Brand X Decision: Questions and Opportunities

How will small providers of voice and data services compete without a network?

By Carl E. Kandutsch ■ *J.D., Ph.D*

On June 27, the U.S. Supreme Court issued its long-awaited decision in *National Cable & Telecommunications Ass'n v. Brand X Internet Servs.*, 125 S.Ct. 2688 (2005), upholding an FCC determination that cable modem service – broadband Internet connectivity provided directly to consumers over cable networks – is exclusively an "information service" and not a "telecommunications service" subject to common carrier regulation.

The Supreme Court's ruling focuses less on the substance of communications law than on administrative law, and its real significance is in upholding the FCC's authoritative role in interpreting laws within the agency's area of expertise. In that sense, the *Brand X* case will have profound consequences as national communications policies are formulated for the broadband era.

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The FCC's deregulatory approach to broadband, endorsed by the Supreme Court in *Brand X*, implies that an owner of broadband infrastructure may leverage that ownership into the broadband services market. The primary beneficiaries of the decision are therefore the firms that own broadband infrastructure (the big cable and telephone companies), which need not share their transport facilities with unaffiliated service providers. The losers are the independent service providers, which must use those transport facilities to sell their services to consumers. Such independent service providers prominently include ISPs and VoIP firms.

Independent ISPs like Brand X itself and Earthlink expressed bitter disappointment with the Court's ruling. Unable to rely on an "open access" regulatory regime, these companies will be forced to negotiate broadband carriage deals with cable operators and ILECS, negotiations in which unaffiliated ISPs lack significant bargaining power.

In historical context, however, the relevance of ISPs in the broadband era is questionable, because technically broadband users connect directly to the Internet without any need for an ISP to mediate the connection as in a narrowband world.

Perhaps *Brand X* will stimulate their efforts to recreate their business models within a framework more appropriate for the new technology. Earthlink, for example, has been actively pursuing a wireless Internet strategy for several years in order to sidestep the cable and telephone industries.

Independent VoIP providers such as Vonage are rightfully worried about the implications of *Brand X*. These companies rely on cable and DSL networks to deliver their voice services. The cable operators and the Bell companies are rolling out their own VoIP services and the logic of *Brand X* gives them little incentive to share their networks with rival VoIP phone services.

VoIP providers Vonage and Nuvio have already complained that cable and DSL companies are blocking calls on their networks, and these practices are likely to increase to the extent that cable modem and DSL services are classified as "information services." Jeff Pulver of Free World Dialup recently commented, "I believe it's a matter of when, not if … If I'm a service provider offering my own voice-over-broadband offering, and I've got the ability to block my competition, why not?"[1] This is troubling because the established telephone companies, fearing cannibalization of their heavily subsidized wireline voice services, do not have the same incentives to develop VoIP services as do independents.

Some unexpected beneficiaries of Brand X could be municipalities that are involved in building or managing their own broadband networks. Community broadband typically relies on independent providers to lease capacity to deliver voice, data and cable video services over publicly financed networks. Independent ISPs and similar unaffiliated broadband service providers who are unable to gain carriage on proprietary networks will be more likely to deal with the municipal owners of non-proprietary "open access" networks in order to reach potential subscribers.

Likewise, the Court's endorsement of closed cable networks could well provide new political ammunition for advocates of community broadband, whose prin-

cipal argument is that the closed cable/telco duopolies fail to serve the public interest.

The Decision

As described in two articles published in the January and February issues of this magazine, months before the Supreme Court's decision, the question of the proper regulatory classification of cable modem service first arose in the Ninth Circuit's ruling in *AT&T Corp. v. City of Portland*, 216 F.3d 871 (9th Cir. 2000), holding that cable modem service encompasses both an "information service" (supporting email, web browsing and other means of managing data) and a "telecommunications service" (involving the pure transmission of data over cable infrastructure).

Following on the heels of the Ninth Circuit case, the FCC issued a Notice of Inquiry on how cable modem service should be classified, a question the Commission had studiously avoided in the context of several cable company mergers. That proceeding ended with a Declaratory Ruling[2] in which the FCC concluded that cable modem service is an interstate and integrated information service that does not include a separate telecommunications service.

The FCC's ruling is based on the view that cable modem service does not fall within the definition of "telecommunications service" – meaning, "the offering of telecommunications for a fee directly to the public"[3] – because a subscriber does not receive a separate "offering" of telecommunications. Although Internet connectivity over a cable system does involve the pure transmission of data, the telecommunications component is not separate from, but "part and parcel" of the integrated Internet service that cable operators sell to consumers.

