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## Adjusting the Horizontal and Vertical in Telecommunications Regulation: A Comparison of the Traditional and a New Layered Approach

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# Adjusting the Horizontal and Vertical in Telecommunications Regulation: A Comparison of the Traditional and a New Layered Approach

**Rob Frieden\***

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## I. INTRODUCTION

Telecommunications laws<sup>1</sup> and regulations<sup>2</sup> in the United States and

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1. See, e.g., Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified at scattered sections of 47 U.S.C.). For background on the Telecommunications Act of 1996, see Aimee M. Adler, *Competition in Telephony: Perception or Reality? Current Barriers to The Telecommunications Act of 1996*, 7 J.L. & POL'Y 571 (1999); Michael Glover and Donna Epps, *Is The Telecommunications Act of 1996 Working?*, 52 ADMIN. L. REV. 1013 (2000); Robert M. Frieden, *The Telecommunications Act of 1996: Predicting the Winners and Losers*, 20 HASTINGS COMM. & ENT. L.J. 11 (1996); Thomas G. Krattenmaker, *The Telecommunications Act of 1996*, 29 CONN. L. REV. 123 (1996); Michael I. Meyerson, *Ideas of the Marketplace: A Guide to the 1996 Telecommunications Act*, 49 FED. COMM. L.J. 251 (1997); John C. Roberts, *The Sources of Statutory Meaning: An Archaeological Case Study of the 1996 Telecommunications Act*, 53 SMU L. REV. 143 (2000).

2. The Federal Communications Commission ("FCC" or "Commission") has crafted a basic and enhanced services dichotomy, with the former referring to telecommunications, typically regulated as essential public utility services, and enhanced services, typically unregulated in view of their nonessential nature. See generally, e.g., Computer III Further Remand Proceedings, *Further Notice of Proposed Rulemaking*, 13 F.C.C.R. 6040, 15 Comm. Reg. (P & F) 2017 (1998), on reconsideration, Computer III Remand Proceedings, *Report and Order*, 14 F.C.C.R. 4289, 15 Comm. Reg. (P & F) 149 (1999), and on reconsideration, Computer III Further Remand Proceedings, *Order*, 14 F.C.C.R. 21628, 18 Comm. Reg. (P & F) 1344 (1999); Computer III Remand Proceedings, *Report and Order*, 6 F.C.C.R. 7571, 70 Rad. Reg.2d (P & F) 121 (1991), vacated in part and remanded, *California v. FCC*, 39 F.3d 919 (9th Cir. 1994), cert. denied, 514 U.S. 1050 (1995).

On occasion courts participate in crafting service definitions. On several occasions, the court presiding over the federal government's antitrust lawsuit against AT&T created service definitions, including regulated telecommunications and unregulated information services. See *United States v. W. Elec. Co.*, 714 F. Supp. 1 (D.D.C. 1988), rev'd in part, 900 F.2d 283 (D.C. Cir. 1990); *United States v. W. Elec. Co.*, 673 F. Supp. 525 (D.D.C. 1987). The

in other nations<sup>3</sup> historically have established policies based on fixed service definitions and relatively static assumptions about the industrial organization of telecommunications and information processing. Vertical, “top-down” regulatory policies typically ascribe regulated or unregulated status-based embedded assumptions about market share,<sup>4</sup> essentialness,<sup>5</sup>

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Modification of Final Judgment (“MFJ”), which established the terms and conditions for the divestiture of the local Bell operating companies (“BOCs”) from AT&T, defined “telecommunications” as:

[T]he transmission, between or among points specified by the user, of information of the user’s choosing, without change in the form or content of the information as sent and received, by means of electromagnetic transmission [with or without benefit of any closed transmission] medium, including all instrumentalities, facilities, apparatus, and services (including the collection, storage, forwarding, switching, and delivery of such information) essential to such transmission.

United States v. W. Elec. Co., 552 F. Supp. 131, 229 (D.D.C. 1982), *aff’d sub nom.* Maryland v. United States, 460 U.S. 1001 (1983). The MFJ defines “information service” as the “offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications.” “Information” is defined as “knowledge or intelligence represented by any form of writing, signs, . . . pictures, sounds, or other symbols.” *Id.* at 229.

3. See Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on Access to, and Interconnection of, Electronic Communications Networks and Associated Facilities, 2002 O.J. (L 108), available at [http://europa.eu.int/eurlex/en/archive/2002/l\\_10820020424en.html](http://europa.eu.int/eurlex/en/archive/2002/l_10820020424en.html) [hereinafter *New European Regulatory Framework*]; see also Proposal for a Directive of the European Parliament and of the Council on a Common Regulatory Framework for Electronic Communications Networks and Services, 2000 O.J. (C 365E) 198, available at <http://europa.eu.int/ISPO/infosoc/telecompolicy/review99/com2000-393en.pdf>. See Information Society Web site, at [http://europa.eu.int/information\\_society/topics/telecoms/regulatory/new\\_rf/index\\_en.htm](http://europa.eu.int/information_society/topics/telecoms/regulatory/new_rf/index_en.htm), for an overview of the new European regulatory framework.

4. Telephone companies incur federal and state common carrier economic regulation based initially on their monopoly market share. “The decree [divesting the AT&T Bell system of its local operating companies] did nothing, however, to increase competition in the persistently monopolistic local markets, which were thought to be the root of natural monopoly in the telecommunications industry.” *Verizon Comm., Inc. v. FCC*, 122 S. Ct. 1646, 1654 (2002).

5. Public utility regulation, like that applied to telephone companies, applies here because of the view that government must intervene in the absence of competition to ensure fair prices, universal access, and high service quality.

Until the 1990’s, local phone service was thought to be a natural monopoly. States typically granted an exclusive franchise in each local service area to a local exchange carrier (LEC), which owned, among other things, the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between switches) that constitute a local exchange network. Technological advances, however, have made competition among multiple providers of local service seem possible, and Congress recently ended the longstanding regime of state-sanctioned monopolies.

*AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371 (1999).

pervasiveness,<sup>6</sup> and use of public resources.<sup>7</sup> These policies do not fully segregate content from the conduit used to deliver the content, with the result of applying different degrees of government oversight based on the method for delivering possibly the same content.<sup>8</sup> These policies also create incentives for regulatory opportunism, i.e., exploiting loopholes to qualify for reduced regulatory burdens and higher profit margins.<sup>9</sup>

Under longstanding regulatory regimes, providers of basic telecommunication services fit under the common carrier classification,<sup>10</sup>

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6. Mass media regulation derives, in part, on its perceived reach and social impact: [A]t least one set of competing claims to the protection of . . . [the First] Amendment derives from the fact that, because of the limited number of broadcast frequencies available and the potentially pervasive impact of the electronic media, "The people as a whole retain their interest in free speech by radio and their collective right to have the medium function consistently with the ends and purposes of the First Amendment."

Columbia Brdcast. Sys., Inc. v. Democratic Nat. Comm., 412 U.S. 94, 182-83 (1973) (citing Red Lion Brdcast. Co. v. FCC, 395 U.S. 367, 390 (1969)).

7. Extensive broadcast regulation attempts to secure a public interest dividend for use of public spectrum, and cable television regulation includes a franchise fee for use of public rights-of-way. "Local franchising was the first form of cable regulation, arising from the need of localities to control access to public rights-of-way and easements and to minimize disruption to traffic and other public activity from the laying of cable lines." Denver Area Educ. Telecomms. Consortium, Inc. v. FCC, 518 U.S. 727, 788 (1996) (citation omitted).

8. See Robert Corn-Revere, *New Technology and the First Amendment: Breaking the Cycle of Repression*, 17 HASTINGS COMM. & ENT. L.J. 247 (1994):

Consider the following scenario:

A federal regulator walks into a room and is confronted with five television sets, each displaying the same program. The show features a steamy sex scene between a man and a woman, complete with nudity, adult language, and lots of sweat. Although transparent to the viewer, each television is fed via a different transmission source. The first television is receiving a terrestrial broadcast transmission, the second obtains the images by coaxial cable, the third is connected to a fiber optic common carrier network, the fourth is hooked to a VCR, and the fifth is receiving a direct broadcast satellite (DBS) feed. Leaving aside any questions of federal versus local jurisdiction and assuming that the images are not obscene, what is the regulator's constitutional authority to control these images?

The answer is, it depends.

*Id.* at 249.

9. See Rob Frieden, *Wither Convergence: Legal, Regulatory, and Trade Opportunism in Telecommunications*, 18 SANTA CLARA COMPUTER & HIGH TECH. L.J. 171 (2002).

10. Common carriers provide essential public utility services on a nondiscriminatory basis, typically subject to extensive economic regulation to ensure just and reasonable rates. Section 153(44) of the Communications Act of 1934, as amended (47 U.S.C. § 153(44) (2000)) defines "telecommunications carrier" as a carrier offering "telecommunications service," and Section 153(46) (47 U.S.C. § 153(46) (2000)), states that "telecommunications services" are common carrier services. For extensive background on the history of common carriage, see James B. Speta, *A Common Carrier Approach to Internet Interconnection*, 54 FED. COMM. L.J. 225 (2002).

while providers of enhanced and information services<sup>11</sup>—which add value to basic telecommunications<sup>12</sup>—fit under the substantially unregulated designation of a private carrier. These basic/enhanced and telecommunications/information service dichotomies worked when markets aligned in a neat, vertical array with limited horizontal market integration. In such a nonconvergent “Old World Order,” markets and regulatory policies could fit into broad categories like broadcasting, cable television, common carrier telephony, private carrier, and nonessential or private services.<sup>13</sup> The lack of integration made it feasible and possibly justifiable for the application of different regulatory requirements.

Technological innovations and industry developments jeopardize

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11. 47 U.S.C. § 153(20) (2000):

“[I]nformation service” means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.

*Id.*

12. The FCC defines “enhanced service” as “any offering over the telecommunications network which is more than a basic transmission service.” Amendment of Section 64.702 of the Comm’n’s Rules and Regs. (Second Computer Inquiry), *Final Decision*, 77 F.C.C.2d 384, para. 97, 47 Rad. Reg.2d (P & F) 669 (1980). The FCC’s definition, more specifically, is service that “combines basic service with computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber’s transmitted information, or provide the subscriber with additional, different, or restructured information, or involve subscriber interaction with stored information.” *Id.* para. 5. Practically speaking, the FCC’s enhanced services definition is compatible with the information services classification contained in the Telecommunications Act of 1996: “The Commission has determined that information services consist of all services that the Commission previously considered to be enhanced services. The Commission, however, also has determined that while all enhanced services are information services, not all information services are enhanced services.” Robert Cannon, *Where Internet Service Providers and Telephone Companies Compete: A Guide to the Computer Inquiries, Enhanced Service Providers and Information Service Providers*, 9 COMM.LAW CONSPECTUS 49, 55 (2001) (citing Implementation of Sections 255 and 251(a)(2) of the Communications Act of 1934, as Enacted by the Telecommunications Act of 1996; Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities, 64 Fed. Reg. 63,235 (1999) (to be codified at 47 C.F.R. Parts 1, 6 and 7); *see also* Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, *First Report and Order and Notice of Proposed Rulemaking*, 11 F.C.C.R. 21905, para. 102, 5 Comm. Reg. (P & F) 696 (1996)).

13. Even prior to the current acceleration of technological and marketplace convergence, some commentators objected to nonuniform and inconsistent regulation and jurisprudence as between, for example, the print and broadcast media. *See* Thomas G. Krattenmaker & L.A. Powe, Jr., *Converging First Amendment Principles For Converging Communications Media*, 104 YALE L.J. 1719 (1995); Mark S. Nadel, *A Technology Transparent Theory of the First Amendment and Access to Communications Media*, 43 FED. COMM. L.J. 157, 182-83 (1991).

these convenient dichotomies, because legislators and regulators cannot easily craft service definitions that survive rapidly changing conditions, and because convergence expands the reach of technologies and versatility of services. Converging technologies and markets make it quite possible for a single venture to own or lease facilities capable of operating across previously discrete and mutually exclusive markets. For example, the Internet seamlessly blends content and conduit, and likewise makes it possible for Internet service providers (“ISPs”) and other ventures to offer a variety of services that fit within many of the existing service definitions that include telecommunications, cable, and information services. What these ventures offer, how they offer them, and how they characterize what they offer depends more on regulatory definitions and classifications than on the basis of operational efficiency or functionality. For example, a heavily regulated venture may seek the safe harbor of less regulation in exchange for creating a separate subsidiary,<sup>14</sup> even though it might lose operational synergies.<sup>15</sup> A less regulated or unregulated venture may avoid triggering regulation by carefully handicapping the competitiveness of its offerings vis-à-vis regulated services so that it might continue to qualify for favorable governmental treatment.

Differences in regulatory classifications for functionally equivalent services have created incentives for stakeholders to find and qualify for

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14. SBC and, until recently, Verizon provided advanced services through separate subsidiaries that were treated as non-dominant under FCC orders conditionally approving major mergers. See GTE Corp. and Bell Atlantic Corp. Consent to Transfer Control of Domestic and International Sections 214 and 310, *Memorandum Opinion and Order*, 15 F.C.C.R. 14032, 20 Comm. Reg. (P & F) 989 (2000); Ameritech Corp. and SBC Comm. Inc. Consent to Transfer Control of Corps. Holding Comm’n Licenses and Lines, *Memorandum Opinion and Order*, 14 F.C.C.R. 14712, 18 Comm. Reg. (P & F) 1 (1999) [hereinafter *Ameritech and SBC Consent Order*]. These subsidiaries had been deemed non-dominant, and thereby subject to less regulation in their provision of broadband services. However, in January 2001, the U.S. Court of Appeals for the District of Columbia Circuit held that data affiliates of incumbent local exchange carriers (“ILECs”) are subject to all obligations of Section 251(c) of the Communications Act of 1934, as amended, including the requirement to unbundle network elements and to make them available for resale by competitors. The court overturned the Commission’s determination in the *Ameritech and SBC Consent Order*, because the separate advanced services affiliate could be deemed an integral part of the ILEC and therefore subject to Section 251(c)(4) of the Telecommunications Act of 1996 that requires such carriers to offer at wholesale rates any telecommunications service that the incumbent carrier retails to noncarriers. *Ass’n of Comm. Enters. v. FCC*, 235 F.3d 662 (D.C. Cir. 2001); see also *Ameritech and SBC Consent Order*, *supra*.

