time, key Indian government officials joined Koo, and praised the service as an alternative to Twitter.

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Given the surprising and counterintuitive investment trends following the implementation of the new intermediary liability regulations in India in May of 2021, we started to look more closely at the investment to try to understand why the data contradicted our initial expectations.

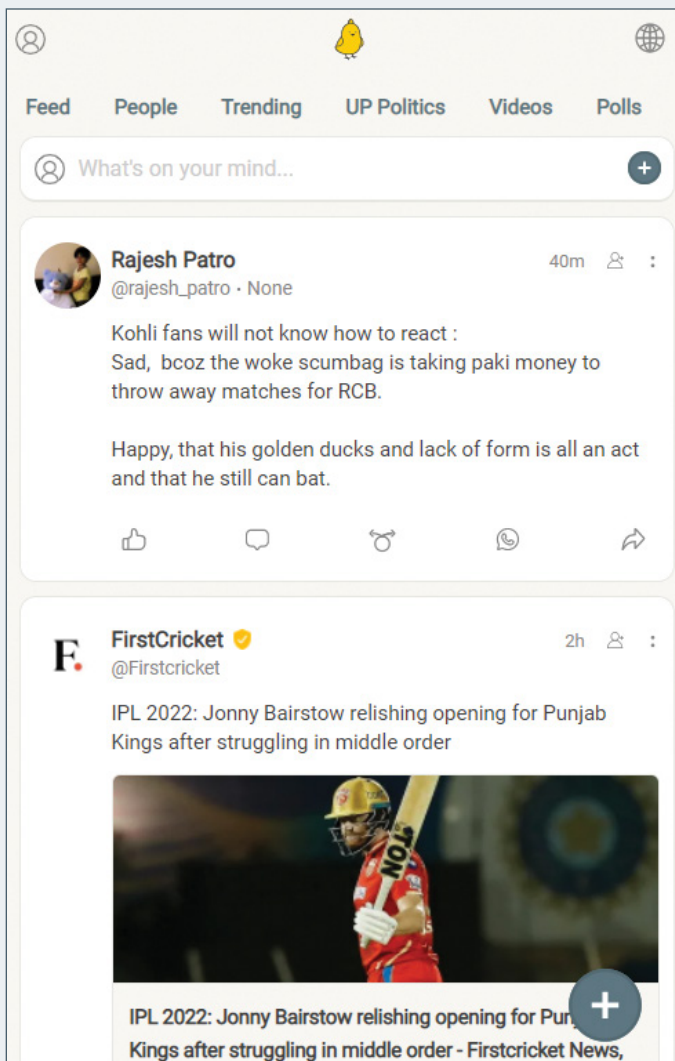
While we expected to see a decline in investment, the actual story is perhaps more interesting, and in the end actually confirms our underlying concerns about the unintended consequences of stricter intermediary liability rules on the internet. The two largest company fundings in our dataset were Trell and Koo. Trell closed a Series B round of approximately \$43 million in July of 2021, soon after the IT Rules went into effect. Koo announced a series of rolling closes for its own Series B round, with the first and largest of them on May 26, 2021 — or exactly one day after the new rules went into effect. That announced round was for approximately \$28 million, however, when combined with two other announced Series B closings, Koo appeared to raise approximately \$38 million total in its B round.

Trell's story has since become something of a scandal in India, as in early 2022 the company was forced to layoff approximately half its staff amid probes into alleged financial misconduct.<sup>8</sup> This came around the same time as a few other well known Indian startups were facing similar allegations. In fact, three of the startups facing such scrutiny were all funded by an Indian subsidiary of the U.S.-based Sequoia Capital, leading the firm to write a blog post promising to improve its efforts regarding better corporate governance.<sup>9</sup>

However, perhaps the more interesting, and more relevant case study for the purposes of this paper, is the story of Koo. Koo is an Indian microblogging platform that looks noticeably similar to Twitter, right down to having a bird as its logo.