In reversing the Ninth Circuit, the Supreme Court held that the Appeals Court should have deferred to the FCC's Declaratory Ruling rather than its own prior ruling in the 2000 *AT&T v. City of Portland* decision, despite the fact that the FCC's ruling came after the Ninth Circuit's decision. The Court reasoned that a court's prior interpretation of a statute can only trump an agency's view

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if the court found that its interpretation was unambiguously required by the statute. Because the Ninth Circuit made no such finding, it should have deferred to the FCC's decision that cable modem service is a unified "information service."

What's Next in Washington?

In recent years, and especially under Chairman Powell, the FCC has made clear, both explicitly and implicitly, its intention to remove broadband services from the reach of the common carrier regulation traditionally applied to voice telephony (and, similarly, to data services, according to the FCC's *Computer Inquiries*). That goal is achieved by classifying such broadband services as "information services" over which the FCC retains jurisdiction under Title I of the Communications Act, but does not actively regulate.

This explains why the cable industry's RBOC rivals, who had been among the strongest proponents (along with consumer advocacy groups) of an "open access" regulatory regime for cable modem providers, applauded the Supreme Court's ruling. Brand X strengthens the phone companies' argument that they should be afforded "regulatory parity" with cable for their broadband DSL services.

The FCC has already issued a Notice of Proposed Rulemaking in which it tentatively concluded that when an incumbent local telephone company (an ILEC) bundles Internet connectivity together with DSL transmission, the bundled product is an "information service" without a separate "telecommunications service" component.[4] The Supreme Court's endorsement of its "hands off the Internet" approach all but removes any doubt that the FCC will finalize its tentative conclusion that DSL is an information service like cable modem service.[5] The decision will likely spur the FCC to classify other broadband services, including VoIP, as unregulated information services.[6]

In fact, on June 30, just three days after *Brand X* was announced, BellSouth told the Federal Communications Commission that it plans to deploy fiber to almost 60 percent more locations in 2005 than it did in 2004.[7] Verizon's reaction was similarly enthusiastic.[8] To the extent that anything that spurs infrastructure investment benefits suppliers, the Supreme Court's decision is probably good news for equipment manufacturers, including suppliers of fiber optic equipment.

Conclusion

Ever since high-speed Internet connectivity first became widely available in the late 1990s, the question of if and how broadband fits into legacy regulatory structures has shrouded the industry in a veil of uncertainty. On one side, there are those who argue that only some sort of structural or economic regulation, based more or less loosely on the common carriage principles traditionally applied to the telephone industry following the breakup of AT&T, can ensure that emerging broadband markets do not become monopolized by incumbent cable and telephone companies.

On the other side, there are those who argue that such heavy-handed regulation will only serve to scare off the tremendous capital investments required to bring ubiquitous broadband to all Americans. The FCC has cast its lot with the de-regulatory, pro-investment side on the equation, and *Brand X* constitutes a judicial endorsement of that bet, setting the course of communications policy for the foreseeable future.

Nonetheless, there are too many cards still on the table for anyone to predict how it all will shake out, particularly with Congress now engaged in an apparently comprehensive re-write of the 1996 Telecommunications Act. **BBP**

About the Author

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References

[1] Quoted in "More Worries for VoIP Vendors" (June 28, 2005), http://www.forbes.com/2005/06/28/voip-cable-blocked-cx_de_0628voip_print.html.

[2] Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet over Cable and Other Facilities*, 17 FCC Rcd 4798 (2002), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-02-77A1.pdf.

[3] 47 U.S.C. § 153(46).

[4] Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, 17 FCC Rcd 3019, ¶¶ 17-25 (2002), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-02-42A1.txt.

[5] Note that FCC's *Computer Inquiry II* ruling (77 F.C.C.2d 384 (1980)) still requires an ILEC offering data services to unbundled the underlying transmission component and offer transmission capacity to other "enhanced service" providers on a non-discriminatory basis as a tariff. The FCC is considering, but has not yet decided, whether to relax or eliminate the *Computer II* unbundling rules in the broadband era.

[6] *See*, Notice of Proposed Rulemaking, *IP-Enabled Services,* 19 FCC Rcd 4863 (2004), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-28A1.pdf.

[7] http://bellsouthcorp.com/proactive/newsroom/release.vtml?id=50287.

[8] "'Brand X' Ruling Could Spur Telco Deregulation," (June 27, 2005), http://www.commsdesign.com/news/tech_beat/showArticle.jhtml?articleID=164903862.