15. See Robert W. Crandall & J. Gregory Sidak, *Is Structural Separation of Incumbent Local Exchange Carriers Necessary for Competition?*, 19 YALE J. ON REG. 335 (2002) (advocating that structural separation is inefficient and unnecessary).

designations that trigger the least regulation,<sup>16</sup> or alternatively the greatest degree of benefits conferred by law or regulation, e.g., subsidies, exemption from financial obligations, or qualified immunity from competition. Stakeholders can manipulate the vertical regulatory structure and qualify for the “best” product or service chain classification, even as other ventures, offering functional equivalents, incur more burdensome requirements based on static assumptions about their market share, past actions, or their comparatively less effective advocacy in legislative, judicial, or regulatory forums.

The European Commission has considered whether a horizontal regulatory and policy orientation would provide a better outcome.<sup>17</sup> Such a “side-by-side” approach seeks to establish regulatory parity among similarly situated operators. It attempts to use a harmonized regulatory approach that makes a functional assessment of what a company currently provides and whether it possesses market power, rather than who provides a service and that provider’s “legacy” regulatory status.<sup>18</sup> Despite greater meshing of content and conduit in a convergent environment, horizontal regulation would concentrate on the hierarchy of identifiable layers involved in the provision of information and telecommunications, including a network/physical layer (the wired, wireless, or optical medium), services carried over such networks (one-way, two-way, narrowband, or broadband), and applications/content (voice, data, video, or Internet) riding at the top of the layered stack.<sup>19</sup> Such a horizontal orientation would trigger

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16. See James H. Lister, *The Rights of Common Carriers and the Decision Whether to Be a Common Carrier or a Non-Regulated Communications Provider*, 53 FED. COMM. L.J. 91 (2000).

17. See *New European Regulatory Framework*, *supra* note 3. For background on the European Union horizontal approach to convergent networks, see generally Commission of the European Communities, Information Society, Regulatory Framework, available at [http://europa.eu.int/information\\_society/topics/telecoms/regulatory/index\\_en.htm](http://europa.eu.int/information_society/topics/telecoms/regulatory/index_en.htm) (last visited Nov. 29, 2002).

18. “A regulatory model based on who provides the services is no longer an appropriate model in the broadband world.” Antonia M. Apps & Thomas M. Dailey, *Non-Regulation of Advanced Internet Services*, 8 GEO. MASON L. REV. 681, 683 (2000).

19. Data networks, including the Internet, fit well into a horizontal model for purposes of understanding the structure and technical interfaces needed to achieve connections. The Open Systems Interconnection (“OSI”) Model provides a helpful example of horizontal modeling:

OSI[] is a standard description or “reference model” for how messages should be transmitted between any two points in a telecommunication *network*. Its purpose is to guide product implementers so that their products will consistently work with other products. The reference model defines seven layers of functions that take place at each end of a communication. Although OSI is not always strictly adhered to in terms of keeping related functions together in a well-defined layer, many if not most products involved in telecommunication make an attempt to



a substantial revamping of regulatory treatment as it would possibly free some ventures that have historically operated under extensive regulation, even as it imposes new regulatory burdens on ventures historically exempt from regulation. A horizontal orientation also would establish a regulatory regime based on how technologies function and would foreclose the need to make semantic distinctions between such converging concepts as telecommunications used in the provision of information services and telecommunications services provided directly to users.

This Article will assess the viability of different vertical regulatory regimes in an increasingly convergent environment. It will review several recent FCC proceedings that have generated opportunities for stakeholders to avoid regulatory parity by qualifying for reduced regulation based on service definitions. The Article will provide current examples of how the changed circumstances, like convergence, have forced ad hoc recrafting, or interpretations of definitions in an increasingly difficult effort to sustain a top-down regulatory regime. The Article also will examine proposals under consideration by the European Union to shift from a vertical regulatory structure to a harmonized, horizontal one.

The Article also will consider whether a horizontal regulatory approach can reduce the number of regulatory asymmetries and inconsistencies, such as those apparent when telephone companies bear common carrier regulatory duties when providing Internet access while cable television ventures do not. A regulatory structure, based on service function instead of service definition or pedigree, offers a theoretically pleasing, but politically unacceptable alternative. It would solve the current inability for courts to distinguish between cable television as a medium for providing information services versus a medium for delivering telecommunications and conventional cable services. Under the current regulatory regimes, cable television operators incur different regulatory burdens and benefits as a function of which vertical regulation applies, viz, extensively regulated common carrier telecommunications, partially regulated cable services, and largely unregulated information services.

The Article concludes that a horizontal regulatory structure may not secure sufficient political support given the risk of extending new burdens on previously unregulated activities even though regulators could calibrate and ease the burdens to the lowest degree still able to protect the public

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describe themselves in relation to the OSI model. It is also valuable as a single reference view of communication that furnishes everyone a common ground for education and discussion.

SearchNetworking.com Definitions, available at [http://searchnetworking.techtarget.com/sDefinition/0,,sid7\\_gci212725,00.html](http://searchnetworking.techtarget.com/sDefinition/0,,sid7_gci212725,00.html) (last visited Nov. 29, 2002).

interest. The horizontal orientation, however, makes better sense in a convergent, increasingly Internet-dominated marketplace and also provides a more intelligent model than the existing vertical orientation that creates unsustainable service and regulatory distinctions.

## II. DEFECTS IN VERTICAL REGULATORY MODELS

With the proliferation of content delivery options over time, legislatures, regulatory agencies, and courts have purposefully created different models for government oversight. These models differentiate the scope of regulation based on perceived need to supersede market forces in view of conditions specific to a particular medium. For example, broadcasters in many nations enjoy less freedom of expression than their print counterparts based on the view that they operate using a scarce public resource, the electromagnetic radio spectrum. More broadly, nations may calibrate regulatory oversight based on expansive notions of the public interest,<sup>20</sup> national security,<sup>21</sup> economic assumptions about the marketplace and sustainability of competition,<sup>22</sup> or empirical observations of market conditions.<sup>23</sup>

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20. For example, the Telecommunications Act of 1996 directed the FCC to review its rules every even-numbered year and repeal or modify those found to be no longer in the public interest. *See, e.g.*, 2000 Biennial Reg. Review of Part 68 of the Comm'n's Rules and Regs., *Report and Order*, 15 F.C.C.R. 24944, para. 1, 22 Comm. Reg. (P & F) 1117 (2000). In its comprehensive biennial review of its rules, the Commission seeks "to eliminate regulations that are no longer necessary because the public interest can be better served through reliance on market forces." 2000 Biennial Reg. Review of Part 68 of the Comm'n's Rules And Regs., *Order on Reconsideration in CC Docket No. 99-216 and Order Terminating Proceeding in CC Docket No. 98-163*, 17 F.C.C.R. 6856, para. 1 (2002).

21. For example, the executive branch of the U.S. government addresses telecommunications national security and emergency preparedness issues. *See* Exec. Order No. 12,472, 49 Fed. Reg. 13,471 (Apr. 3, 1984).

22. "The 'contestable markets' literature suggests that even monopolists may behave competitively if they face the threat of swift entry by effective competitors whenever the monopolist raises prices above cost or reduces product quality. Thus, potential competition may, in principle, constrain market power as effectively as actual competition." Implementation of Section 11 of the Cable TV Consumer Prot. and Competition Act of 1992, *Further Notice of Proposed Rulemaking*, 16 F.C.C.R. 17312, para. 69 (2001) (responding to court reversal and remand of FCC attribution rules limiting a single cable television firm to a maximum thirty-percent national share of multi-channel video programming subscribership and a forty-percent vertical limit on carriage of programming).

23. *See* 2000 Biennial Reg. Review Spectrum Aggregation Limits For Commercial Mobile Radio Servs., *Report and Order*, 16 F.C.C.R. 22668, para. 32 (2001).

Measures of market concentration in the record show a substantial continuing decline in concentration in most local CMRS [commercial mobile radio service] markets. We find that considerable entry has occurred and that meaningful competition is present, particularly given the presence of such earmarks of

In the United States, expansive yet inconsistent government oversight models have developed for print, broadcast, cable television, telephone, and Internet communications. Purists have objected to such media-specific modeling, especially as it relates to the First Amendment and other constitutional guards against government intrusion.<sup>24</sup> Some rational justifications, however, have supported these different models, including the lack of significant intermodal competition or substitution, and limited technological and market convergence. In a preconvergent environment, media-specific regulatory models could apply because citizens, in large part, looked to different media for different functions, and governments could craft a plausible rationale for applying varying degrees of oversight and regulatory burdens based on articulable factors.

Variations in the scope of government intrusion have occurred in the United States on grounds that decision-makers can distinguish between speakers based on whether they control the content they deliver, as well as the nature, reach, and impact of that content. Broadcasting is a pervasive and intrusive medium.<sup>25</sup> Using public spectrum, it has incurred public trustee status and public interest obligations<sup>26</sup> even as business competitors, such as cable television, qualified for significantly less government oversight.<sup>27</sup> The former bears an obligation to repay the public for use of

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competition as falling prices, increasing output, and improving service quality and options. Specifically, concentration in CMRS markets, as measured by subscriber share, is falling.

*Id.* (empirical findings that CMRS markets are competitive).

24. See Krattenmaker & Powe, *supra* note 13; Nadel, *supra* note 13.

25. For example, in *FCC v. Pacifica Foundation*, the Supreme Court rejected strict scrutiny threshold for government content regulation and thereby approved of comparatively more stringent regulation vis-à-vis other forms of speech, based on the view that broadcasting had a “uniquely pervasive presence” and was “uniquely accessible to children.” 438 U.S. 726, 748, 749 (1978).

26. “[O]f all forms of communication, it is broadcasting that has received the most limited First Amendment protection.” *Pacifica*, 438 U.S. at 748. In *Red Lion Broadcasting Co. v. FCC*, the Supreme Court held that the finiteness of useful broadcasting frequencies and media scarcity necessitated government allocation and regulation to ensure that licensees best serve the public interest. 395 U.S. 367, 400-01 (1969).

27. Cable television operators enjoy substantial First Amendment protection when they engage in expressive conduct, e.g., as speakers and content programmers, and less protection when they provide a conduit for the speech of others, e.g., retransmission of broadcast signals. In *United States v. Playboy Entertainment Group, Inc.*, the Supreme Court held that mandatory scrambling of signals containing sexually oriented programming, or limiting access to such content to late-night hours when children do not make up a significant portion of the cable television viewing audience, violated the First Amendment as not providing the least restrictive means of restricting speech. 529 U.S. 803, 825-27 (2000). The Court, however, has affirmed as legitimate economic regulation in the public

radio spectrum through public interest programming,<sup>28</sup> while the latter incurs less regulatory burdens even though it also makes direct payments to municipalities through franchise fees.<sup>29</sup>

A continuum of government oversight reach and regulatory burdens has developed.<sup>30</sup> Broadcasters face the most intrusive level of government oversight of both economic performance and content, followed by cable television operators, in light of the potential for adverse economic impact on broadcasters. Telephone companies incur significant economic regulation in view of their essential common carrier public utility function, even though they typically operate as neutral conduits providing carriage of content created by others. Print media qualifies for the least degree of government oversight, primarily because it does not use public resources and serves an essential public interest function in promoting honest and fair governance. The jurisprudence for Internet-mediated information, communications, and entertainment (“ICE”) has begun to develop with preliminary indications favoring limited government intervention whenever possible.<sup>31</sup>

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interest mandatory carriage of broadcast signals by cable operators. *See Turner Brdct. Sys., Inc. v. FCC*, 512 U.S. 622, 662 (1994); *Turner Brdct. Sys., Inc. v. FCC*, 520 U.S. 180, 189 (1997).

28. “The broadcasters, as public trustees, have an obligation in a democratic society to inform the beneficiaries of the trusteeship, *id est*, the public, of the different attitudes and viewpoints which are held by the various groups which make up the community.” *Red Lion Brdct. Co. v. FCC*, 381 F.2d 908, 928 (D.C. Cir. 1976), *aff’d*, 395 U.S. 367, 401-02 (1969).

29. Municipalities exercise local franchising authority over cable providers by granting nonexclusive franchises. Under cable franchise agreements, cable providers must pay annual franchise fees, typically a percentage of their gross revenues. This fee compensates municipalities, *inter alia*, for access to public rights-of-way. *See* Andrea L. Johnson, *A City Guide to Developing, Using, and Regulating Regional Telecommunication Networks Under the Telecommunications Act of 1996*, 21 NOVA L. REV. 515, 537 (1997). *See* 47 U.S.C. § 253(c) (2000).

Nothing in this section affects the authority of a State or local government to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of public rights-of-way on a nondiscriminatory basis, if the compensation required is publicly disclosed by such government.

*Id.*

30. “It is true that our cases have permitted more intrusive regulation of broadcast speakers than of speakers in other media.” *Turner Brdct. Sys., Inc.*, 512 U.S. at 637. “We have long recognized that each medium of expression presents special First Amendment problems.” *Pacifica*, 438 U.S. at 748 (citation omitted). *See also* *City of Los Angeles v. Preferred Comms., Inc.*, 476 U.S. 488, 496 (1986) (Blackmun, J., concurring: “Different communications media are treated differently for First Amendment purposes.”); *Metromedia, Inc. v. City of San Diego*, 453 U.S. 490, 500-01 (1981) (plurality opinion).

