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Defining Cable Broadband Internet Access Service: Background and Analysis of the Supreme Court's *Brand X* Decision

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Summary

In 2002, the Federal Communications Commission (FCC) issued a *Declaratory Ruling and Notice of Proposed Rulemaking* regarding the provision of Internet services over cable connections to address the legal status of such services under the Communications Act of 1934, as amended. In the *Declaratory Ruling*, the Commission determined 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." By classifying cable modem service as an information service and not a telecommunications service or a hybrid information and telecommunications service, the Commission precluded the mandatory application of the requirements imposed on common carriers under Title II of the Communications Act, thus allowing the provision of such services to develop with relatively few regulatory requirements.

There were numerous challenges to the FCC's classification of cable modem service as an information service, which were consolidated, and by judicial lottery assigned to the Ninth Circuit for review. The Ninth Circuit, applying its own interpretation of the act, vacated the FCC's ruling regarding the classification of cable modem service as an information service. On appeal, the Supreme Court overturned the Ninth Circuit's decision, finding that the FCC's interpretation of the act was "reasonable" in light of the statute's ambiguity. The Court's decision revives the FCC's classification of cable modem service as an "information service" and refocuses attention on several important issues regarding the regulation of broadband services that Congress is likely to consider in its reexamination of the Telecommunications Act of 1996.

This report provides an overview of the regulatory actions leading up to and an analysis of the Supreme Court's decision in *National Cable & Telecommunications Association v. Brand X Internet Services*. It also provides a discussion of the possible legal and economic implications of the Court's decision. The report will be updated as events warrant.

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Background

FCC's Regulatory Authority under the Communications Act

Title I of the Communications Act states that the act "applies to all interstate and foreign communications by wire or radio,"[1] and the legislative history of the act indicates that the FCC has "regulatory power over all forms of electrical communication," even those not explicitly mentioned in the act.[2] Title I confers upon the Commission the authority to promulgate regulations "reasonably ancillary to the effective performance of the Commission's various responsibilities" outlined elsewhere in the act.[3]

In contrast to Title I, Title II of the Communications Act, imposes certain specific requirements on common carriers in their provision of telecommunications services. Generally, Title II requires common carriers to provide service "upon reasonable request therefor," and at a "just and reasonable" rate.[4] Under Title II, common carriers are also required to provide services without "unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services."[5] In addition, the act requires certain carriers to provide potential competitors with access to their network.[6] Entities regulated under Title II may also be subject to additional requirements governing universal service support, the provision of disability access, public safety, consumer protection, and law enforcement access.

FCC's Declaratory Ruling and Rulemaking

In 2002, the Federal Communications Commission issued a *Declaratory Ruling and Notice of Proposed Rulemaking* regarding the provision of Internet

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[1] 47 U.S.C. 152(a).

[2] S. Rep. No. 73-781, at 1 (1934). *See also* United States v. Southwestern Cable Co., 392 U.S. 157 (1968).

[3] *Southwestern Cable* at 178.

[4] 47 U.S.C. 201.

[5] 47 U.S.C. 202.

[6] 47 U.S.C. 251(a) (establishing general duties of common carriers) and 251(c)(2) and (3) (relating to duties of incumbent local exchange carriers). *See also* 47 U.S.C. 201(a) (requiring nondiscriminatory access).

services over cable connections to address the legal status of such services under the Communications Act of 1934, as amended.[7] In the *Declaratory Ruling*, the Commission determined 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."[8] By classifying cable modem service as an information service and not a telecommunications service or a composite service that combines an information service and a telecommunications service, the Commission precluded the mandatory application of the requirements imposed on common carriers under Title II of the Communications Act, thus allowing the provision of such services to develop with relatively few regulatory requirements.

In making the determination that cable modem services are information services and not telecommunications services, the Commission first looked to the relevant statutory definitions of each as established by the Telecommunications Act of 1996.[9] In enacting the Telecommunications Act of 1996, Congress codified a definitional distinction between "telecommunications" (and "telecommunications service") and "information service." "Telecommunications" is defined under the act as 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 or received."[10] "Information service", on the other hand, is defined as the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing or making available information via telecommunications."[11] Noting that the statutory definitions are based on the functions that are made available with the service rather than the facilities used to provide the service, the Commission then examined the functions that cable modem service makes available to its end users.[12]

Citing its determination in an earlier proceeding that Internet access service in general should be classified as an information service, the Commission found that since cable modem service is "an offering of Internet access service," it must also be an information service.[13] The Commission stated that "cable modem service is a single, integrated service that enables the subscriber to utilize Internet access service

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[7] *In the Matter of Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, 17 FCC Rcd. 4798 (March 15, 2002).