As noted earlier, Koo closed the bulk of its Series B venture round on the day that the new rules went into effect, and that appears to be quite symbolic.

Twitter had initially pushed back<sup>10</sup> on the new rules, as



the government threatened to jail Twitter executives if the company did not agree to remove tweets that were critical of the government's handling of the COVID-19 pandemic. Indeed, the day before the new rules went into effect, police in India raided Twitter's offices in Delhi and Gurgaon.<sup>11</sup> Once the law was in effect, the government gave official notice to Twitter that it was losing its intermediary liability protections for failing to comply with the law.<sup>12</sup> It took three more months until Twitter notified the government that it was in compliance with the law (including having to hire a Chief Compliance Officer, a Resident Grievance Officer, and other local employees to respond to government demands to remove content).<sup>13</sup> It has long been assumed that one

part of the requirement to have these local employees in India is to provide the government with a tool for demanding compliance with censorship demands: if there are local employees, they can be threatened with arrest and jail time for not removing content the government does not like.

However, in the interim, Twitter's pushback on the new rules, as well as the government's public berating of the company, was a main driver in boosting Koo's market share in India.<sup>14</sup> The company has continued to use controversy around Twitter to seek to grow its users<sup>15</sup> including by courting the country's ruling party, Bharatiya Janata Party (BJP), to its service.<sup>16</sup>

Koo has also proudly embraced India's highly controversial<sup>17</sup> Aadhaar verification system which enables, among other things, the government to obtain significant data on the users of Koo. In announcing its support of Aadhaar, Koo's co-founder announced that users shouldn't be able to "easily get away with whatever you say," striking a very different stance from Twitter's long-standing focus on protecting the free speech rights, including the right to be anonymous,<sup>18</sup> of its users.

The end result then suggests that the actual impact of the new IT Rules in India is one of protectionism, and effectively enabling a local competitor to take over market share from a larger American company, and in turn that a local company forging not just a close relationship with the government, but one that embraces an identification and verification system that has been widely criticized over concerns about privacy and security.

While this may help the ruling party in the short term, it certainly raises questions about the larger, longer term impact on free speech, innovation, privacy, and security. Nationalistic and populist motivations behind using intermediary liability laws as a form of digital trade barrier raise questions about the country's commitment to actual competition and innovation in the long run.

## Pakistan

Similar to India, in 2021 Pakistan created new intermediary liability regulations, known as the “Removal and Blocking of Unlawful Online Content (Procedure, Oversight and Safeguards) Rules 2021” (sometimes referred to as the RBUOC Rules). These were an outgrowth of a 2016 law, the Prevention of Electronic Crimes Act of 2016,<sup>19</sup> which gave more power to the Pakistan Telecommunication Authority (PTA) to block websites directly, rather than ordering ISPs to implement blocks.

Like many other similar laws, the RBUOC Rules are written in a manner that sounds quite similar to the NetzDG. As with NetzDG, if Pakistani authorities alert an internet company of harmful content, the company has a short period of time to remove the content: 48 hours for content deemed a threat to security, public order, decency and morality, the glory of Islam or “any material contemptuous of the dignity of superior courts.”<sup>20</sup> In cases where the content is deemed particularly concerning, a platform may only have 12 hours to remove it.<sup>21</sup> Also, similar to NetzDG, the law requires internet service providers to supply any data and content on any of their systems to law enforcement authorities.

Failure to abide by the rules can lead to fines for the service provider as well as the potential to have the service blocked entirely across the country.

As these rules were being debated there was already tremendous concern about how these laws would be used for censorship,<sup>22</sup> with Freedom House warning how these laws would lead to censorship and a lessening of freedom in the country.<sup>23</sup> Even in the leadup to the RBUOC Rules

becoming law, the Pakistan Telecommunication Authority had been criticized for social media censorship<sup>24</sup> with temporary countrywide bans placed on TikTok<sup>25</sup> and YouTube.<sup>26</sup>

With the newer rules in place, there have been credible accusations that the Pakistani government temporarily blocked YouTube during a speech by former Prime Minister Imran Khan.<sup>27</sup>

There has been little direct investment in social media companies based in Pakistan, though there has been significant investment in internet startups with hundreds of millions of dollars raised by some internet companies in 2021.<sup>28</sup> While many of the biggest internet companies in the country were focused on commerce, rather than user-generated content, there are at least some signs of trouble brewing in the wake of the country’s stringent internet laws.