31. For example, the Supreme Court has applied a strict scrutiny standard for Internet content regulation, including statutes designed to protect children. *See, e.g., Reno v. ACLU*, 521 U.S. 844, 885 (1997) (holding that statute that conditioned access to Internet-mediated

### III. VERTICAL REGULATION IN APPLICATION

Media-specific regulation operates in a vertical, top-down context. Governments adopting this model segregate ICE industries into specific media categories, each with an identifiable and hierarchical product cycle, or “food chain.” A vertical regulatory model makes little distinction among various operators in each chain, but big distinctions between chains. As a result, operators with substantially different market shares may face the same scope of regulation, even as other operators with comparatively greater market power in other chains incur less burdensome regulatory duties as they qualify for treatment under a different vertical model.

In application, vertical modeling imposes government-originated assumptions about the industrial structure, market power, and reach of ICE companies. These assumptions become unsustainable when any one ICE company diversifies and begins to provide services attributable to another food chain. As well, these assumptions do not work well when any one ICE venture seamlessly may integrate content creation and content delivery functions, as occurs when ISPs offer both Internet access—a conduit function—and Internet-mediated content.

One can appreciate how vertical modeling offers simplicity and supports the ability to calibrate different regulatory treatment for various ICE ventures. Governments can subdivide the broad and expansive ICE industry into specific categories. The broadcasting category covers networks and individual outlets with some indirect impact on content creators, syndicators, and packagers. The broadcasting category triggers media-specific regulatory decision-making that affects spectrum management, ownership opportunities, public interest obligations, etc. Despite the expansive nature of such regulation, little attention applies horizontally, i.e., between broadcasters and other ICE media,<sup>32</sup> except when other media have an impact on the vertical broadcast chain. Accordingly, the broadcasting regulatory model has limited impact on the cable

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content lacked the precision that the First Amendment requires for content regulation). *But see* John F. McGuire, Note, *When Speech is Heard Around the World: Internet Content Regulation in the United States and Germany*, 74 N.Y.U. L. REV. 750, 758-59 (1999) (citing Dawn L. Johnson, Comment, *It's 1996: Do You Know Where Your Cyberkids Are? Captive Audiences and Content Regulation on the Internet*, 15 J. MARSHALL J. COMPUTER & INFO L. 51, 79-85 (1996)); Sarah B. Hogan, Note, *To Net or Not to Net: Singapore's Regulation of the Internet*, 51 FED. COMM. L.J. 429, 432 (1999).

32. Indeed, recent court cases have reversed FCC regulations limiting the scope of horizontal cross-ownership opportunities between media and market-share limitations. *See, e.g.,* Fox TV Stations v. FCC, 280 F.3d 1027 (D.C. Cir. 2002) (vacating the cable-broadcast cross-ownership rule and remanding to the FCC justifications for national television ownership caps); Sinclair Brdcast. Group, Inc. v. FCC, 284 F.3d 148 (D.C. Cir. 2002) (remanding to the FCC the duty to justify ownership limits on local broadcast stations).

television model, except when horizontal interaction or integration occurs between the two that has a potential adverse impact on the vertical regulation of either industry. For example, the FCC imposes “must-carry” obligations on cable television operators, primarily to ensure the continuing viability of over-the-air broadcast television.<sup>33</sup> Must-carry requirements help sustain FCC assumptions about broadcasting, including its public interest value vis-à-vis other media—one of the key rationales for erecting a specific broadcasting vertical model in the first place. In other words, assumptions the FCC first made about broadcasting when it erected a specific vertical model become self-sustaining despite changed marketplace and technological circumstances. The Commission resists the duty to recalibrate its regulatory requirements of both broadcasting and other media that affect it unless significant adverse financial impacts occur. In the must-carry example, the perceived need to support and sustain “free” broadcast television supports mandatory carriage of broadcast signals by cable television operators, despite the fact that more U.S. television viewers watch television via a cable conduit than via the airwaves.

#### IV. MARKETPLACE AND TECHNOLOGICAL CONVERGENCE JEOPARDIZE REGULATORY POLICIES BASED ON SERVICE DEFINITIONS

As the “goal of telecommunications policy has shifted from the control of natural monopoly to the promotion of competition,”<sup>34</sup> so, too, must government policymakers recognize the consequences of such a major paradigm shift in emphasis. This revamped approach triggers new assumptions about the nature of ICE markets, with at least some of these assumptions corroborated by empirical evidence, e.g., the appearance of market entrants even though the sustainability of competition may not yet be clear.<sup>35</sup> The existing or prospective changes, however, typically do not

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33. See *Turner Brdcst. Sys., Inc.*, 520 U.S. 180.

34. John E. Lopatka & William H. Page, *Internet Regulation and Consumer Welfare: Innovation, Speculation, and Cable Bundling*, 52 HASTINGS L J. 891, 891 (2001).

35. The FCC has engaged in decision-making based on assumptions about future marketplace developments. For example, the FCC accepted the premise of some economists that when a market evidences some potential for becoming competitive, the Commission should begin the process of deregulating that market, which is now “contestable.”

Contestable markets are characterized by the absence of sunk costs (so that firms can instantaneously and costlessly enter and exit) and by slower response times by incumbents relative to entrants (so that entrants can depart before incumbents can lower price and inflict losses on them). If entry were that easy, then concentration among incumbents would not affect market performance, nor would it matter if an incumbent acquired one of many possible entrants into such a market.

John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and*

trigger the formulation of new service definitions, or a departure from preexisting vertical models. In other words, even if new or more robust competition develops across vertical models, e.g., telephone versus cable television companies in the provision of broadband Internet access, the FCC has applied precompetition and preconvergence definitions with increasingly anomalous results.

During the transition from monopoly regulation to significantly deregulated competition, the potential exists for substantial disparity in regulatory treatment of competitors largely based on how preexisting service definitions apply. Asymmetry in regulatory treatment may provide the lesser-regulated venture a competitive advantage based on the ability to accrue cost savings. “The FCC tolerates regulatory disparity between competitive providers where necessary to fulfill” legislative or public policy purposes like those articulated in the Telecommunications Act of 1996 (1996 Act).<sup>36</sup>

Regulatory agencies, prone to ambiguity, inconsistency, and artificial tilts in the competitive playing field, cannot sustain regulatory asymmetry in the face of appellate court scrutiny. The FCC has a rather poor record in having its decisions affirmed on appeal. Likewise, the FCC’s rationale for favoring or incubating a particular technology or service classification loses much intellectual support over time. As new technologies and services gain market share, the FCC should abandon regulatory handicapping because failing to do so typically would result in even greater inconsistencies and anomalous outcomes—slavishly adhering to service classifications that impose greater regulatory burdens on one category of service provider having less market share than on a less-regulated category of provider having more market share.

In its campaign to insulate information services from regulation, the FCC has created several opportunities for stakeholders to subvert public policy objectives. For example, ventures able to shoehorn their telecommunications services into the information services category—no matter how close to functional equivalence to conventional dial-up telephony—qualify for exemption from having to pay fees that fund universal service programs.<sup>37</sup> In its effort to eliminate inconsistent

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*Prospective Competitors*, 52 CASE W. RES. L. REV. 173, 189 n.61 (2001). See also WILLIAM J. BAUMOL ET AL., *CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE* (1982). While some might consider this results-oriented decision-making, others consider this a way to expedite regulatory change in view of a fast-paced market and technological developments and the potential for lags in regulatory responses.

36. Robert S. Metzger & Benjamin P. Broderick, *Communications Convergence*, 18 COMPUTER & INTERNET LAW., Oct. 2001, at 12.

37. Robert M. Frieden, *Universal Service: When Technologies Converge and*

regulatory treatment of Internet access providers, the FCC seems intent on reclassifying a tariffed, retail telecommunications service, e.g., Digital Subscriber Line (“DSL”) service, as an information service, thereby establishing regulatory parity with unregulated cable modem services.<sup>38</sup>

## V. VERTICAL REGULATORY MODELS CREATE REGULATORY ARBITRAGE AND BRINKMANSHIP OPPORTUNITIES

Traditional vertical regulatory regimes have become increasingly faulty in a convergent environment, largely because they use definitions that establish mutually exclusive categories and a substantial dichotomy of regulatory burdens. ICE service providers have become quite adept at manipulating this regulatory system with an eye toward accruing cost savings by qualifying for less-burdensome regulatory requirements. Additionally, stakeholders use litigation to delay or thwart change. While they may oppose the requirement to form separate subsidiaries when doing so reduces synergies and adds costs, stakeholders will resort to structural separation if sufficient financial and operational benefits accrue.

Vertical regulatory models encourage system gaming by stakeholders, but the creators, implementers, and administrators of these models have to assume responsibility for creating asymmetrical rights and responsibilities and the opportunities to migrate to less-burdensome classifications.<sup>39</sup> Some degree of regulatory opportunism will result simply because technologies evolve and service definitions provide broad, somewhat ambiguous, snapshots of technology when the terms initially are crafted. But most examples of regulatory asymmetry result from fundamental flaws in model creation followed by ad hoc tinkering and retrofits.<sup>40</sup>

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*Regulatory Models Diverge*, 13 HARV. J.L. & TECH. 395, 431-33 (2000) [hereinafter *Universal Service*].

38. See Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, *Notice of Proposed Rulemaking*, 17 F.C.C.R. 3019 (2002).

39. “[A]ll forms of asymmetric regulation contain an intrinsic bias toward some firms or technologies.” Mark Schankerman, *Symmetric Regulation for Competitive Telecommunications*, 8 INFO. ECON. POL’Y 3, 6 (1996).

40. Professor Günter Knieps asserts:

There is a wide range of possible asymmetric regulation. Whereas, in the past, legal entry barriers protected monopolistic carriers, the regulatory pendulum now seems to swing in the opposite direction. Asymmetric regulation in favor of newcomers is motivated by the conviction that, even after the abolishment of the legal monopoly, the incumbent carrier would still possess a factual monopoly position on the network infrastructure and the normal voice telephone service. Therefore, initial support of newcomers, at least for a sufficient transition period, has been recommended recently in the national regulatory debates . . . .

Prof. Dr. Günter Knieps, *Deregulation in Contestable and Non-Contestable Markets*, 23 FORDHAM INT’L L.J. 90, 99 (2000) (citation omitted).



## VI. EXAMPLES OF HOW DEFINITION-DRIVEN VERTICAL REGULATION FAILS

Technological and marketplace convergence have created a real or perceived need by ICE ventures to avoid the common carrier classification and by the Congress and the FCC to liberalize requirements for those operators retaining this status. Vertical regulatory modeling tightly links common carriage with telecommunications service. Until regulatory flexibility was established in the 1996 Act,<sup>41</sup> all telecommunications service providers incurred the full range of common carrier responsibilities, specified in Title II of the Communications Act of 1934, as amended,<sup>42</sup> including the duty to file cost-based tariffs, to interconnect with other carriers, and to provide service to all qualified consumers on a nondiscriminatory basis. In response to increasing competition from ventures that were able to avoid common carriage responsibilities by offering services that could fit in the unregulated enhanced service or information services category, both Congress<sup>43</sup> and the FCC<sup>44</sup> sought to reduce the scope and burdens of the common carrier classification. In doing so, the government eliminated what had been “bright line,” mutually exclusive categories, a sine qua non of vertical regulation.

Service definitions have become even less effective, because increasingly no one can easily and unambiguously determine into which category and vertical regulatory slot a particular service or function fits:

The existing regulatory framework was built around the concept that different services were provided by different providers, without overlap. Thus, telephone companies providing telephone service are

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41. 47 U.S.C. § 160(a) (2000).

42. *Id.* § 201.

43. The FCC may forbear from applying any regulation or any provision of the Communications Act of 1934 if “enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations . . . are just and reasonable and are not unjustly or unreasonably discriminatory,” enforcement is not necessary to protect consumers, and “forbearance . . . is consistent with the public interest.” *Id.* § 160(a).

44. See *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Notice of Proposed Rulemaking*, 17 F.C.C.R. 3019 (2002) [hereinafter *Wireline Broadband NPRM*].

First and foremost, the Telecommunications Act of 1996 introduced a mandate that the Commission promote competition, deregulation and innovation wherever possible in the communications market. The Act clearly evidences Congress’ intent to involve as many potential providers as possible to bring consumers the benefits of newer, better and more cost-effective products and services.

*Id.* para. 35. See, e.g., *Review of Reg. Requirements for Incumbent LEC Broadband Telecomms. Servs., Notice of Proposed Rulemaking*, 16 F.C.C.R. 22745 (2001) [hereinafter *ILEC Broadband Notice*]; *Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Notice of Proposed Rulemaking*, 16 F.C.C.R. 22781 (2001).

regulated as common carriers under Title II of the Communications Act of 1934 . . . . But, to the extent that [other] wireline networks can deliver the same services to the consumer at the same quality, it is difficult to understand why different technologies should trigger different regulatory treatment for the same services.<sup>45</sup>

Simply put, a “regulatory model based on who provides the services is no longer an appropriate model in the [convergent] broadband world.”<sup>46</sup> In reducing the scope and reach of common carriage, as well as the still-applicable requirements, Congress and the FCC largely eliminated the vertical link between a service definition and the applicable regulatory model. Traditional common carriers continued to provide telecommunications services, but other private carriers could provide functionally equivalent telecommunication services without the common carrier classification. In other words, creative marketing and lawyering created opportunities, first, for private carriers to offer what common carriers previously had offered exclusively and, second, for incumbent common carriers to present a compelling argument for further relaxation of common carrier burdens.

One might conclude that increased competition among ventures, regardless of regulatory classification, would solve any short-term problem in definition creation and application. Short-term problems have persisted, however, and have immediate and chronically adverse impact on the viability and robustness of competition.<sup>47</sup> They also have led to arguments that regulatory asymmetry has resulted in confiscation of private resources,<sup>48</sup> created disincentives for infrastructure investment,<sup>49</sup> and tilted

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45. Apps & Dailey, *supra* note 18, at 682-83.

46. *Id.* at 683.

47. Many authors consider the 1996 Act as having failed to achieve the objectives articulated in the law. See Adler, *supra* note 1; Glover & Epps, *supra* note 1; Michael T. Osborne, Comment, *The Unfinished Business of Breaking Up “Ma Bell:” Implementing Local Telephone Competition in the Twenty-First Century*, 7 RICH. J.L. & TECH. 4 (2000), at <http://www.richmond.edu/jolt/v7i/note1.html>.

