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ANALYSIS OF A CHANGING INDUSTRY

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FCC DEFINES A “THIRD WAY” TO REGULATE BROADBAND INTERNET ACCESS SERVICE: SERIOUS POLICY OBSTACLES STAND IN THE WAY

On May 6, Federal Communications Commission (FCC) Chairman Julius Genachowski shook up the broadband transition by announcing a significant policy change in how he wants to regulate broadband Internet access service provided by companies currently regulated under Title I of the Communications Act of 1934, as amended. The chairman’s intended destination will have serious implications for providers of broadband Internet access service and the implementation of the National Broadband Plan (NBP). In this edition of *JSI News & Commentary*, we explore the policy implications and reflect on the possible difficulties the FCC faces in regulating broadband service.

Broadband Internet Access Service

Before we explore the FCC’s new proposal, we must revisit how broadband Internet access service is currently regulated. For rate-of-return rural local exchange carriers (LECs), broadband Internet access service is offered under the same regulatory “common carriage” Title II classification of the Act that applies to telecommunications services. For these carriers, the service is generally purchased by an Internet service provider (ISP) that, in turn, provides the connection to the Internet backbone and the network functionality and support to retail customers. All other providers of broadband Internet access service offer the service under the “non-common carriage” Title I classification of the Act which applies to information services in accordance with how the Commission has classified this service. It is important to note that prior to the classification of broadband Internet access service, the FCC did not regulate ISPs as Title II providers and does not intend to regulate ISPs as Title II providers under its new approach.

FCC Treatment of Broadband Internet Access Service

The FCC began the process of considering broadband Internet access service under Title I regulation in 2002, with its Cable Modem Declaratory Ruling. In 2005, the FCC extended its application of Title I regulation to wireline broadband Internet access service for all wireline providers (rate-of-return carriers excluded). Later in 2006, the FCC applied Title I to Internet access provided through broadband-over-power-lines (BPL) service. In 2007, the FCC extended its Title I treatment to wireless broadband Internet access service. These four orders spanning the years 2002-2007 define how the FCC has addressed broadband Internet access service and

constitute what the FCC would like to change by adopting a new approach to its regulations. Let's look briefly at two of these important orders.

Cable Modem Service

Cable modem service is understood to be “a service that uses cable system facilities to provide residential subscribers with high-speed Internet access, as well as many applications or functions that can be used with high-speed Internet access.” The FCC concluded that cable modem service is inseparable from the functions performed by an ISP (affiliated or unaffiliated with the cable operator) and consequently determined that it is an information service. The FCC recognized that “cable modem service typically requires the performance of a number of specific functions. Cable operators may self-provide all of these functions, or they may contract with affiliated or unaffiliated ISPs to provide some or all of them. The functions can be categorized as Internet connectivity, enhanced applications, operations, and customer service.” The concept of Internet connectivity or the function “that enables cable modem service subscribers to transmit data communications to and from the rest of the Internet” is very important with respect to whether Title II regulation applies to the providers of Internet connectivity.

The FCC observed that in addition to the Internet access functions that may be provided through an ISP, there are Internet applications that ride this connectivity and are monitored and controlled through a series of Internet access functions. The FCC concluded that while Internet access functions could be provided through an ISP—affiliated or unaffiliated—with the cable modem service provider, the entity that “ultimately provides cable modem service to the subscriber is the cable operator.”

Wireline Broadband Internet Access Service

The service familiar to rural LECs is wireline broadband Internet access service (WBIAS). Until 2005, LECs were required to provide this service under Title II. Subsequently and as a direct result of the Supreme Court's decision affirming the Cable Modem Declaratory Ruling, the FCC provided larger price-cap carriers the freedom to offer WBIAS under Title I; rate-of-return rural LECs, however, offer this service under Title II. In its decision, the FCC concluded that “what matters is the finished product made available through a service rather than the facilities used to provide it.” Under this theory, the transmission component provided by wireline carriers is integrated with the Internet connectivity and network functionality provided by the ISP.