In early 2022, reporters in the area were looking at Pakistan’s thriving internet sector, and asking which startup would be declared the first “unicorn” (a company with a \$1 billion [USD] valuation).<sup>29</sup> In an article entitled “Who will be Pakistan’s first unicorn?” it was stated that only one local company, Airlift, was “in the running to become a unicorn this year.” Airlift had raised \$85 million<sup>30</sup> in 2021, the largest private funding round ever in Pakistan. Yet, in the early summer, just months after being declared the most likely to reach unicorn status, Airlift shut down.<sup>31</sup>

Other Pakistani startup darlings faced similar difficulties. Foodpanda, which was launched a decade ago and described as paving the way for the “first startup wave”<sup>32</sup> in Pakistan, has struggled, with its top executives leaving, and the company facing a government investigation<sup>33</sup> over po-

*There have been credible accusations that the government temporarily blocked YouTube during a speech by former Prime Minister Imran Khan*

tential antitrust issues. This has led to headlines describing how the popular startup has “stumbled” in Pakistan.<sup>34</sup>

All of this is raising concerns about foreign tech investment in the country. Over the past couple of years, Pakistan was held up by many as an untapped market for global tech investment<sup>35</sup> leading to a flood of investment from outside the country<sup>36</sup> over just the past few years, going from just \$36 million in 2019 to \$350 million in 2021. However, there are significant concerns that the internet crackdown on the government and the struggles of some high profile startups may chill that interest greatly.<sup>37</sup>

Indeed, there is some level of contradiction between the RBUOC Rules that put liability on internet companies, with other efforts by the Pakistani government to encourage internet growth in the country. Indeed, in early 2022, the Pakistani government announced a “Cloud First Policy”<sup>38</sup> designed to encourage the investment and usage of the internet. It also announced the establishment of special “tech zones” to create incentives and tax breaks for more investment in tech companies.<sup>39</sup>

A report by the Atlantic Council, however, warns that inconsistent and contradictory policies seem likely to chill investment, stating: “vague definitions of restricted types of data coupled with a zealous regulator could deter foreign investment.”<sup>40</sup>

## Indonesia

As with many other countries, Indonesia has recently passed a series of laws to regulate content moderation online, with a focus on putting liability on internet websites

for third-party content, and requiring the companies take down requested content within an extremely short period of time, just 24 hours for most content, and just four hours for “urgent” requests.

In Indonesia, there has been a series of laws, building on 2008’s Information and Electronic Transactions Law (ITE) which has been called out for abuse and censorship.<sup>41</sup> While there had been some hope that the law would be modified to restrict the government’s ability to use it to

stifle critics,<sup>42</sup> it appears that the country went in a different direction. It issued Government Regulation (GR) 71 in 2019<sup>43</sup> and Ministerial Regulation (MR) 5 in 2020 and Ministerial Regulation 10 (amending MR5) in 2021. However, these rules have only just recently come into force.<sup>44</sup>

Once again, the law appears quite similar, in framing, to Germany’s NetzDG law, with some additional similarities with the Digital Services Act (DSA) in the EU. The law requires websites to take down content quickly

in response to government demands. These takedown demands can be extensive, according to Rest of World’s reporting,<sup>45</sup> discussing the frequency of takedowns before the law went into effect — and noting how the companies often rejected those demands in the past.