48. See, e.g., *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) (stating that an ILEC failed to show that an FCC decision promoting local exchange service competition without first implementing a new universal service support system resulted in a regulatory taking, because the carrier did not prove any loss of revenue).

49. See Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunications Networks*, 109 YALE L.J. 417, 425 (1999); accord *U.S. Telecom Ass’n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002) (granting petitions for review, and remanding to the FCC its order requiring ILECs to share local loop lines and to unbundle service elements in view of the Commission’s failure to consider incipient cable and satellite competition as well as its decision to establish a national policy that does not consider local competitive conditions). “Each unbundling of an element imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities.” *Id.* at 427.

the competitive playing field in favor of one ICE category to the detriment of others. Common carriage no longer provides a vertical link between what a venture provides and how government will treat it.

### VII. CONFUSING TELECOMMUNICATIONS TRANSPORT ANCILLARY TO AN INFORMATION SERVICE WITH COMMON CARRIAGE TELECOMMUNICATION SERVICES

Marketplace and technological convergence already have triggered the combination of telecommunications and information services, an outcome that subverts the mutual exclusivity established by separate vertical regulatory models.<sup>50</sup> Such integrated services eliminate the designation of a single, universally accepted service designation; and can result in confusion over which classification should apply, and whether for regulatory purposes, a decoupling of telecommunications and information services can occur. In turn, this confusion stimulates litigation to reestablish regulatory certainty, transparency, and fairness. This cycle has occurred on several occasions recently and, with each instance, the need for structural reform becomes more pressing.

### VIII. INTERNET ACCESS

Internet and broadband services provide a key example of the regulatory quagmire vertical modeling has generated. Currently, both the FCC and reviewing courts have struggled with the need to apply legislatively crafted definitions while limiting regulatory asymmetries.<sup>51</sup>

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50. "Basic service, or 'pure transmission over a communications path,' eventually became 'telecommunications service' under the Telecommunications Act of 1996. This category cannot overlap with the definition of 'information service.'" Jim Chen, *The Authority to Regulate Broadband Internet Access over Cable*, 16 BERKELEY TECH. L.J. 677, 708 (2001) (citations omitted).

51. The 1996 Act, which amended the Communications Act of 1934, 47 U.S.C. § 151 (2000), provides the definitions of cable service, information service, and telecommunications service. "Cable service" is defined in 47 U.S.C. § 522(6): "(A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming service, and (B) subscriber interaction, if any, which is required for the selection or use of such video programming or other programming service." "Cable system" is defined as: a facility, consisting of a set of closed transmission paths and associated signal generation, reception, and control equipment that is designed to provide cable service which includes video programming and which is provided to multiple subscribers within a community, but such terms do not include (A) a facility that serves only to retransmit the television signals of the 1 or more television or broadcast stations; (B) a facility that serves subscribers without using any public right-of-way; (C) a facility of a common carrier which is subject, in whole or in part, to the provisions of title II of this Act, 47 USCS §§ 201 et seq., except that such facility shall be considered a cable system (other than for purposes of section 621(c)) 47 USCS § 541(c) to the extent such facility is used in the transmission of

The Commission currently deems telephone company-provided broadband access a telecommunications service, but it has strongly indicated the desire to convert the classification of these offerings into the information services category.<sup>52</sup> Such a flip in vertical food chains evidences how inflexible and unworkable the definitions have become, particularly because a competing technology—cable modem access—already qualifies for the unregulated information service classification.<sup>53</sup> However, the manner in which the Commission seeks to establish regulatory parity comes across as disingenuous. The Commission proposes to downgrade and subordinate the previously regulated, stand-alone telecommunications component so that it now qualifies as a minor fused component of an information service. Should the FCC formalize its proposal, it will have established a mechanism for deregulating services without having to demonstrate that a competitive marketplace exists. Likewise, the Commission may find that it might not have a way to limit stakeholders from shoehorning core, basic regulated services into an unregulated safe harbor. For example, a traditionally regulated telecommunications common carrier might try to seek to characterize its basic telephone services as ancillary, subordinate, and otherwise fused to its Internet access and other information service offerings.

The telecommunications/information service definition dichotomy coupled with the vertical nature of regulation also fails when applied to Internet access and Internet-mediated services such as packet-switched telephony. From a top-down approach, telephone companies need not always provide common carrier telecommunications services, nor must

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video programming directly to subscribers unless the extent of such use is solely to provide interactive on-demand services; (D) an open video system that complies with section 653 of this title 47 USCS § 573 or (E) any facilities of any electric utility used solely for operating its electric utility systems.

*Id.* § 522(7). “Information service” means “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.” *Id.* § 153(20). “Telecommunications” means “the transmission, between or among points specified by the user, of information of the user’s choosing, without change in the form or content of the information as sent and received.” *Id.* § 153(43). “Telecommunications service” means “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.” *Id.* § 153(46).

52. *Wireline Broadband NPRM*, *supra* note 44.

53. Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities, Internet over Cable Declaratory Ruling, *Declaratory Ruling and Notice of Proposed Rulemaking*, 17 F.C.C.R. 4798 (2002) [hereinafter *Cable Modem NPRM*].

cable television companies always provide cable services. Technological convergence means that current (dial-up telephone service), retrofitted (DSL),<sup>54</sup> or future (broadband fiber-optic cable), telephone company platforms can transcend many different service categories. Likewise, retrofitted and future platforms for delivering broadband services can span several different service categories. Cable television operators that partially or completely replace coaxial cables with fiber-optic facilities can couple the customary delivery of video programming with access to a variety of new data, Internet and telephone services.

Even now, reviewing courts have reached different conclusions as to what services particular ICE companies may offer. Because the vertical regulatory model applies a regulatory regime based on specific service definitions, different courts have inconsistently interpreted definitions contained in controlling laws and have reached different conclusions as to the scope and nature of the regulations.

### IX. CABLE INTERNET ACCESS

Several courts have confronted the issue of whether cable television operators must provide access to multiple ISPs instead of exclusive access to a single owned or affiliated ISP. In addressing the issue whether a state or municipal government can impose such a common carrier requirement, courts have struggled to determine which service definition applies to cable television company-delivered Internet access and, in turn, which regulatory model applies. Different courts have arrived at different conclusions, a confusing but predictable outcome when courts examine convergent technologies, but have to apply mutually exclusive service definitions.

In the span of a few months, three courts came to three different conclusions regarding the scope of Internet access responsibilities that a county or municipal government lawfully can impose on a cable television operator. A federal District Court in Oregon determined that cable broadband Internet access fit within the "cable service" definition contained in the Communications Act of 1934, as amended, and that municipal franchising authority properly addressed the issue of how

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54. Bell Atl. Tel. Cos., *Order*, 13 F.C.C.R. 18911 (1998).

Bell Atlantic describes its digital subscriber line ("DSL") offering as an interstate data special access service that provides a high speed access connection between an end user subscriber and an Internet Service Provider (ISP) by utilizing a combination of the subscriber's existing local exchange physical plant (*i.e.* copper facility), a specialized DSL-equipped wire center, and transport to the Asynchronous Transfer Mode Cell Relay Service where the ISP will connect to Bell Atlantic's network.

*Id.* para. 1.

franchisees must open their networks for broadband Internet access.<sup>55</sup> The appellate court rejected this determination, instead applying the telecommunications service definition and holding that the Communications Act of 1934 forecloses municipalities from having the jurisdiction to require cable operators to provide telecommunications services.<sup>56</sup> The Ninth Circuit Court of Appeals determined that the content delivery function, integral to the provision of broadband Internet access, constituted a telecommunications service, because the characteristics of Internet access cannot fit the video- and content-predominant characteristics specified in the cable services definition. This court recognized the potential for its holding to trigger the imposition of complete or streamlined telecommunications common carrier regulation. The court also held, however, that the FCC had exclusive jurisdiction to determine whether and how to regulate such telecommunications services,<sup>57</sup> perhaps inferring and endorsing the Commission's comparatively greater reluctance to extend telecommunications "legacy regulation"<sup>58</sup> to operators using telecommunications capabilities for the delivery of information services.<sup>59</sup>

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55. *AT&T Corp. v. City of Portland*, 43 F. Supp. 2d 1146 (D. Or. 1999), *rev'd*, 216 F.3d 871 (9th Cir. 2000).

56. *AT&T Corp.*, 216 F.3d 871.

57. *Id.*

Thus far, the FCC has not subjected cable broadband to any regulation, including common carrier telecommunications regulation. We note that the FCC has broad authority to forbear from enforcing the telecommunications provisions if it determines that such action is unnecessary to prevent discrimination and protect consumers, and is consistent with the public interest.

*Id.* at 879.

58. "Given our attempts to reduce the regulatory burden on ILECs, we are especially reluctant to impose similar legacy regulation on new competitive carriers." Access Charge Reform, *Seventh Report and Order and Further Notice of Proposed Rulemaking*, 16 F.C.C.R. 9923, para. 41 (2001). "But as we have found elsewhere with our regulatory framework, our legacy regulations for equipment approval may impede rather than facilitate innovation." Authorization and Use of Software Defined Radios, *Notice of Proposed Rulemaking*, 15 F.C.C.R. 24442, 24446 (Separate Statement of Comm'r Susan Ness).

New technologies, while perhaps similar in appearance or in functionality, should not be stuffed into what may be ill-fitting regulatory categories in the name of regulation. Rather, the Commission should continue the approach of studying new technologies and only stepping in where the purpose for which the Commission was created, protecting the public interest, demands it.

JASON OXMAN, THE FCC AND THE UNREGULATION OF THE INTERNET 24-25 (FCC Office of Plans and Policy, Working Paper No. 31, (1999)) at [http://www.fcc.gov/Bureaus/OPP/working\\_papers/oppwp31.pdf](http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp31.pdf).

59. "Furthermore, FCC regulation of ILECs and their DSL broadband transport services does not affect cable broadband transport services because the FCC has refused to suggest that the common carrier regulations that apply to telephone companies would apply to cable broadband Internet access." Aaron M. Wigod, *The AOL-Time Warner Merger: An Analysis*

Another federal court came up with yet a different determination on which definition and regulatory model should apply. In *MediaOne Group, Inc. v. County of Henrico*,<sup>60</sup> the federal District Court for the Eastern District of Virginia invalidated an open-access ordinance as violating Section 541(b)(3)(D) of the Communications Act of 1934, as amended, that prohibits franchising authorities from requiring a cable operator to provide any telecommunications service or facilities other than institutional networks. The court reasoned that a cable television operator could itself provide a cable service that blended telecommunications and information services.

It also held, however, that should a state government agency attempt to require cable operators to provide just the telecommunications capability for accessing unaffiliated ISPs, the state agency would be impermissibly imposing common carrier telecommunications service responsibilities.<sup>61</sup> This court emphasized substantive, rather than jurisdictional, grounds for prohibiting state government regulation. Regardless of whether a cable operator could unbundle or decouple telecommunications transmission functions from a cable or information service, the court reasoned that a state government agency could not lawfully compel a cable television operator to provide a telecommunications service or a particular transmission technology—two burdens properly borne solely by common carriers. Accordingly, this court considered cable television operator-delivered broadband access a cable service, even though it acknowledged that components or layers of the composite service constituted telecommunications services.<sup>62</sup> While the lower federal court in *Portland* emphasized the power of local governments to impose obligations as part of the franchising process, the *MediaOne* court pointed to several limitations on what requirements a franchising authority could impose.<sup>63</sup>

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*of the Broadband Internet Access Market*, 6 J. SMALL & EMERGING BUS. L. 349, 362 (2002). See *Cable Modem NPRM*, *supra* note 53.

60. 97 F. Supp. 2d 712, 714 (E.D. Va. 2000), *aff'd*, 257 F.3d 356 (4th Cir. 2001).

61. “None of the specific grants of regulatory power authorizes a locality to require that the franchise holder give other ISPs the right to use its cable modem platform. Nor can such power be necessarily implied from the express language or deemed essential and indispensable to the County’s purposes.” *Id.* at 717.

62. “The County is therefore requiring MediaOne to provide a telecommunications facility as a condition for the approval of the transfer of control, and accordingly, the Ordinance is in violation of Section 541(c)(3)(D).” *Id.* at 714.

63. *MediaOne Group, Inc. v. County of Henrico*, 257 F.3d 356 (4th Cir. 2001).

Henrico County’s open access provision violates the federal Communications Act, 47 U.S.C. § 541(b)(3)(D), by forcing MediaOne to provide its telecommunication facilities (its cable modem platform) to any ISP as a condition for the County’s

These three cases depict significant confusion in determining the length and breadth of what constitutes a telecommunications service, particularly when coupled with either a cable service or an information service. In some instances, the differences in what a venture offers do not matter. For example, the Supreme Court recently opted not to differentiate cable services from other services available via a single conduit for the purpose of qualifying the cable television operator to access telephone pole space and to install the cable necessary to deliver any type of ICE service to consumers.<sup>64</sup> But in many other instances, the application of service definition directly impacts the range of regulation and scope of jurisdiction by federal, state, and municipal agencies, e.g., common carrier telecommunications services versus private carrier information services.

#### X. THE FEDERAL COMMUNICATIONS COMMISSION TRIES TO BECOME TECHNOLOGY AGNOSTIC, BY DIFFERENTIATING TELECOMMUNICATIONS CAPABILITIES FROM SERVICES

For its part, the FCC has expressed a strong disinclination to subject the telecommunications service function to regulation when it becomes integrated with and delivers broadband services, regardless of who provides this function. In two separate proceedings, the FCC has sought to diminish the importance of the telecommunications services component, as a separate and regulated element of a convergent information service regardless of whether a historically regulated common carrier telephone company provides the telecommunications capability<sup>65</sup> or whether a cable television firm does.<sup>66</sup>

The Commission's unstated rationale for this outcome lies in its goal of reducing regulatory asymmetry between broadband services provided by ventures heretofore regulated as telecommunications service providers, i.e., common carriers, and ventures heretofore unregulated or subject to less burdensome regulations as providers of cable or information services. Put more bluntly, the FCC clearly seeks to eliminate the application of

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approval of the transfer of control of the franchise. Because the open access provision is inconsistent with the federal Communications Act, it is preempted and superceded.