The FCC's New Approach—A Third Way

We can guess the question on your mind: Why is the FCC's proposal called the “Third Way”? Chairman Genachowski characterized his approach as a narrowly tailored broadband framework. JSI looks at it as a “Goldilocks approach” to the FCC's current problem; *i.e.*, not too much and not too little regulation. The FCC chairman developed his regulatory approach in response to a devastating defeat in the U.S. Court of Appeals, D.C. Circuit, on April 6. In *Comcast v. FCC*, the Court rejected the FCC's claim that it can regulate broadband under an ancillary provision of the Act without a direct mandate expressed within another specific provision. The aftermath of this decision sent tremors throughout the industry because it imperiled both the proposed rules for Net Neutrality and key provisions of the NBP. Chairman Genachowski's approach is to “reclassify” Internet communications as a “telecommunications service” and forbear on all Title

II provisions with the exception of six sections: three (secs. 201, 202, and 208) forbid unreasonable denials of service and other unjust or unreasonable practices; the others pertain to privacy (222), universal service (254), and ensuring that telecommunications services and equipment are accessible to individuals with disabilities (255). The Third Way approach does not leave broadband as Title I, nor does it impose all sections of Title II on this service.

It is important to note that this so-called Third Way reclassifies Internet communications as a telecommunications service for purposes of Section 254, which addresses universal service. This proposed treatment of broadband communications will have at least two possible effects. First, the revenues of all broadband communications – including cable, wireless, and wireline Internet services – will be subject to the federal universal service contribution factor. Right now, cable providers assess contributions only on a portion of their VoIP services. In the future, the federal assessment would be on the revenues for the entire Internet communication service. The second effect of broadband being classified as a telecommunications service will be that the FCC may distribute funds directly to broadband service. Without classifying Internet communications as a telecom service, the FCC would have to fashion a program in which it would provide funding for underlying telecom networks that have the capability to provide advanced telecom (or broadband) services.

There are many reasons why providers regulated under Title I do not want to move to Title II. JSI observes that one reason certainly is the fact that these providers would be subject to federal contributions for universal service for the entire Internet transmission service. If the FCC were to actually classify all Internet communications as Title II service, we would expect the contribution factor to drop because of the large increase in the revenue base subject to the contribution factor. From a policy viewpoint, this would greatly improve the climate to argue to increase high-cost funding by retaining the current programs that are successfully delivering broadband capabilities to areas served by rural LECs and add a broadband program aimed to meet the NBP goals.

Despite what would be a very promising development in the current struggle with universal service reform proposed in the NBP, we are not optimistic that the Third Way will be successful. The first challenge facing the chairman's approach is the fact that "reclassification" does not place the entire Internet communication under Title II. Recall that what is being reclassified is only "broadband Internet access service" and not the entire transmission from the end user and the Internet backbone (referred as "client-to-cloud transmission"). The reclassified service is the first segment of the on-ramp to the Internet superhighway. Reclassification of this transport segment does not address the transport piece provided by the ISP to the Internet backbone (the so-called middle mile). To complete the picture using on-ramps and highways, regardless of how the FCC classifies the first 20 yards of the highway on-ramp, there is another 30 yards that would be provided by ISPs. ISP services have never been regulated as Title II, and "classification" as Title II service would be a major policy change that we do not believe the industry or Congress will accept. In the end, the failure to regulate the entire on-ramp would not allow the FCC to provide the effective Net Neutrality regulations it so desires. Thus, it would appear that the Third Way fails to deliver the FCC's marquee Net Neutrality rules because regardless of how the first 20 yards of the on-ramp are regulated, the additional 30 yards would be unregulated and not subject to the FCC's rules.

Another major hurdle the Third Way faces is the fact that as recently as 2007, the FCC examined a factual record and determined that broadband Internet access service (in this case, wireless) should not be regulated as Title II. If the FCC were to reverse *itself* on four decisions dating from 2002-2007 without a strong factual record that justifies Title II classification, we would have to agree with Commissioner Robert McDowell that the Third Way approach is likely to suffer defeat upon court review.

Is the Third Way the Right Way?

The FCC has major problems with the opinion in *Comcast v. FCC*. Chairman Genachowski admits that this opinion “creates a serious problem that must be solved so that the Commission can implement important, commonsense broadband polices, including reforming the Universal Service Fund to provide broadband to all Americans, protecting consumers and promoting competition by ensuring transparency regarding broadband access services, safeguarding the privacy of consumer information, facilitating access to broadband services by persons with disabilities, protecting against cyber-attacks, ensuring next-generation 911 services for broadband communications, and preserving the free and open Internet.” We doubt the FCC will be successful with its Third Way approach, and this will ultimately lead to congressional action required to advance public policy.