*Kominfo is known to have requested takedowns for thousands of pieces of content in a month, sometimes more, according to internal transparency reports by leading tech companies. Between June and December 2021, Kominfo asked Google to delist over 500,000 URLs across its search engine, the company’s transparency report showed. (The*

company eventually delisted only .03 percent of the requested URLs.) Twitter reported that it received legal demands to remove content from nearly 30,000 accounts between July and December 2021. The senior official at a social media platform who attended the January meeting also confirmed to Rest of World that Kominfo asked his company to take down thousands of pieces of content at one time. Under the new regulation, that could translate to millions in fines. The ministry's document also stipulates that if a platform fails to take down content, Kominfo would double, then triple the fines, before eventually blocking the platform.

There are already signs that the government has no problem blocking websites if they refuse to abide by these new rules. In July of 2022, Indonesia blocked PayPal, Yahoo, and a number of gaming sites and services, including Steam, Epic Games, Dota 2, and Counter-Strike.<sup>46</sup>

Like NetzDG, the law is framed as preventing “dangerous” content from spreading, including listing content that “disturbs the community and public order” as prohibited. Also, as with the NetzDG, Indonesia MR5 requires websites to hand over data to authorities for investigations, including private data. And as with similar laws, there are legitimate concerns regarding government abuse of power for

both censorship and investigations.<sup>47</sup>

The full effect of these laws on investment in Indonesia is not yet known, given that the laws only just went into effect. However, it is reasonable to be concerned about the harm it might do to a country that had been poised as a leader in entrepreneurship in Southeast Asia. The latest report from ASEAN<sup>48</sup> places Indonesia second to Singapore in the region, and notes that it currently has 23 of the top 100 funded startups in the region (and 14 of 46 “unicorns” in the region). Most of the top startups, however, seem to be focused on commerce and logistics rather than social media or user-generated content.<sup>49</sup> The largest unicorn in the country, GoTo Group, actually is the culmination of a 2021 merger of two of the largest Indonesian “unicorns,” Gojek and Tokopedia, combining the delivery services of Gojek with the e-commerce marketplace of Tokopedia.

As with Pakistan, in Indonesia there appear to be conflicting sets of regulations, as the country's leaders seek to grow the entrepreneurial tech sector. As the ASEAN report highlights, Indonesia has adopted regulatory reforms to ease the process of bringing foreign investment into the company and simplify business licensing, and has developed 12 special economic zones with another seven already under construction. It has also removed or decreased foreign direct investment restrictions in the digital sector.<sup>50</sup>

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## 6. China's Crackdown on Celebrity Internet CEOs

AS NOTED EARLIER IN THIS REPORT with regards to the German NetzDG law, it has become clear that more authoritarian countries around the globe are taking lessons from “internet regulations” from the west, often around intermediary liability, in order to use similar laws and similar language to further their own control over speech and to limit the power of the internet in those countries. Another useful example of this is to look at China, who has recently instituted a variety of new laws that appear to be an attempt by the Chinese government to crackdown on “celebrity” internet CEOs who seemed to be gaining in star power in the country.

In the summer of 2021, China’s Ministry of Industry and Information Technology announced that it was launching a campaign to “regulate internet companies.” For a decade prior, China’s internet industry had been growing massively, and China was building global internet success stories from Alibaba to Tencent to ByteDance/TikTok. The new campaign likely began in late 2020 when Alibaba founder Jack Ma disappeared for many months<sup>1</sup> leading to speculation that the Chinese government was unhappy with how much power, wealth, and publicity he and other internet company leaders had amassed.<sup>2</sup> In early 2021, China fined Alibaba \$2.8 billion for “antitrust” violations.<sup>3</sup>

However, the full crackdown was officially announced in July of 2021, and very quickly many other Chinese internet “success” stories faced regulatory fines and other demands. Alibaba was fined again, along with Tencent and Baidu, also for “antitrust” violations.<sup>4</sup> The delivery giant Meituan was then fined \$533 million for antitrust violations.<sup>5</sup> The massive ride sharing company Didi (often considered China’s equivalent of Uber), was ordered not to issue an IPO in the U.S. When it did so anyway, the company was blocked from signing up new users in China, then its app was removed from Chinese app stores, and the company was also fined for alleged antitrust violations.<sup>6</sup>

What’s quite notable in all of this was the language used by Chinese officials, as well as the types of regulations they put in place, which sounded similar to many of the other regulations and policies put in place around the globe (and discussed elsewhere in this paper).