*Id.* at 359.

64. *Nat'l Cable & Telecomms. Ass'n, Inc. v. Gulf Power Co.*, 534 U.S. 327 (2002) (stating that cable television operators have a lawful right to attach their facilities to poles installed and maintained by unaffiliated public utilities regardless of whether the attachments are used solely to provide cable television services, or high-speed Internet access).

65. *Wireline Broadband NPRM*, *supra* note 44, para. 4.

66. *Cable Modem NPRM*, *supra* note 53, para. 6.



longstanding common carrier regulatory burdens on telephone companies when they bundle or blend broadband telecommunications services with information services. The Commission proposes to do this by deeming any broadband Internet access service, carried by either cable television systems<sup>67</sup> or incumbent local exchange carriers, an information service.<sup>68</sup>

The FCC believes the identical designation for services transmitted via different technological architectures represents a functional approach that supports ubiquitous deployment of advanced services, harmonized regulation of multiple technical platforms, minimum necessary regulation, and a consistent analytical framework.<sup>69</sup>

The FCC claims it has adopted a “functional approach, focusing on the nature of the service provided to consumers, rather than one that focuses on the technical attributes of the underlying architecture.”<sup>70</sup> The FCC also acknowledges that attributing the same service classification to different technologies “may not lead to identical regulatory models across platforms. . . . [in view of] legal, market, or technological distinctions [that] may require different regulatory requirements between platforms, or between certain types of providers of one particular platform.”<sup>71</sup> Accordingly, the Commission has not established a single regulatory model for information services, but instead has at least two parallel vertical tracks: information services mediated via cable television systems, and information services mediated via local exchange carriers. To achieve this partial harmonization of regulatory treatment, the Commission has to subordinate the telecommunications transport function relative to the information services provided and dismiss the previously recognized legal, marketplace, and technological differences between the two carriers.

## XI. SUBORDINATING AND DIFFERENTIATING TELECOMMUNICATIONS CAPABILITIES AND SERVICES

The FCC justifies its information services designation of cable and telephone company-provided Internet access by first noting that it has to

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67. “[W]e conclude that cable modem service, as it is currently offered, is properly classified as an interstate information service, not as a cable service, and that there is no separate offering of telecommunications service.” *Id.* para. 7.

68. “Because wireline broadband Internet access services fuse communications power with powerful computer capabilities and content, these services appear to fall within the class of services that the Commission has traditionally identified as ‘information services,’ which blend communications with computer processing.” *Wireline Broadband NPRM*, *supra* note 44, para. 13.

69. *Id.* paras. 3-6.

70. *Id.* para. 7.

71. *Id.*

make an either/or decision. The Commission made this assertion in a 1998 report to Congress responding to queries about the status of services, such as Internet-mediated long-distance telephone services, that have qualified for information services regulatory exemptions, but increasingly provide a competitive alternative to regulated telecommunications services.<sup>72</sup> While acknowledging that “hybrid” service may exist, the Commission nevertheless insisted that “the categories of ‘telecommunications service’ and information service [as defined] in the 1996 Act are mutually exclusive.”<sup>73</sup>

Having decided to apply the information services classification, the FCC then had to find a way to dismiss as insignificant the fact that a telecommunications link delivered information services to various users. The FCC achieved this outcome by holding that the telecommunications linkage function did not have a separate and identifiable existence, even though previously wireline carriers tariffed this service as retail telecommunications. If the FCC can glibly reclassify and subordinate telecommunications functionality when coupled with an information service, might the Commission allow traditionally regulated common carriers the opportunity to offer basic telecommunications services on an unregulated basis if coupled with information services, e.g., ancillary voice telephony, as part of an unregulated suite of information services?

To maintain mutual exclusivity between telecommunications services and information services, the Commission needed to differentiate between telecommunications as an integral part in providing a service, and telecommunications as a capability or building block: “[W]e tentatively conclude that the transmission component of retail wireline broadband Internet access service provided over an entity’s own facilities is ‘telecommunications’ and not a ‘telecommunications service.’”<sup>74</sup> It appears that when providing Internet services mediated via existing plants otherwise available to provide retail telecommunications services, a local exchange carrier no longer operates as a telecommunications service provider. Instead, it provides to consumers the opportunity to “use” telecommunications as the building block for information services: “When

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72. Federal-State Joint Bd. on Universal Serv., *Report to Congress*, 13 F.C.C.R. 11501, 11 Comm. Reg. (P & F) 1312 (1998) [hereinafter *Report to Congress*]; see also Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Comms. Act of 1934, as amended, *First Report and Order and Further Notice of Proposed Rulemaking*, 11 F.C.C.R. 21905, 5 Comm. Reg. (P & F) 696 (1996); *Universal Service*, *supra* note 37; Robert M. Frieden, *Dialing for Dollars: Will the FCC Regulate Internet Telephony?*, 23 RUTGERS COMP. & TECH. L.J. 47 (1997).

73. *Report to Congress*, *supra* note 72, para. 39.

74. *Wireline Broadband NPRM*, *supra* note 44, para. 17.

an entity offers subscribers the 'capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications,' it does not provide telecommunications; it is using telecommunications."<sup>75</sup>

The FCC now proposes to subdivide what was once identified as a telecommunications service into two telecommunications subsets: (1) telecommunications subordinate to, and the building block for, the delivery of an information service; and (2) telecommunications integral to the delivery of a telecommunications service to end users. The transition from category one to two results when the telecommunications functionality draws a fee directly from the public.<sup>76</sup>

## XII. EQUATING INTERNET ACCESS VIA CABLE TELEVISION AND LOCAL EXCHANGE FACILITIES

Should the Commission persist in creating this new deregulatory regime, it could consider telephone company broadband services, such as Digital Subscriber Lines, as equally entitled to the largely unregulated status available to cable modem broadband services.

On its face, the FCC's deregulatory initiative appears compelling as it reduces asymmetrical regulation and places two deep-pocketed ventures on a level competitive playing field. Some analysts have asserted that cable television operators have enjoyed an unfair competitive advantage in having qualified for the information services—an unregulated "safe harbor" that prevents federal, state, or municipal regulators from imposing open access and other possibly costly common carrier obligations.<sup>77</sup> But in

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75. *Report to Congress, supra* note 72, para. 41. This report was mandated by the Appropriations Act of 1998, Pub. L. No. 105-119, 111 Stat. 2440, 2521-2522, § 623, referring to 47 U.S.C. § 153(20) as defining various relevant terms.

76. *Wireline Broadband NPRM, supra* note 44.

[W]e tentatively conclude that providers of wireline broadband Internet access service that provision the service over their own facilities do not offer 'telecommunications for a fee directly to the public.' Indeed, it seems as if a provider offering the service over its own facilities does not offer 'telecommunications' to anyone, it merely uses telecommunications to provide end-users with wireline broadband Internet access services, which . . . we believe is an information service. Therefore, we tentatively conclude that in the case where an entity combines transmission over its own facilities with its offering of wireline Internet access service, the classification of that input is telecommunications, and not a telecommunications service.

*Id.* para. 25.

77. *See* Wigod, *supra* note 59.

The merger [of America Online with Time Warner] unites the second largest cable broadband transport service with the largest narrowband ISP in the world. In the AOL-Time Warner cable divisions, AOL-Time Warner will attempt to migrate AOL's twenty-three million narrowband subscribers to cable broadband offered

its chosen deregulatory quest, the FCC has engaged in a flawed and disingenuous strategy to combine previously different regulatory models based on new functional similarity. Suddenly a telecommunications service can become stripped of its common carrier regulatory triggers if and when the FCC chooses to emphasize the content or enhancements carried via the telecommunications conduit.

A far better and more straightforward approach would emphasize the substantial flexibility granted to the FCC by the 1996 Act to free telecommunications services providers of nearly all traditional common carrier regulatory responsibilities if circumstances and the public interest support such deregulation. This model provides for true technology agnosticism without the likely adverse and unanticipated outcomes of the Commission's proposed strategy.

### XIII. AN INABILITY OR REFUSAL TO HARMONIZE DIVERGENT REGULATORY MODELS

The vertical regulatory regime established by law and implemented by the FCC requires an either/or determination.<sup>78</sup> Only by ignoring or rationalizing the telecommunications service functionality as a subelement of a composite broadband service can the FCC transfer Internet access to the information services classification and thereby qualify for top-down unregulated status. The Commission relegates the telecommunications service aspect of broadband access to a subordinate role not worth triggering regulation by differentiating between a telecommunications

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by AOL-Time Warner. Similarly, Time Warner will migrate its cable television subscribers from narrowband to the cable broadband AOL-Time Warner is offering. Additionally, AOL-Time Warner will migrate nonaffiliated ISPs' subscribers from narrowband to cable broadband in the AOL-Time Warner cable divisions. [Having the right to] [d]eny[] access or discriminating against nonaffiliated ISPs who seek to offer competitive cable broadband Internet access to consumers furthers these objectives and ensures the success of AOL-Time Warner in the broadband Internet access market.

*Id.* at 364; Mark A. Lemley & Lawrence Lessig, *The End of End-to-End: Preserving the Architecture of the Internet in the Broadband Era*, 48 UCLA L. REV. 925 (2001); Mark Cooper, *Open Access to the Broadband Internet: Technical and Economic Discrimination in Closed, Proprietary Networks*, 71 U. COLO. L. REV. 1011 (2000); Harold Feld, *Whose Line Is It Anyway? The First Amendment and Cable Open Access*, 8 COMMLAW CONCEPTUS 23 (2000). Other authors consider mandated access unnecessary. See James B. Speta, *Handicapping the Race for the Last Mile?: A Critique of Open Access Rules for Broadband Platforms*, 17 YALE J. ON REG. 39 (2000).

78. "The FCC believed that not treating telecommunications and information services as mutually exclusive would lead to the conclusion that all such services were telecommunications services. (It was right.)" Steve Kelley, *Liberating our Digital Future: How the 1996 Telecommunications Act Definitions are Hobbiling Change*, 27 WM. MITCHELL L. REV. 2137, 2150 (2001) (citation omitted).

service delivered to end users and a telecommunications “capability” used to deliver the predominating information service that, of course, is also provided to end users.<sup>79</sup> In the Commission’s new strategy for deregulating Internet access regardless of provider, traditionally regulated telecommunications services can lose their standalone status and become packaged with and subsumed in an information service.<sup>80</sup>

Rather than narrow a regulatory loophole, the FCC has created an incredibly larger one. The Commission’s *Wireline Broadband Notice of Proposed Rulemaking*<sup>81</sup> and efforts to promote user access to advanced telecommunications<sup>82</sup> appear to offer telecommunications service providers the ability to free themselves of any and all common carrier burdens that otherwise would apply to broadband telecommunications service simply by characterizing these offerings as information services. For example, ILECs could characterize their DSL broadband Internet service as an information service, despite the Commission’s previous determination that enhanced retail copper wire local loops provide telecommunications services.<sup>83</sup> As

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79. Even though “wireline broadband Internet access services fuse communications power with powerful computer capabilities and content,” the Commission concluded that the composite service constitutes an information service. *Wireline Broadband NPRM, supra* note 44, para. 13.

80. The Commission tentatively concluded that “the transmission component of retail wireline broadband Internet access service provided over an entity’s own facilities [which typically are also used to provide telecommunications services] is ‘telecommunications’ and not a ‘telecommunications service.’” *Id.* para. 17.

81. *See generally id.*

82. Inquiry Concerning the Deployment of Advanced Telecomms. Capability to All Americans in a Reasonable and Timely Fashion, *First Report*, 14 F.C.C.R. 2398, 14 Comm. Reg. (P & F) 1292 (1999); *Second Report*, 15 F.C.C.R. 20913, 22 Comm. Reg. (P & F) 390 (2000); *Third Report*, 17 F.C.C.R. 2844 (2002).

83. Section 251(c)(4) imposes on ILECs the duty to offer for resale at wholesale rates “any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers.” 47 U.S.C. § 251(c)(4)(A) (2000). The Commission has concluded that DSL services offered on a retail basis to end users are subject to the requirement of Section 251(c)(4) and therefore these services constitute telecommunication services.

[B]ased on our examination of the statutory language, the Act’s purpose, and the specific facts before us, we conclude that advanced services sold to residential and business end-users are subject to the section 251(c)(4) discounted resale obligation, without regard to their classification as telephone exchange service or exchange access service.

Deployment of Wireline Servs. Offering Advanced Telecomms. Capability, *Second Report and Order*, 14 F.C.C.R. 19237, para. 8, 18 Comm. Reg. (P & F) 407 (1999). However, the Commission has expressly refused to decide whether DSL service not provided on a retail basis to end users fits within the telecommunications services category.

The Commission has not addressed the situation where an incumbent LEC does not offer DSL transport at retail, but instead offers only an Internet access service. . . . Accordingly, because Commission precedent does not address the

DSL technology has the capability of providing both Internet broadband services and conventional voice telephony over the same wire, the Commission's all-or-nothing thinking probably would permit ILECs to bundle "associated and ancillary voice services" with the predominant broadband Internet access information service, thereby qualifying both types of services for the unregulated information services classification.<sup>84</sup> To add to the regulatory quagmire, any transfer of telecommunications service into the information service classification would reduce the source of funding for universal services that is limited by law to providers of telecommunications services.<sup>85</sup>

The FCC appropriately has expressed reservations about extending preexisting "legacy" regulations to Internet access and Internet-mediated

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specific facts or legal issues raised here, we decline to reach a conclusion in the context of this section 271 proceeding.