[8] 17 FCC Rcd. 4798, 4799.

[9] 17 FCC Rcd. at 4820.

[10] 47 U.S.C. 153(43). "Telecommunications service" is 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." 47 U.S.C. § 153(46).

[11] 47 U.S.C. 153(20)(emphasis added).

[12] 17 FCC Rcd. at 4821.

[13] *Id* at 4822. *See also In the Matter of Federal-State Joint Board on Universal Service*, 13 FCC Rcd. 11501 (April 10, 1998).

through a cable provider's facilities and to realize the benefits of a comprehensive service offering."[14] The Commission rejected the notion that cable modem service included an "offering of telecommunications service to a subscriber," conceding that while the service was provided "via telecommunications," the telecommunications component was not "separable from the data-processing capabilities of the service."[15]

Ninth Circuit's Decision

The Ninth Circuit determined that the question before it was whether its prior interpretation of the Telecommunications Act controlled review of the Commission's decision regarding the classification of cable modem service.[16] Three years prior, in *AT&T v. City of Portland*, a three judge panel of the Ninth Circuit determined that cable modem service was not a cable service, but was both an information and a telecommunications service.[17] In the *Brand X* case, the court held that it was bound to follow its own precedent regarding the classification of cable modem service rather than apply the two-part test set forth by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* for reviewing an agency's interpretation of a statute it is charged with administering.[18] Thus, the court in the *Brand X* case vacated the part of the Commission's *Declaratory Ruling* regarding the classification of cable modem service as an information service.[19]

Supreme Court's Decision

The Court began its decision with the conclusion that *Chevron*'s framework should be used to evaluate the Commission's interpretation of the statute and that the Ninth Circuit should have also applied *Chevron*, rather than following its own construction of the statute in the *Portland* case.[20] In *Chevron*, the Court held that "ambiguities in statutes within an agency's jurisdiction to administer are delegations of authority to the agency to fill the statutory gap in a reasonable fashion."[21] If the Court determines that the statute is ambiguous and the agency's interpretation of the statute is reasonable, "*Chevron* requires a federal court to accept the agency's

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[14] *Id.*

[15] *Id.* at 4823.

[16] *Brand X Internet Services v. Federal Communications Commission*, 345 F.3d 1120 (9th Cir. 2003).

[17] 216 F.3d 871 (9th Cir. 2000).

[18] 345 F.3d 1120, 1132. *See* discussion of Supreme Court's decision in *Brand X infra* regarding the two-part test established in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

[19] *Id.*

[20] Slip Op. at 8.

[21] *Id*, citing *Chevron*, 467 U.S. at 865-866.

construction of the statute, even if the agency's reading differs from what the court believes is the best statutory interpretation."[22]

The Ninth Circuit's decision not to apply *Chevron* in favor of the "conflicting construction of the [Communications] Act it had adopted in *Portland*" was based on an "incorrect" assumption.[23] According to the Supreme Court, the Ninth Circuit incorrectly assumed that its construction "overrode the Commission's regardless of whether *Portland* had held the statute to be unambiguous."[24] However, the Supreme Court noted that "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[25]

After determining that the Ninth Circuit erred in applying its own construction of the act, the Court moved to its *Chevron* analysis.[26] As to the statute's ambiguity, the Court first looked to the definitions of "telecommunications service" and "telecommunications" in the Telecommunications Act of 1996.[27] The Court determined that while "cable companies in the broadband Internet service business 'offe[r]' consumers an information service in the form of Internet access and they do so 'via telecommunications,'" it does not "inexorably follow as a matter of ordinary language that they also 'offe[r]' consumers the high-speed data transmission (telecommunications) that is an input used to provide this service."[28] Restating the principle established in *Chevron*, the Court stated that "where a statute's plain terms admit of two or more reasonable ordinary usages, the Commission's choice of one of them is entitled to deference," and concluded that the use of the term "offer" in the definition of "telecommunications service" was ambiguous in such a way as to admit two or more reasonable ordinary usages.[29]

After determining that the statute was ambiguous as to the classification of cable modem service, the Court then applied the second step of the *Chevron* analysis

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[22] *Id*, citing *Chevron* at 843-844.

[23] Slip Op. at 10.

[24] *Id*.

[25] *Id*.