While many of the initial fines were about supposed antitrust violations, China also amended its antitrust law to enable further enforcement<sup>7</sup> and launched a new “anti-monopoly bureau” in the government to further crack down on internet companies.<sup>8</sup>

Perhaps more noteworthy, however, was that it also echoed the language of the EU and elsewhere, in pushing laws that it claimed were about “protecting privacy.” Specifically, it passed a “Data Security Law” that took effect on September 1, 2021, and a “Personal Information Protection Law” that took effect on November 1, 2021.<sup>9</sup>

The language of these laws, in many ways, mirrors other data protection and intermediary liability laws. It includes concepts like “obligations for data processors” and restrictions on cross-border data transfers.

While some noted that it seemed fairly obvious that China was simply using the language of western internet laws in order to crack down on private companies and their high-profile executives (while similarly noting that the Chinese government itself was the largest collector of data in the country),<sup>10</sup> others (mainly in Europe) seemed, perhaps naively, to believe it was being done in good faith. The European Chamber (which represents European businesses trying to conduct business in China) called it a “significant positive development.” The Financial Times has even suggested that China was “emerging as a surprise leader on data privacy rules.”<sup>11</sup>

This entire effort appears to be having quite an impact on investment, however. While some have insisted that it hasn’t slowed investment,<sup>12</sup> it is clear that investment has

shifted away from internet companies and towards hardware technology, such as chips and robotics.

Investment data out of China is not always as accurate, and because many of these laws went into effect just recently, it is a bit soon to say exactly how much of an impact the laws have had. There are some potentially confounding factors, such as political headwinds nominally distinct from the laws themselves—though in China, the line between written law and discretionary Communist Party favor can be fuzzy. Regardless, the early results are stark.

We looked at investment into internet companies in China, and noted that while investment stayed strong through 2021, the first half of 2022 shows that it has completely fallen off a cliff, just after these new laws went into effect. Projecting that first half out to a full year suggests investment levels that may be less than one-third of what they’ve been for the last few years.

It seems clear that the government’s new rules on internet companies have resulted in investment in internet companies dropping

drastically relative to the baseline trend.