Joint Application by SBC Comms. Inc., Southwestern Bell Tel. Co., and Southwestern Bell Comms. Servs., Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecomms. Act of 1996 to Provide In-Region, InterLATA Servs. in Ark. and Mo., *Memorandum Opinion and Order*, 16 F.C.C.R. 20719, para. 82, 25 Comm. Reg. (P & F) 183 (2001).

84. "Because wireline broadband Internet access services fuse [tele]communications power with powerful computer capabilities and content, these services appear to fall within the class of services that the Commission has traditionally identified as 'information services,' which blend [tele]communications with computer processing." *Wireline Broadband NPRM*, *supra* note 44, para. 13. This rationale might support the decision not to regulate an Internet access provider when it leases dial-up telephone and DSL telecommunications lines in the provision of its information services and Internet access. It ignores, however, the fact that heretofore both carriers and consumers have decoupled the telecommunications and information-processing aspects of Internet access. When consumers install a modem and use dial-up telephone lines for Internet access, the telephone line remains available for voice communications and no permanent fusion has occurred. Similarly, the fact that DSL conditions basic copper loops and expands their bandwidth does not eliminate the telecommunications capabilities of the loop through fusion with its Internet access capabilities.

85. Two FCC Commissioners considered the consequences of such an outcome. Commissioner Copps stated that the Commission should not unilaterally "remove . . . [wireline broadband] services from the numerous competition, universal service, and consumer protection provisions that Congress imposed on common carriers providing telecommunications services." *Wireline Broadband NPRM*, *supra* note 44, at 3072, 3073 (Separate Statement of Comm'r Michael J. Copps, dissenting in part, concurring in part). Commissioner Kevin Martin noted that the Commission left open the possibility of offsetting universal service funding shortfalls resulting from expanding the set of information services, by expanding the set of mandatory contributors to include nonwireline broadband Internet access providers, such as wireless, cable, and satellite providers. *Id.* at 3074-76 (Separate Statement of Comm'r Kevin J. Martin). For an assessment of the consequences resulting from the lack of competitive neutrality insofar as universal service funding requirements, see *Universal Service*, *supra* note 37, at 433.

services.<sup>86</sup> To do so would broaden the range of common carrier telecommunications regulation at a time when the Commission wants simultaneously to incubate new technologies by refraining from imposing stifling regulatory burdens and to free incumbents of similar burdens. This well-intentioned reticence to extend regulation, however, forces the FCC to come up with clever but unsustainable equivocations, such as ad hoc, hybrid categories,<sup>87</sup> to avoid answering difficult questions regarding the future reach of regulation. Much of this ad hoc rethinking of how definitions apply stems from the vertical regulatory models the Commission has erected and seeks to maintain. While new technologies do force regulatory agencies to determine into which categories innovative new services fit, the predominant trigger for trouble lies in the Commission's perceived need to make all or nothing assignments, i.e., mutually exclusive, self-contained classifications of telecommunications versus information services.

At least one court has refused to endorse identifying the Internet as a single preexisting regulatory classification such as information service. In *Gulf Power Co. v. FCC*,<sup>88</sup> a divided Eleventh Circuit Court of Appeals held that the FCC lacked authority to prescribe a formula for calculating the rates cable television companies should pay public utilities for use of pole

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86. *Wireline Broadband NPRM*, *supra* note 44.

The Commission will avoid simply extending existing rules that were crafted to govern legacy services provided over legacy networks. Over many years, several distinct major networks have been deployed and optimized to provide very specific services. Legacy regulations were based on technical and market assumptions concerning these networks and the services they delivered.

*Id.* para. 6.

87. For example, the Commission has acknowledged the difficulty in completely segregating telecommunications services from information services, especially when providers of the latter offer functional equivalents to the former. The Commission expressly identified types of Internet-mediated telephone service as possibly fitting into either the telecommunication services or the information services category:

Specifically, when an IP telephony service provider deploys a gateway within the network to enable phone-to-phone service, it creates a virtual transmission path between points on the public switched telephone network over a packet-switched IP network. These providers typically purchase dial-up or dedicated circuits from carriers and use those circuits to originate or terminate Internet-based calls. From a functional standpoint, users of these services obtain only voice transmission, rather than information services such as access to stored files. The provider does not offer a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information. Thus, the record currently before us suggests that this type of IP telephony lacks the characteristics that would render them 'information services' within the meaning of the statute, and instead bear the characteristics of 'telecommunications services.'

*Report to Congress*, *supra* note 72, para. 89.

88. 208 F.3d 1263 (11th Cir. 2000), *rev'd and remanded sub nom.* *Nat'l Cable & Telecomm. Ass'n v. Gulf Power Co.*, 534 U.S. 327 (2002).

or conduit space when providing broadband Internet access in addition to cable services. The court held that the FCC had authority to regulate the rate for cable service and telecommunications, but not for Internet service that the court considered outside both categories.<sup>89</sup>

A reversal by the Supreme Court, however, eliminated the precedential value in this rejection of a telecommunications/information service dichotomy. The Court reversed and remanded the case based on a reading of Section 224(b) of the Pole Attachment Act, which broadly defines pole attachments as including “any attachment by a cable television system”<sup>90</sup> regardless of what services the attachment supports: “The addition of . . . [an additional] service does not change the character of the attaching entity—the entity the attachment is ‘by.’”<sup>91</sup> The Supreme Court’s reading of the Pole Attachment Act provides a passing endorsement of the telecommunications/information service dichotomy, because the Court affirmed the FCC decision to permit rate-regulated Internet access pole attachments<sup>92</sup> and noted that the Commission “decided that Internet services [provided by cable television systems] are not telecommunications services.”<sup>93</sup>

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89. The Pole Attachment Act of 1996, as amended, 47 U.S.C. § 224, requires the FCC to regulate the rates, terms and conditions for pole attachments and specifically mentions those two types of attachments: 1) those used by a cable television system to provide cable service and 2) those used by a cable television system to provide a telecommunications service. The Eleventh Circuit held that Internet service “is neither.” *Id.* at 1276.

90. 47 U.S.C. § 224(a)(5) (2000).

91. *Gulf Power Co.*, 534 U.S. at 333.

92. “Again, no rate challenge is before us, but we note that the FCC proceeded in a sensible fashion.” *Id.* at 337.

93. *Id.* (citing Implementation of Section 703(e) of the Telecomms. Act of 1996, *Report and Order*, 13 F.C.C.R. 6777, paras. 31-34, 11 Comm. Reg. (P & F) 79 (1998)). Additionally, the Court did not find fault with the Commission’s failure to specify whether cable system-provided Internet access constitutes a cable service even though the Commission determined that commingled cable television and Internet access pole attachments qualified for the cable service rate under Section 224(d)(3) of the Pole Attachments Act, as opposed to a higher rate for pole attachments provided to providers of telecommunications services under Section 224(e)(1). The Court, however, did note stakeholder frustration in the FCC’s refusal to categorize Internet services and by the Commission’s decision to authorize the cable service pole attachment rate for commingled services without having decided they constitute cable services: “[D]ecisionmakers sometimes dodge hard questions when easier ones are dispositive; and we cannot fault the FCC for taking this approach.” *Gulf Power Co.*, 534 U.S. at 338. In a partial dissenting opinion, Justice Thomas, joined by Justice Souter, would have vacated the Court of Appeals’ judgment and remanded the case to the FCC with a requirement that the Commission “decide at long last whether high-speed Internet access provided through cable wires constitutes cable service or telecommunications service or falls into neither category.” *Id.* at 347.



The FCC has applied such all-or-nothing strategies before. In determining jurisdictional scope, the Commission prefers a “contamination” theory in lieu of shared jurisdiction. A telecommunications network with ninety-nine percent intrastate traffic and one percent interstate traffic could motivate the Commission to establish exclusive federal jurisdiction.<sup>94</sup> Federal preemption of state regulation presumes a bright-line distinction between jurisdictional reach just as a telecommunications/information service dichotomy assumes mutual exclusivity. More recently the 1996 Act has required the FCC to share jurisdiction with state public utility commissions, and to rely on Federal-State Joint Boards with mixed success.<sup>95</sup> The FCC may express support for the concept of shared jurisdiction, but its preference for either/or service categories and regulatory models proves its baseline regulatory thinking.

Eventually, the FCC must confront and resolve the fact that Internet access and Internet-mediated services seamlessly blend telecommunications and information services. The Commission has identified instances where telecommunications is ancillary to an information service, or a “capability” essential for delivering advanced services. But rather than adopt a functional analysis without regard to who provides the service and what regulatory classification they previously secured, the Commission takes great and unsustainable efforts to make distinctions between various telecommunication applications with an eye toward avoiding altogether the application of the telecommunication services classification.

In its implementation of the 1996 Act’s Section 706, which calls for FCC promotion of innovation and investment in advanced telecommunications capabilities,<sup>96</sup> the Commission appears intent on

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94. “The ‘contamination theory’ contemplates that a service or facility used only partially for intrastate communication is not subject to Commission jurisdiction.” Dept. of Defense v. Gen. Tel. Co. of the Northwest, 38 F.C.C.2d 803, para. 8 n.17, 26 Rad. Reg.2d (P & F) 245 (1973); see also Chesapeake & Potomac Tel. Co. of Md., *Memorandum Opinion and Order on Reconsideration*, 2 F.C.C.R. 3528, 63 Rad. Reg.2d (P & F) 369 (1985), *vacated as moot, Order*, 3 F.C.C.R. 748 (1988).

95. See, e.g., Federal-State Joint Board on Universal Serv., *Twelfth Report and Order, Memorandum Opinion and Order, and Further Notice of Proposed Rulemaking*, 15 F.C.C.R. 12208, 21 Comm. Reg. (P & F) 210 (2000).

96. “Section 706 of the Telecommunications Act of 1996 (1996 Act) charges the Commission with ‘encourag[ing] the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans’ by ‘regulatory forbearance, measures that promote competition . . . , or other regulating methods that remove barriers to infrastructure investment.’” *Cable Modem NPRM, supra* note 53, para. 4 (alterations in original). See *Inquiry Concerning the Deployment of Advanced Telecomms. Capability to*

stripping, of the telecommunications service classification and common carrier responsibilities, any and all broadband services offering throughout at speeds in excess of 200 kilobits per second.<sup>97</sup> Regardless of the fact that incumbent telecommunications carriers have heretofore offered many broadband services as telecommunications services and without much regard to the degree of present or prospective competition, the Commission has proposed to eliminate conventional common carrier requirements specified in Title II of the Communications Act of 1934, as amended, in the *Wireline Broadband Notice of Proposed Rulemaking* and a related *Notice of Proposed Rulemaking* reviewing the regulatory requirements for ILECs.<sup>98</sup> Additionally, the Commission seeks to eliminate much of the 1996 Act-mandated access to unbundled network elements (“UNEs”) based on the view that it mandates such mandatory access by market entrants only so long as ILECs maintain bottleneck control and market power over access to first- and last-mile infrastructure, i.e., the transmission and switching facilities needed to access end-users.<sup>99</sup> Remarkably, FCC initiatives match or exceed congressional bills that heretofore have failed passage in both houses of Congress,<sup>100</sup> primarily because of concerns that such wholesale liberalization will enable ILECs to solidify bottleneck control and market power without having to complete the significant structural adjustments needed to accommodate competition.<sup>101</sup>

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All Americans in a Reasonable and Timely Fashion, *Notice of Inquiry*, 13 F.C.C.R. 15280 (1998) [hereinafter *Deployment of Advanced Telecommunications*]. See also cases cited *supra* note 82.

97. *Deployment of Advanced Telecommunications*, *supra* note 96, para. 7.

98. *ILEC Broadband Notice*, *supra* note 44.

[W]e request comment on the appropriate regulatory requirements under Title II of the [Communications] Act for the provision of broadband services by incumbent LECs given current market conditions. In particular we ask interested parties to address how the Commission can best balance the goals of encouraging broadband investment and deployment, fostering competition in the provision of broadband services, promoting innovation, and eliminating unnecessary regulation.

*Id.* para. 7 (examining whether changing market conditions favor deregulation of ILEC broadband services). “We tentatively conclude that wireline broadband Internet access services—whether provided over a third party’s facilities or self-provisioned facilities—are information services subject to [limited] regulation under Title I of the Act” instead of Title II common carrier regulation. *Wireline Broadband NPRM*, *supra* note 44, para. 16.

99. Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, *Notice of Proposed Rulemaking*, 16 F.C.C.R. 22781, para. 1 (2001).

100. See The Internet Freedom and Broadband Deployment Act of 2001, H.R. 1542 107th Cong. (2002) (passed in the House of Representatives Feb. 27, 2002, and received in the Senate and read twice and referred to the Committee on Commerce, Science, and Transportation Feb. 28, 2002). Legislative history available at <http://thomas.loc.gov/>.

101. See, e.g., Robert E. Hall & William H. Lehr, *Promoting Broadband Investment and Avoiding Monopoly*, Sand Hill Econometrics, at <http://www.sandhillecon.com/>

More broadly, the FCC appears keenly interested in establishing a substantial dichotomy between ILEC regulatory burdens and responsibilities applicable to basic telephony on one hand, and anything that relates to broadband and information services (including the Internet access whether by retrofitted copper facilities or new technologies like fiber optics) on the other hand. The Commission also has expressed an interest in dismantling some of its key regulatory safeguards established in the *Third Computer Inquiry*.<sup>102</sup> Specifically, the Commission appears quite willing to abandon the requirement that providers of both basic and enhanced telecommunications services, e.g., ILECs, unbundle the basic

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hlpaper2/Broadband.PDF (Feb. 21, 2002) (consultants' study sponsored by AT&T); *Tauzin-Dingell is Evil! Eight Reasons Why the Tauzin-Dingell Bill is BAD for America's Telephone Customers*, TeleTruth, at <http://www.teletruth.org/News/tauzinDingell/8reasons.html> (last visited Nov. 29, 2002).