The next step in the process of adopting the Third Way comes Thursday, June 17, when the FCC hold its monthly open meeting, in which it will seeks comments and issue a notice of inquiry (NOI). The FCC has already indicated that after the comment cycle established in the NOI has closed, it intends to proceed directly to issue a declaratory ruling adopting the Third Way. Litigation, JSI would add, will then certainly follow. We will continue to provide coverage and analysis of the Third Way, the NBP, and the broadband transition in upcoming issues of *JSI News & Commentary*. If you have questions about this article, contact Manny Staurulakis (mstaurulakis@jsitel.com), Steve Meltzer (smeltzer@jsitel.com), or John Kuykendall (jkuykendall@jsitel.com) in JSI’s Maryland office, at 301-459-7590, or Douglas Meredith (dmeredith@jsitel.com) in Utah, at 801-294-4576.

CLIENTS URGED TO PARTICIPATE, PROVIDE INDIVIDUAL DATA IN NBP UNIVERSAL SERVICE REFORM NPRM

In the March 26 edition (No. 1001) of *JSI News & Commentary*, we provided extensive analysis of the 15 recommendations on federal universal service and intercarrier compensation reform included in the National Broadband Plan (NBP) as put forth by a task force of Federal Communications Commission (FCC) staff members. Subsequently, on April 21, the FCC began implementing these recommendations by issuing a notice of inquiry (NOI) and notice of proposed rulemaking (NPRM). Comments on the NOI and NPRM are due by July 12, and replies on August 11.

While JSI will file comments in response to the NOI and NPRM, we strongly recommend that clients file individual comments providing specific data on how the FCC’s proposals will affect

your operations and the rural subscribers you serve. JSI is available to assist clients in drafting and filing comments, the substance of which should include the data requested in the NPRM. Specifically, the FCC encouraged those that believe the proposals would negatively affect their ability to provide affordable voice service “to identify all assumptions and to provide data, including information on network investment plans over the next five years and free cash flows, to support that position.”

In the NOI, the FCC sought comments on whether an economic model should be used to quantify the minimum amount of universal support required to support networks that provide broadband and voice service. In addition, the FCC asked for comments on a model developed by its staff to estimate the amount of additional funding that would be required in the future to close the “broadband availability gap” through the Connect America Fund (CAF). In response to the NOI, JSI plans to file comments demonstrating the myriad reasons why forward-looking modeling simply does not apply in the context of rural carriers and that an embedded cost standard must continue to be used for these carriers.

In the NPRM, the FCC sought comments on proposals to “cap and cut” legacy high-cost universal service support. Two of the proposals include capping legacy high-cost support provided to incumbent telephone companies at 2010 levels and shifting rate-of-return carriers to price-cap regulation. As we explained in our March newsletter, these proposals have several negative consequences for clients, including sending an immediate message to postpone or cancel investment projects. Accordingly, JSI will file comments opposing these proposals and encourages clients to do the same.

If you have questions or would like JSI’s assistance in preparing individual comments, contact Steve Meltzer (smeltzer@jsitel.com) or John Kuykendall (jkuykendall@jsitel.com) in JSI’s Maryland office, at 301-459-7590, or Douglas Meredith (dmeredith@jsitel.com) in Utah, at 801-294-4576.

NEW BROADBAND REGULATIONS ON THE HORIZON?

Although in its Third Way, the FCC has indicated that it plans to regulate broadband only in a few major areas, such as non-discrimination, universal service, and privacy, a closer look at the National Broadband Plan (NBP) reveals that the FCC envisions putting in a whole new policy framework to govern the provision of broadband services. The basis of the need for such new regulations is the FCC’s misconception that current regulations governing the circuit-switched PSTN (public switched telephone network) must be totally replaced by regulations governing an IP-based network and that a timeline must be established to ensure that this transition occurs.

According to Chapter Four of the NBP, the current regulations that require carriers to maintain plain old telephone service (POTS) “are not sustainable ... lead to investment in assets that could be stranded ... (and) siphon investments away from new networks and services.” The solution posited in the NBP is to have a transition deadline similar to the deadlines established for transitioning mobile service from analog to digital and transitioning broadcast TV from analog to

digital. In furtherance of developing this transition timeline, the FCC will soon seek comments on the regulatory framework and the applicability of current “voice-specific” regulations, such as interconnection, numbering, and carrier of last resort obligations.