[26] Slip Op. at 14.

[27] Slip Op. at 16. *See* n.12, *supra*.

[28] Slip Op. at 17.

[29] Slip Op. at 17 - 18. With respect to the ambiguity of the term "offer," the Court went on to say:

> Because the term "offer" can sometimes refer to a single, finished product and sometimes to the "individual components in a package being offered" (depending on whether the components "still possess sufficient identity to be described as separate objects"), the statute fails unambiguously to classify the telecommunications component of cable modem service as a distinct offering. This leaves federal telecommunications policy in this technical and complex area to be set by the Commission, not by warring analogies. Slip Op. at 20.

to determine whether the Commission's interpretation was "a reasonable policy choice for the Commission to make."[30] The respondents in the case argued that the Commission's construction was unreasonable because "it allows any communications provider to 'evade' common-carrier regulation [under Title II] by the expedient of bundling information service with telecommunications."[31] The Court rejected this argument, stating that it did not "believe that these results follow from the construction the Commission adopted."[32] The Court went on to articulate its interpretation of the Commission's construction:

> As we understand the *Declaratory Ruling*, the Commission did not say that any telecommunications service that is priced or bundled with an information service is automatically unregulated under Title II. The Commission said that a telecommunications input used to provide an information service that is not "separable from the data-processing capabilities of the service" and is instead "part and parcel of [the information service] and is integral to [the information service's] other capabilities" is not a telecommunications offering.[33]

The Court also rejected the respondent's argument that cable modem service provided simply the ability to transmit information. In so doing, the Court noted that the Internet access provided by the cable modem service allowed consumers to have access to DNS service (allowing them to reach third-party websites), the World Wide Web, electronic mail, remote terminal access, and file transfer capabilities, which effectively provides the "capability for . . . acquiring, storing . . . retrieving and utilizing . . . information" inherent in the definition of an information service.[34] The Court therefore concluded that the Commission's construction was reasonable.[35]

The Court also rejected respondent MCI, Inc.'s argument that the Commission's treatment of cable modem service is inconsistent with its treatment of DSL service, and is therefore "an arbitrary and capricious deviation from agency policy in violation of the Administrative Procedures Act.[36] The Court concluded that the Commission provided a "reasoned explanation for treating cable modem service differently from DSL service," and that "the Commission is free within the limits of reasoned interpretation to change course if it adequately justifies the change."[37]

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[30] Slip Op. at 25, citing 467 U.S. at 845.

[31] *Id.*

[32] Slip Op. at 26.

[33] Slip Op. at 26, citing *Declaratory Ruling*, *supra* note 7.

[34] Slip Op. at 28, quoting 47 U.S.C. 153(20).

[35] Slip Op. at 29.

[36] Slip Op. at 20. *See* 5 U.S.C. 706(2)(A).

[37] *Id.*

Legal Implications

The Court's reversal of the Ninth Circuit's decision effectively revives the Commission's *Declaratory Ruling* classifying cable modem service as an information service. As such, cable operators providing broadband internet access are currently not subject to the myriad of regulatory requirements mandated under title II of the act. Most notably, providers of cable modem services are not obligated to provide unaffiliated internet service providers access to their broadband platforms. In addition, providers of cable modem services remain free, at this point, from provisions governing discrimination in the provision of services; universal service support; assistance to law enforcement in the interception of communications made over the network; network accessibility to individuals with disabilities; and the protection of subscriber information.

Moreover, the Commission's classification of cable modem service as an information service appears to limit the scope of state and local regulatory authority over such services. Regulatory requirements and fees imposed on cable operators by localities pursuant to the franchising authority conferred under title VI of the act are apparently applicable only to the provision of "cable services."[38] Classification of cable modem service as an "information service" appears to preclude the imposition of such requirements on cable operators' broadband internet offerings.[39]

The question remains however, whether the FCC can and will impose certain regulatory requirements on the provision of cable modem service pursuant to its authority under title I of the act. In *Brand X*, the Court expressly acknowledged the existence of such authority and the possibility that the Commission might "impose special regulatory duties on facilities-based ISP's under its Title I ancillary jurisdiction." The FCC is currently examining whether and which of such duties should be imposed as part of two proceedings pending before it.[40]

Implications for Competition Policy

Since the *Brand X* decision upholds the FCC's classification of cable modem service as an information service, subject to relatively few regulatory requirements, it does not change the status quo. It is likely, however, to spur follow-on FCC activity on the classification of DSL service and also may affect the current debate about modifying the Communications Act.