102. See Reg. and Policy Problems Presented by the Interdependence of Computer and Comms. Servs. and Facilities, *Final Decision and Order*, 28 F.C.C.2d 267, 21 Rad. Reg.2d (P & F) 1591 (1971), *aff'd in part, modified sub nom.* GTE Serv. Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973), *decision on remand*, 40 F.C.C.2d 293 (1973), 26 Rad. Reg.2d (P & F) 1687 (1973); Amendment of Section 64.702 of the Comm'n's Rules and Regs. (Second Computer Inquiry), *Final Decision*, 77 F.C.C.2d 384, 47 Rad. Reg.2d (P & F) 699 (1980); Amendment of Sections 64.702 of the Comm'n's Rules and Regs. (Third Computer Inquiry), *Report and Order*, 104 F.C.C.2d 958, 60 Rad. Reg.2d (P & F) 603 (1986) [hereinafter *Computer III Phase I Order*], *recon.*, 2 F.C.C.R. 3035, 62 Rad. Reg.2d (P & F) 1584 (1987) [hereinafter *Phase I Reconsideration Order*], *further recon.*, 3 F.C.C.R. 1135, 64 Rad. Reg.2d (P & F) 649 (1988), *second further recon.*, 4 F.C.C.R. 5927, 66 Rad. Reg.2d (P & F) 1323 (1989), *Computer III Phase I Order and Phase I Reconsideration Order, supra, vacated by California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) [hereinafter California I]; Amendment to Sections 64.702 of the Comm'n's Rules and Regs. (Third Computer Inquiry), *Report and Order*, 2 F.C.C.R. 3072, 62 Rad. Reg.2d (P & F) 1662 (1987) [hereinafter *Phase II Order*], *recon.*, 3 F.C.C.R. 1150, 64 Rad. Reg.2d (P & F) 783 (1988), *further recon.*, 4 F.C.C.R. 5927, 66 Rad. Reg.2d (P & F) 1323 (1989), *Phase II Order vacated by California I, supra*; Computer III Remand Proceedings, *Report and Order*, 5 F.C.C.R. 7719, 68 Rad. Reg.2d (P & F) 873 (1990), *recon.*, 7 F.C.C.R. 909, 70 Rad. Reg.2d (P & F) 394 (1992), *pet. for review denied*, California v. FCC, 4 F.3d 1505 (9th Cir. 1993); Computer III Remand Proceedings: Bell Operating Co. Safeguards and Tier 1 Local Exchange Co. Safeguards, *Report and Order*, 6 F.C.C.R. 7571, 70 Rad. Reg.2d (P & F) 121 (1991) [hereinafter *BOC Safeguards Order*], *recon. dismissed in part sub nom.* Implementation of the Telecomms. Act of 1996: Telecomms. Carriers' Use of Customer Proprietary Network Info. and Other Customer Info., *Notice of Proposed Rulemaking*, 11 F.C.C.R. 12513, 3 Comm. Reg. (P & F) 2249 (1996), *BOC Safeguards Order, vacated in part and remanded, California v. FCC*, 39 F.3d 919 (9th Cir. 1994), *cert. denied*, 514 U.S. 1050 (1995); Computer III Further Remand Proceedings: Bell Operating Co. Provision of Enhanced Servs., *Further Notice of Proposed Rulemaking*, 13 F.C.C.R. 6040, 15 Comm. Reg. (P & F) 2017 (1998) [hereinafter *Computer III Further Notice*]; Computer III Further Remand Proceedings: Bell Operating Co. Provision of Enhanced Servs., *Report and Order*, 14 F.C.C.R. 4289, 15 Comm. Reg. (P & F) 149 (1999), *recon.*, 14 F.C.C.R. 21628, 18 Comm. Reg. (P & F) 1344 (1999) [hereinafter *Computer III Further Order*].

telecommunications transport function and provide that basic service on a tariffed and standalone basis.<sup>103</sup>

The Commission cannot achieve the twin goal of sustaining service classifications and the vertical regulatory regimes while also creating novel ways to ignore the telecommunication services aspect of a convergent, blended, and hybrid service that clearly has a horizontal layer of telecommunications delivered to consumers. Worse yet, continuing the “effort to segment telecommunications services, cable services and information services, at least in the way Congress and the FCC have gone about it, increases the problem of discrimination among providers in competition with each other and, consequently, could have the effect of deterring competition.”<sup>104</sup>

#### XIV. APPELLATE COURTS FREQUENTLY REJECT THE FEDERAL COMMUNICATIONS COMMISSION’S REGULATORY MODELING

The FCC has achieved a rather poor track record with appellate courts, particularly when the Commission’s policy rationales stretch the customary judicial deference to agency expertise.<sup>105</sup> Such stretching occurs when the Commission engages in results-oriented decision-making, regardless of the record created, statutory limitations, or restrictions imposed by vertical regulatory models. Having created the “safe harbor,” a largely unregulated information services category, the FCC currently ignores the current or prospective degree of competition in first- and last-mile access to information services with the clear intention of deregulating traditionally regulated common carrier telecommunications services. The 1996 Act provides a basis for the Commission to undertake such deregulation; however, the Commission has not implemented that process which deregulates common carriers offering telecommunications services if competition exists and the public interest supports deregulation. Instead, the Commission pulls telecommunications capabilities out from the telecommunications service classification, thereby achieving deregulation without having to undertake the fact-finding and record-generating to support specific, i.e., section-by-section deregulation as required by Section

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103. *Computer III Further Notice*, *supra* note 102; *Computer III Further Order*, *supra* note 102 (addressing certain portions of the *Computer III Further Notice*); *see also* Further Comment Requested to Update and Refresh Record on Computer III Requirements, *Public Notice*, 16 F.C.C.R. 5363, 5364 (2001) (asking “whether ISPs can obtain, under the ONA [open network architecture] framework, the telecommunications service inputs that they require from the BOCs [Bell operating companies], including . . . DSL service”).

104. Kelley, *supra* note 78, at 2161.

105. *See Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 863-65 (1984).

10 of the 1996 Act. Such a wholesale grand scheme for abandoning Title II common carrier regulation should not pass muster with reviewing courts.

## XV. EXAMPLES OF JUDICIAL REVERSALS

### A. *Deregulation that Ignores Statutory Requirements*

It took the FCC three trips to an appellate court before the Commission secured approval of its longstanding desire to free common carriers of the duty to file and comply with tariffs.<sup>106</sup> Prior to receiving legislative authorization in the 1996 Act to permit the elimination of Title II common carrier responsibilities, the Commission summarily concluded that it made sense to do so.<sup>107</sup> Appellate courts twice admonished the Commission that it cannot eliminate requirements imposed by law simply because the Commission thinks the law should no longer apply.<sup>108</sup>

### B. *Playing the Interstate Telecommunications Card to Preempt State Jurisdiction or Legislative Requirements*

The interstate nature of many telecommunications services supports a single, coordinated federal policy under FCC jurisdiction. The Commission, however, may use the interstate classification to foreclose

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106. In *MCI Telecommunications Corp. v. FCC*, the Circuit Court of Appeals for the District of Columbia struck down "mandatory detariffing" as inconsistent with the Communications Act of 1934. 765 F.2d 1186, 1188 (D.C. Cir. 1985). See also *AT&T Co. v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), *aff'd sub nom.* *MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218 (1994) (the FCC could not suspend, permissively or mandatorily, the tariff filing obligations for interexchange carriers, whether they had market power or not); see also *MCI WorldCom, Inc. v. FCC*, 209 F.3d 760 (D.C. Cir. 2000).

107. Policy and Rules Concerning Rates for Competitive Common Carrier Servs. and Facilities Authorizations Therefor, *Notice of Proposed Rulemaking*, 77 F.C.C.2d 308 (1979); *First Report and Order*, 85 F.C.C.2d 1 (1980); *Further Notice of Proposed Rulemaking*, 84 F.C.C.2d 445 (1981); *Second Further Notice of Proposed Rulemaking*, 47 Fed. Reg. 17,308 (1982); *Second Report and Order*, 91 F.C.C.2d 59 (1982), *recon. denied*, 93 F.C.C.2d 54 (1983); *Third Further Notice of Proposed Rulemaking*, 48 Fed. Reg. 28,292 (1983); *Third Report and Order*, 48 Fed. Reg. 46,791 (1983); *Fourth Report and Order*, 95 F.C.C.2d 554 (1983), *vacated by AT&T*, 978 F.2d 727, *cert. denied*, *MCI Telecomms. Corp. v. AT&T*, 509 U.S. 913 (1993); *Fourth Further Notice of Proposed Rulemaking*, 49 Fed. Reg. 11,856 (1984); *Fifth Report and Order*, 98 F.C.C.2d 1191, 56 Rad. Reg.2d (P & F) 1204 (1984); *Sixth Report and Order*, 99 F.C.C.2d 1020, 57 Rad. Reg.2d (P & F) 1391 (1985), *vacated by MCI Telecomms. Corp.*, 765 F.2d 1186 (collectively referred to as the Competitive Carrier proceeding). The FCC's detariffing object finally passed muster with an appellate court after enactment of the Telecommunications Act of 1996 that provided conditional authorization to eliminate Title II common carrier responsibilities. See *MCI WorldCom, Inc.*, 209 F.3d 760.

108. *MCI Telecomms. Corp.*, 765 F.2d 1186; *AT&T*, 978 F.2d 727, *cert. denied*, *MCI Telecomms. Corp.*, 509 U.S. 913.

state involvement, even for services and policies pertaining to both local, intrastate, and interstate jurisdictions. For example, Internet access traffic originating via LEC facilities and handed off to an ISP, or to another LEC that in turn hands the traffic off to an ISP, was deemed interstate by the FCC.<sup>109</sup> This classification exempts such traffic from the reciprocal compensation requirement imposed on LECs by Section 251 of the Communications Act of 1934, as amended. An appellate court reversed the FCC and remanded the case to the Commission. On remand, the FCC reaffirmed its conclusion that traffic delivered to an ISP is interstate, and the Commission ordered a transition to “bill and keep” cost recovery whereby both ILECs and ISPs recover costs from their own customers without the carriers compensating each other.<sup>110</sup> On a second appeal, the Court of Appeals for the D.C. Circuit remanded, but did not reverse, the FCC on the narrow grounds that the Commission could not have relied on Section 251(g) of the 1996 Act to carve out a “bill and keep” zero compensation arrangement for calls to ISPs.<sup>111</sup> That section did not provide the basis for a substantive change in policy as it only authorized the FCC to maintain LEC regulatory duties that predated enactment of the 1996 Act in the transition to the new requirements established by the 1996 Act.

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109. Implementation of the Local Competition Provisions in the Telecomms. Act of 1996, *Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68*, 14 F.C.C.R. 3689, para. 1, 15 Comm. Reg. (P & F) 201 (1999), *vacated sub nom.* Bell Atlantic v. FCC, 206 F.3d 1 (D.C. Cir. 2000) (FCC ordered to explain why LEC termination of ISP calls are not local in nature); Implementation of the Local Compensation Provisions in the Telecomms. Act of 1996, *Order on Remand and Report and Order*, 16 F.C.C.R. 9151, para. 1, 23 Comm. Reg. (P & F) 678 (2001) [hereinafter *LEC Order on Remand*] (reaffirming conclusion that traffic delivered to an ISP is interstate but reducing compensation to the ISP, thereby eliminating regulatory arbitrage opportunities), *remanded sub nom.* WorldCom, Inc. v. FCC, 288 F.3d 429 (D.C. Cir. 2002).

110. *LEC Order on Remand*, *supra* note 109.

[W]e modify the analysis that led to our determination that ISP-bound traffic falls outside the scope of section 251(b)(5) and conclude that Congress excluded from the “telecommunications” traffic subject to reciprocal compensation the traffic identified in section 251(g), including traffic destined for ISPs. Having found, although for different reasons than before, that the provisions of section 251(b)(5) do not extend to ISP-bound traffic, we reaffirm our previous conclusion that traffic delivered to an ISP is predominantly interstate access traffic subject to section 201 of the Act, and we establish an appropriate cost recovery mechanism for the exchange of such traffic.

*Id.* para. 1. “Based upon the record before us, it appears that the most efficient recovery mechanism for ISP-bound traffic may be bill and keep, whereby each carrier recovers costs from its own end-users.” *Id.* para. 4.

111. *WorldCom, Inc.*, 288 F.3d at 430.

### C. *Fuzzy Math and Creative Statutory Interpretation*

On several occasions, appellate courts have chided the FCC for the assumptions, methodology, and calculations used to determine what carriers and consumers have to pay for various types of facilities and service. For example, in the conversion from traditional public utility rate-of-return regulation to incentive regulation, the FCC had to determine how to create opportunities for carriers to benefit financially from efficiency gains without unreasonably depriving consumers some portion of these gains. The FCC has required LECs under the “price cap” regulatory regime<sup>112</sup> to share a portion of their earnings in excess of specified rates of return with their customers by temporarily reducing the price cap ceiling in a subsequent period. Over several years, the FCC has increased the “X-factor” attributable to technological efficiency gains and allocated to consumers. In its performance review order, released in 1997, the Commission further revised the price cap plan by prescribing a new productivity X-factor of 6.5%. The D.C. Circuit Court of Appeals affirmed the FCC’s requirement that carriers share positive efficiency gains with consumers, but reversed the FCC for failing to justify adequately the calculation of a 6% productivity factor coupled with a 0.5% consumer productivity factor.<sup>113</sup> On remand, the FCC addressed the issue of incentive regulation from a somewhat different perspective, opting to embrace a proposal of an ad hoc industry trade association known as the Coalition for Affordable Local and Long Distance Services (“CALLS”).<sup>114</sup> The CALLS proposal eliminated the necessity of adjusting retrospectively the X-factor in response to the court’s remand by keeping the X-factor at 6.5%, but targeting reductions to a traffic-sensitive price cap basket as well as the access charges applied to long-distance, interexchange carriers.<sup>115</sup>

The FCC and reviewing courts continue having to address aspects of reforming the process by which LECs charge interexchange carriers for facilities access to originate and terminate long-distance telephone calls. Stakeholders devise and propose new ways for recouping the multibillion-

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112. The FCC instituted price-cap regulation for the regional Bell operating companies (“RBOCs”) and GTE in 1991 and permitted other LECs to adopt price-cap regulation voluntarily, subject to certain conditions. Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order*, 5 F.C.C.R. 6786, para. 262, 267, 68 Rad. Reg.2d (P & F) 226 (1990).