Last year, in a public notice, the FCC requested comments on these same issues outside of the context of the NBP, and JSI explained its position in comments that are summarized below. Now that these issues have been raised in the context of the NBP, however, we believe that the FCC is signaling its intent to press forward in seeking to have carriers transition more quickly to VoIP and other IP-based communications and away from a circuit-switched POTS environment. We also believe that the FCC plans to link the regulatory framework established for this transition with the rules established regarding universal service and intercarrier compensation reform. This is evidenced by the fact that in Chapter Four of the NBP, the FCC noted that recommendations made in Chapter Eight regarding universal service and intercarrier compensation “will affect the path of the transition” and thus will have to be considered when the regulatory framework for the transition is developed.

The FCC’s Misconceptions Regarding IP-Based Technologies

Both when the FCC sought comment on the PSTN-to-IP network issues last year and more recently when it raised these issues in the NBP, it seems to promote an overall market transition to IP technology. JSI observed in its comments, however, that IP technologies are not necessarily the most favorable choice for any particular service provider. The technology is still evolving to improve such areas as network security requirements and support for streaming video. Continued evolutionary changes to the technology, therefore, are needed to accommodate full implementation of voice, data, and video services. Accordingly, a *choice* of technologies is necessary among service providers. If the FCC provides regulations that are less stringent or otherwise more favorable for one technology, service providers will naturally gravitate toward that technology over another creating disparity in the market place.

Historically, telecommunications laws and FCC rules have maintained technological neutrality. Laws and regulations governing interconnection, for example, have ensured that each voice customer has the ability to call any other voice customer without regard for the technology used to provide the service. All telecom providers, whether using circuit-switched, packet-switched, or IP technologies in their networks, are subject to the same rules for the provision of services. To accommodate differences in technologies, the FCC has left the development of specifications and standards for technologies to industry standards organizations, such as the Alliance of Telecommunications Industry Solutions (ATIS). With organizations like ATIS, technological standards and distinctions can remain separate from industry policy and regulations promoting technological neutrality in the governance of communications services.

Complimentary Regulations for Broadband Service – Not New Ones for IP

JSI recommends that the FCC focus its public inquiry on an overall transition to *broadband service* and not to IP technology. Broadband itself is a technology-neutral platform that can be provided over wireless, fiber optics, hybrid fiber coax, digital subscriber line, satellite, ATM, Frame Relay, or IP. Since service providers can offer broadband over any number of these

technologies, policy should not single out IP or any other technology. Regulation of broadband service is favorable because all service providers will be treated equally under law and regulation regardless of the technology they use.

More specifically, the FCC should create only policies that will complement its palette of regulations governing existing services using existing technologies and that will not encourage any particular technology to emerge over others. The FCC should focus its investigation on a transition to broadband policy, while recognizing that IP is but one of many technologies used with a broadband platform for the provision of services to the end user. Further, the FCC should consider broadly how a migration to broadband might be impacted by existing regulations and other areas such as interconnection and consumer protections.

JSI observes that although the industry has seen other significant migrations, such as the move from analog to digital broadcast television or from analog to digital mobile communications, the move to an IP-based communications network does not compel the FCC to consider the same broad policy changes. In the analog-to-digital conversions, the market commanded new policy to enable the FCC to manage spectrum acquisition and disbursement. Today's migration to an IP-based network is led only by market economies of scale and efficiencies and is without the same kind of specific ancillary policy requirements apparent in the analog-to-digital conversions.

If you would like more information on JSI's comments and positions relating to the FCC's consideration of migrating from a PSTN to an all IP communications network, contact Valerie Wimer (vwimer@jsitel.com) in JSI's Maryland office, at 301-459-7590, or Terri Parrilla (tparrilla@jsitel.com) in JSI's Mississippi office, at 228-896-0841.

NEW JSI SERVICE: VIDEO COMPLIANCE REVIEW

With all the focus placed on the monumental changes proposed in the NBP, JSI clients with video operations should not overlook their compliance obligations. Even though the video business is "deregulated," rules and regulations abound. To assist clients in ensuring compliance with specific federal, state, and local rules and regulations, JSI has developed a video compliance "audit" service that includes an onsite review of your company's video/cable system and a report summarizing our findings. Among the major items included in the review are: FCC reporting requirements; local or statewide franchise agreements; copyright royalty payments; EEO requirements; public inspection file; billing, and programming contracts.

If you would like more information, please contact John Becci (jbecci@jsitel.com) in JSI's Maryland office, at 301-459-7590.

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