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[38] See e.g. 47 U.S.C. § 542 (limiting application of franchise fees to a percentage of revenue derived from the provision of "cable services.").

[39] See 47 U.S.C. § 544(b)(prohibiting local franchising authority, in its request for franchises and franchise renewal proposals, from establishing requirements for "video programming or other information services.").

[40] *See* 17 FCC Rcd at 4839-4840; *see also Matter of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 17 FCC Rcd 3019 (Notice of Proposed Rulemaking examining, in part, the Universal Service obligations of broadband providers).

DSL service currently is treated as having a telecommunications service component and therefore is subject to the access and other requirements in Title II of the act. The FCC, however, already has tentatively concluded that DSL-based Internet access service is an information service.[41] When the *Brand X* decision was announced, FCC Chairman Kevin Martin issued a press release stating: "This decision provides much-needed regulatory clarity and a framework for broadband that can be applied to all providers. We can now move forward quickly to finalize regulations that will spur the deployment of broadband services for all Americans." Similarly, Commissioner Kathleen Abernathy stated: "Now that the Court has resolved lingering uncertainty regarding the regulatory treatment of cable-based Internet access services, I am hopeful that the Commission will act quickly to establish a similarly forward-looking approach for competitive wireline xDSL services." Industry observers expect Chairman Martin to seek expeditious Commission action to rule that DSL-based Internet access services also are information services. Observers expect that even if the other commissioners have some concerns about a relaxed regulatory regime, those concerns might be outweighed by the desire to provide regulatory neutrality between cable modem and DSL service.

But there continues to be a policy debate about the best regulatory framework for fostering investment and innovation in both the physical broadband network and in the applications (services) that ride over that network. The physical network providers (local exchange carriers and cable system operators) argue that they will be discouraged from undertaking costly and risky broadband network build-outs and upgrades if their networks are subject to open access and/or non-discrimination requirements that might limit their ability to exploit vertical integration efficiencies or to maximize the return on (or even fully recoup) their investments. On the other hand, the independent applications providers argue that in order for them to best meet the needs of end-users and offer innovative services in competition with the vertically integrated network providers — and, in some cases, services not offered at all by network providers — they must have the same unfettered open access to the physical networks that the network providers enjoy or, at the least, be protected by non-discrimination rules. Similarly, many end-users argue that their broadband network providers should not be allowed to restrict their usage of the broadband network as long as they do not in any way compromise the integrity of the network.

There are four general approaches to the regulation of broadband network providers vis-a-vis independent applications providers: structural regulation, such as open access; ex ante non-discrimination rules; ex-post adjudication of abuses of market position, as they arise, on a case-by-case basis; and non-mandatory principles as the basis for self regulation. Open access generally refers to a structural requirement that would prevent a broadband network provider from bundling broadband service with Internet access from its own in-house ISP. The basic principle behind a network non-discrimination regime is to give users the right to use non-harmful attachments or applications, and give innovators the corresponding

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[41] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers, Notice of Proposed Rulemaking*, 17 FCC Rcd 3028 and 3030.

freedom to supply them — so long as the integrity of the network is not affected. Ex post adjudication of abuses of market position would place the burden of proof on a complainant that any restrictions imposed by a broadband provider on access to its network is harmful to consumers. Non-mandatory principles, such as the Four Internet Freedoms articulated by former-FCC chairman Michael Powell,[42] would leave access relationships entirely to the market place, on the assumption that it is platform providers' own self interest to minimize restrictions. Some observers have suggested that the appropriate level of regulation on broadband network providers may depend upon whether a viable third broadband platform option — most likely wireless — becomes available to independent applications providers and end-users.[43]

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[42] These are Freedom to Access Content, Freedom to Use Applications, Freedom to Attach Personal Devices, and Freedom to Obtain Service Plan Information. *See* Remarks of Michael K. Powell, Chairman, Federal Communications Commission, at the Silicon Flatirons Symposium on "The Digital Broadband Migration: Toward a Regulatory Regime for the Internet Age," University of Colorado School of Law, February 8, 2004.

[43] *See*, e.g., Christine Vestal, "Wireless Is Key to Post-*Brand X* Broadband Competition, FCC Staffers Say," *Communications Daily*, June 30, 2005, at pp. 2-4; Dinesh Kumar, "Utilities Set to Benefit from *Brand X* Ruling, BPL Officials Say," *Communications Daily*, June 30, 2005, at pp. 5-6.