113. *United States Tel. Ass’n v. FCC*, 188 F.3d 521, 525, 527 (D.C. Cir. 1999).

114. See *Access Charge Reform*, *Sixth Report and Order*, 15 F.C.C.R. 12962, para. 1, 20 Comm. Reg. (P & F) 636 (2000), *aff’d in part, rev’d in part, and remanded in part*, *Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

115. *Id.* paras. 141-142.

dollar local access expense<sup>116</sup> even as reviewing courts find deficiencies in existing rules.<sup>117</sup> In a comprehensive and mixed decision, the Fifth Circuit Court of Appeals held that the FCC properly justified an increase in the subscriber line charge (“SLC”) caps for residential and single-line business telephone customers from \$3.50 to \$6.50 over a period of several years.<sup>118</sup> Increases in the SLC provide funds for defraying LEC plant investments on a pro-rata basis rather than on a usage basis. A usage basis would result in overcharging and undercharging because much of the investment in the capability of handling long-distance telephone calls does not vary with usage. The court also held that the Commission properly justified a charging policy that recovers most joint and common costs of universal service directly from end users as an explicit subsidy in lieu of indirect and flawed subsidies built into long-distance telephone service rates.<sup>119</sup> The court, however, held that the FCC acted arbitrarily and capriciously in establishing a \$650 million Universal Service Fund figure and lacked a rational basis for establishing a 6.5% figure to represent LECs’ productivity gains for purposes of calculating revised access charges.

#### XVI. A WAY TO HARMONIZE DIVERGENT REGULATORY MODELS

A better way to consider the appropriate regulatory regime lies in distillation of convergent services along a horizontal plane and the subdivision of these integrated services into multiple layers of services:

Think of Internet access as occurring through the provision of multiple layers of services: the physical layer that transports an electronic signal; the operational layer that depends on control software . . . ; the application layer that uses software that formats information . . . ; and the content layer . . . . A case can and should be made that the

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116. Multi-Association Group (MAG) Plan for Reg. of Interstate Servs. of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, *Second Report and Order and Further Notice of Proposed Rulemaking*, 16 F.C.C.R. 19613, para. 1, 25 Comm. Reg. (P & F) 1 (2001) (proposal of National Rural Telecom Association, National Telephone Cooperative Association, Organization for the Promotion and Advancement of Small Telecommunications Companies, and U.S. Telecom Association for access charge reform applicable to predominantly rural carriers still subject to rate of return regulation).

117. *Texas Office of Pub. Util. Counsel*, 265 F.3d at 317.

118. *See id.* at 320, 323. The FCC has initiated a proceeding to examine costs attributable to the SLC. *See* Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps, *Public Notice*, 16 F.C.C.R. 16705 (2001).

119. *Texas Office of Pub. Util. Counsel*, 265 F.3d at 324. The Fifth Circuit Court of Appeals previously stated that “the plain language” of Section 254(e) of the 1996 Act did not “permit the FCC to maintain any implicit subsidies for universal service support.” *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999).



application and content layers fit the definition of “information services” while the physical and operational layers behave much more like “telecommunications services.”<sup>120</sup>

The European Union (“EU”) has acknowledged a simple premise that other nations, including the United States,<sup>121</sup> have failed to appreciate fully: “The convergence of the telecommunications, media and information technology sectors means all transmission networks and services should be covered by a single regulatory framework.”<sup>122</sup> The EU approach establishes a definition for electronic communication network,<sup>123</sup> electronic communication service,<sup>124</sup> and information society services,<sup>125</sup> a specified

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120. Kelley, *supra* note 78, at 2144.

121. However, a recent Working Paper from the FCC Office of Plans and Policy shows great appreciation for the EU approach even as the paper correctly notes the difficulty in implementation outside the EU. “[T]here would seem to be much to recommend the European framework [e.g., linking significant market power with regulation without reference to specific technologies or services that have or will converge]. Unfortunately, the European approach does not fit neatly into U.S. regulatory practice.” J. SCOTT MARCUS, THE POTENTIAL RELEVANCE TO THE UNITED STATES OF THE EUROPEAN UNION’S NEWLY ADOPTED REGULATORY FRAMEWORK FOR TELECOMMUNICATIONS 27 (FCC Office of Plans and Policy, Working Paper No. 36, July 2002), available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-224213A2.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-224213A2.pdf) [hereinafter Marcus Paper].

122. Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a Common Regulatory Framework for Electronic Communications Networks and Services (Framework Directive), 2002 O.J. (L 108) 33, available at [http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l\\_108/l\\_10820020424en00330050.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/l_108/l_10820020424en00330050.pdf).

123. Electronic communications network is defined as:

[T]ransmission systems and, where applicable, switching or routing equipment and other resources which permit the conveyance of signals by wire, by radio, by optical or by other electromagnetic means, including satellite networks, fixed (circuit- and packet-switched, including Internet) and mobile terrestrial networks, electricity cable systems, to the extent that they are used for the purpose of transmitting signals, networks used for radio and television broadcasting, and cable television networks, irrespective of the type of information conveyed.

*Id.* at 38-39.

124. Electronic communications service is defined as:

[A] service normally provided for remuneration which consists wholly or mainly in the conveyance of signals on electronic communications networks, including telecommunications services and transmission services in networks used for broadcasting, but exclude services providing, or exercising editorial control over, content transmitted using electronic communications networks and services; it does not include information society services, as defined in Article 1 of Directive 98/34/EC, which do not consist wholly or mainly in the conveyance of signals on electronic communications networks.

*Id.* at 39.

125. Information society services refers to:

[A]ny service normally provided for remuneration, at a distance, by electronic means and at the individual request of a recipient of services. For the purposes of this definition:—“at a distance” means that the service is provided without the parties being simultaneously present,—“by electronic means” means that the service is sent initially and received at its destination by means of electronic

set of information services where the telecommunications carriage component can be recognized as subordinate to the information service provided, e.g., home banking.<sup>126</sup> But rather than apply regulation based on specific service definitions, the EU's framework establishes a process for determining whether to apply regulation and when to remove it.<sup>127</sup> Additionally, the European approach establishes a harmonized, horizontal regulatory model that subjects ICE industries to government oversight geared to remedy-specific instances of ineffective competition, solely "in markets where there are one or more undertakings with significant market

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equipment for the processing (including digital compression) and storage of data, and entirely transmitted, conveyed and received by wire, by radio, by optical means or by other electromagnetic means,—”at the individual request of a recipient of services” means that the service is provided through the transmission of data on individual request.

Directive 98/48/EC of the European Parliament and of the Council of 20 July 1998 Amending Directive 98/34/EC Laying Down a Procedure for the Provision of Information

in the Field of Technical Standards and Regulations, 1998 O.J. (L 217) 21; *see also* Annex V.

126. Information society services include:

*Electronic commerce*: often called, confusingly and incorrectly, “teleshopping” or described as an “electronic purchasing system”, electronic commerce would enable the consumer to order products directly via his television set or computer terminal.

*Distance teaching*: distance teaching would be provided interactively; it would rely on an audiovisual aid and would enable the student to answer questions, choose alternatives, and receive an assessment of his/her abilities.

*Electronic publications/information services*: this term covers a wide range of services such as news, weather reports, online databases, etc. For services such as travel information or information about the times of various events, one of the possibilities often offered by electronic commerce is direct booking.

*Professional teleservices*: professional services such as telemedicine and legal advice afford an expert the opportunity of giving advice from his place of work to his client's home with total interactivity between the two.

*Home banking*: clients can obtain information about their accounts and carry out financial transactions directly and at a distance via a/the network.

*Online entertainment*: this includes services such as online video games or video-on-demand which would enable the consumer to order a programme or a film at any time, watch it on his screen and manipulate its content (ranging from fast winding or rewinding to making wholesale changes).

*Regulatory Transparency in the Internal Market for Information Society Services*, Proposal for a European Parliament and Council Directive Amending for the Third Time Directive 83/189/EEC Laying Down a Procedure for the Provision of Information in the Field of Technical Standards and Regulations, I.A.1., at <http://europa.eu.int/ISPO/infosoc/legreg/docs/regtrans.html> (July 24, 1996).

127. The new EU regulatory framework requires “that certain regulatory impositions should be imposed in the presence of SMP [significant market power], and lifted in its absence, [perhaps] express[ing] [a] regulatory desiderata and the desired *timing* of regulation and deregulation more clearly and more simply than do equivalent U.S. statutes.” Marcus Paper, *supra* note 121, at 27.

power, . . . and where national and Community competition law remedies are not sufficient to address the problem.”<sup>128</sup>

The EU approach separates content from conduit and subjects either horizontal layer to regulation only where market distortions have occurred, or potentially may occur in view of the market power exercised by one or more stakeholders.<sup>129</sup> The primary regulatory oversight model derives from general antitrust/competition policy rather than from an industry- or service-specific predicate. Regulation occurs if and only if competition does not exist in a particular geographic or specific market, and existing regulatory obligations may be withdrawn on the basis of market analysis.<sup>130</sup>

## XVII. CONCLUSION

The FCC has attempted to cause common carrier regulation to evaporate by reclassifying the vertical regulatory model into which existing telecommunications services fit. Telecommunications law permits the Commission to eliminate Title II common carrier responsibilities on an ad hoc basis, but the Commission appears unwilling or undisciplined to use the deregulatory flexibility available to it. Instead, the Commission appears intent on eliminating any telecommunications service if it can be subsumed within and subordinate to a cable or information service. This semantic tinkering satisfies the Commission's dichotomous thinking that services must fit entirely in one vertical model, but only by creating two ambiguous and not necessarily mutually exclusive categories: telecommunications as a capability or building block for another service, and telecommunications as a service in its own right.

To sustain several parallel vertical models (telecommunications services, cable services, information services), the Commission has erected a mechanism for ignoring, subordinating, or dismissing

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128. *Public Consultation on a Draft Commission Recommendation on Relevant Product and Service Markets within the Electronic Communications Sector Susceptible to Ex Ante Regulations in Accordance with Directive 2002/21/EC of the European Parliament and of the Council on a Common Regulatory Framework for Electric Communication Networks and Services*, Commission of the European Communities Working Document, at [http://www.oftel.gov.uk/ind\\_info/eu\\_directives/draft\\_rec\\_relmar.pdf](http://www.oftel.gov.uk/ind_info/eu_directives/draft_rec_relmar.pdf) (June 17, 2002).

129. For an overview of the EU approach, see *Europe's Liberalised Telecommunications Market—A Guide to the Rules of the Game*, Commission of the European Communities Staff Working Document, at <http://europa.eu.int/ISPO/infosoc/telecompolicy/en/userguide-en.pdf> (last visited Nov. 30, 2002).

130. *Proposed New Regulatory Framework for Electronic Communications Networks and Services, Draft Guidelines on Market Analysis and the Calculation of Significant Economic Power*, Commission of the European Communities Working Document, available at <http://europa.eu.int/ISPO/infosoc/telecompolicy/en/com2001-175-5en.pdf> (Mar. 28, 2001).

telecommunications functionality that previously constituted regulated telecommunications services. But the identifiable telecommunications service function does not evaporate, particularly in light of the fact that carriers can take telecommunications functionality used as a building block for an information service and easily configure it for conventional telecommunications services. To achieve preferred deregulatory status, these carriers can just as easily mask the telecommunications service functionality by emphasizing its supporting or subordinate role in the provision of an information service. In either instance, the telecommunications functionality exists as do the common carrier regulatory responsibilities, absent a specific deregulatory initiative meeting the requirements of Section 10 of the 1996 Act.

The FCC cannot cut corners by making an artificial distinction between telecommunications used to transport an information service and telecommunications services. In both instances a telecommunications service exists, and the carrier providing the telecommunications should be regulated under Title II of the Communications Act of 1934 unless and until it can qualify for section-by-section deregulation based on the public interest and favorable marketplace conditions.

The horizontal regulatory approach championed by the European Commission offers a rational and consistent regulatory model alternative. Content and conduit fit into separate regulatory classifications with content providers generally exempt from regulation. Conduit providers, regardless of the medium, typically fit within conduct and economic regulation that can be calibrated as a function of the particular carrier's market share and the level of competition in the various conduit submarkets. Regardless of whether telecommunications provides transport for an information service or offers standalone transport, the conduit function should be regulated to the extent any conduit operator has market power or bottleneck control, and any market still requires government oversight to promote sustainable competition and consumer protection.

The European Commission has devised a more straightforward and viable regulatory model than its U.S. counterpart. However, just because the EU arguably has a better model does not guarantee that any nation will embrace it. Indeed, different political circumstances all but foreclose the application of the EU horizontal model in the United States. No regulatory model that increases the scope of governmental oversight will work in the United States, no matter how rational and consistent its application. The FCC may express reticence in extending legacy regulation, but on the other hand, it emphasizes preexisting, legacy legal and regulatory status, except when it suits its grand regulatory mission to offer something new.

Accordingly, the FCC will extend the status quo of regulated status to telecommunications service providers and unregulated status to information service providers. Likewise, the FCC will make do with inconsistent regulatory models that extend non-common carrier, private carrier status to cable television operators, even when these ventures offer what appears to be telecommunications services. But in an effort to eliminate regulatory burdens for any venture providing any information service, the common carrier vertical model has become inoperative.

Congress did not authorize the FCC to eliminate common carriage regulatory status when carriers provide telecommunications services. The FCC can only selectively and incrementally eliminate aspects of Title II regulation on an ad hoc basis when and if changed circumstances support deregulation. By adopting the EU horizontal approach, the FCC could calibrate and largely reduce telecommunications common carrier regulation without eviscerating a traditional and still legislatively valid classification. Sadly, this approach will not generate the slightest interest or support in the United States.