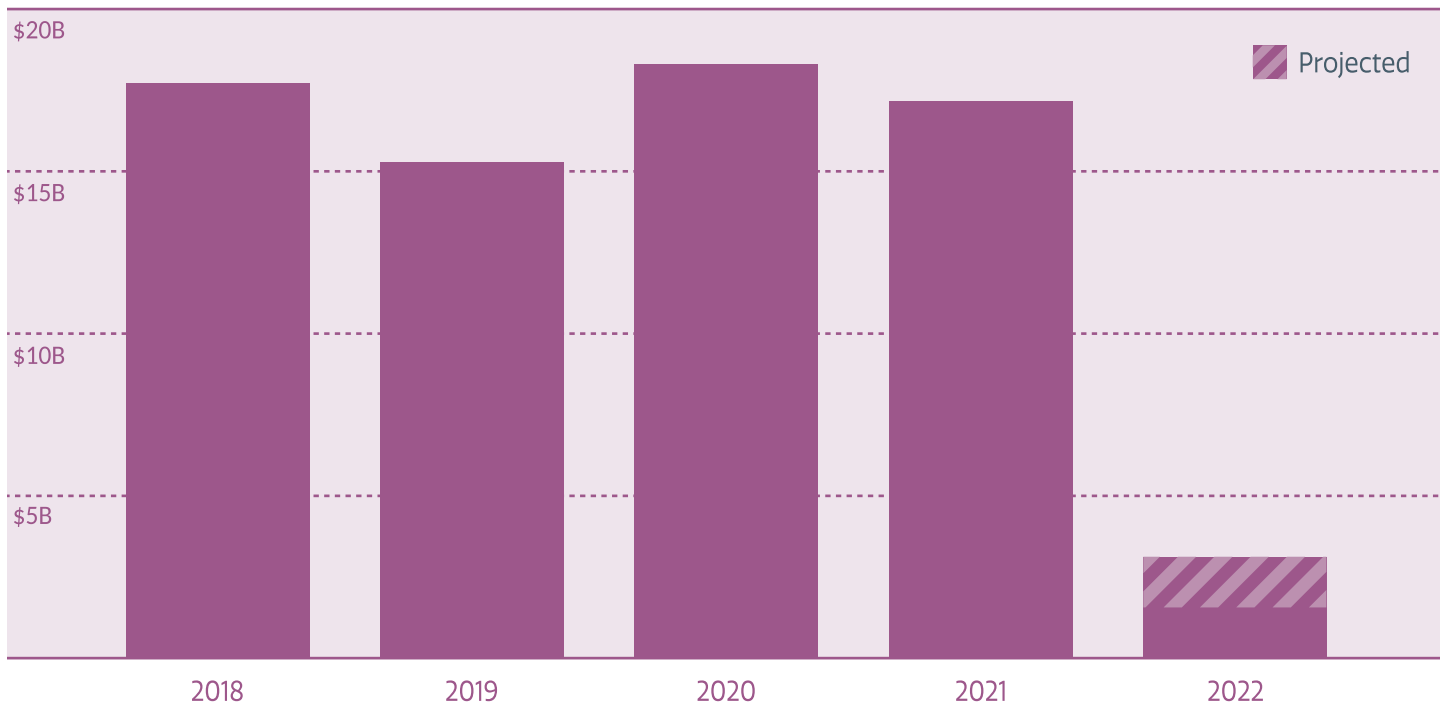
As a control, we compared these numbers to investment rates in the U.S. for internet companies. This showed that over the same period, investment in internet companies continued to rise in the U.S. during the same period, but without a corresponding drop-off as was seen in China.

While perhaps not a perfect comparison, this does demonstrate that this was not a case of investors pulling back from funding internet companies entirely.

*It seems clear that the government's new rules on internet companies have resulted in investment dropping drastically relative to the baseline trend*

## Internet company funding in China

» Source: Crunchbase, with projection



## Internet company funding in China v. United States

» Source: Crunchbase, with projection



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A world map with several countries highlighted in a dark purple color. The highlighted countries include the United States, Canada, the United Kingdom, India, China, Indonesia, and Australia. The rest of the world is shown in a light grey color.

## 7. Conclusion

**THIS REPORT SOUGHT TO EXAMINE** the impact of a variety of intermediary liability platform regulations around the globe, looking at whether or not those laws met their stated goals, and how they impacted a variety of aspects of internet innovation, including investment and competition. What we frequently found was that these laws not only failed to live up to their stated purposes and intentions, but they often had significant negative unintended consequences.

The rhetoric around most of these laws was often about reining in the power of “Big Tech” and creating a fairer playing field. In reality, the laws and the compliance costs associated with them often created barriers to entry, and placed the majority of the burden on smaller startup competitors. Our research found that investors appeared to be well aware of this, and there were noticeable declines in investment in the areas most directly targeted by these laws.

On top of that, we found other disturbing consequences from these laws, including the suppression of speech, often creating real harm within various communities.

Finally, the justifications for these laws have been used by authoritarian leaders to implement their own regulations that are similar in structure, but are in fact being used to give certain governments more power, control, and the ability to surveil their citizenry. Enabling these countries to justify their own authoritarian purposes through the language of “data protection” and “platform responsibility” should be a major concern.

Policymakers considering future platform regulations should take heed. Regulations should be evidence-based with clear indications that will achieve stated goals, and do so in a manner that doesn’t lead to negative unintended consequences that negate whatever gains and benefits could be provided by these regulations.

**As this report illustrates, just because you put in place a law that you say will limit the power of certain companies, does not mean it will actually function that way in the marketplace. Indeed, it could do the exact opposite.**