FCC – IN THE TWILIGHT ZONE

The recent Verizon vs FCC Appeals Court net neutrality decision has put the FCC in a regulatory twilight zone, reports **JONATHAN JACOB NADLER**

In Verizon vs Federal Communications Commission, the United States Court of Appeals for the District of Columbia Circuit (DC Circuit) held that the US Federal Communications Commission (FCC) has broad authority to regulate the internet, but nevertheless struck down most of the network neutrality rules that the agency had adopted. The court, in an opinion by Judge David Tatel, ruled that:

- The FCC reasonably concluded that if broadband providers (such as Comcast and Verizon) can block edge providers (such as Amazon and Google) from being able to access end users, or can provide access to edge providers on discriminatory terms, edge providers will be deterred from investing in and developing content, services and applications which, in turn, will dampen end-user demand for internet-based offerings which, ultimately, will deter investment in broadband network infrastructure.
- The FCC has legal authority to regulate the commercial relationship between broadband providers and edge providers in order to remove barriers to investment in broadband network infrastructure.
- However, the FCC's decision to prohibit broadband providers from blocking or unreasonably discriminating against edge providers was unlawful because it contravenes the statutory prohibition against imposing 'common carrier' obligations on providers of 'information services'.

The court therefore vacated the FCC's anti-blocking and anti-discrimination rules, leaving in place only rules requiring broadband providers to disclose their network management practices.

The DC Circuit's decision leaves the FCC in a regulatory twilight zone. While the agency has broad authority to regulate the internet, it cannot adopt the regulations that would most effectively achieve its goal of preserving an 'open' internet.

THE FCC OPEN INTERNET ORDER

In the December 2010 Open Internet Order, the FCC found that the existence of an open internet promotes *"a virtuous circle of innovation in which new uses of the network... lead to increased end-user demand for broadband, which drives network improvements, which in turn lead to further innovative network uses"*. The agency further determined that "the openness of the internet... faces real threats". Specifically, the FCC found that broadband providers have the ability and incentive to: (1) block or discriminate against edge providers that offer services and applications that compete against services and applications offered by the broadband providers; (2) charge edge providers for access (or prioritised access) to end users in order to generate additional revenue; and (3) degrade the quality of the service that they provide to edge providers that decline to pay for prioritised access.

Given these concerns, the FCC adopted three 'Open Internet Rules', which the agency stated were "grounded in broadly accepted internet norms":

- **Transparency.** Broadband providers must disclose information regarding their network management practices, performance, and the commercial terms of their broadband services.
- **No blocking.** Fixed broadband providers (such as digital subscriber line (DSL), cable modem, or fixed wireless providers) may not block lawful content, applications, services, or non-harmful devices. Mobile broadband providers may not block lawful websites, or applications that compete with their voice or video telephony services.
- **No unreasonable discrimination.** Fixed broadband providers may not unreasonably discriminate in transmitting lawful network traffic.

The rules effectively require broadband providers to deliver all edge provider traffic to the end users at the same speed, without imposing any form of termination charge, thereby transforming current market practices into permanent regulatory obligations.

Because the Communications Act does not expressly authorise the FCC to regulate the internet, much less the relationship between broadband providers and edge providers, the FCC needed to identify a source of statutory authority to adopt these rules. The agency placed primary reliance on Section 706 of the Telecommunications Act of 1996, which substantially amended the Communications Act of 1934.

Section 706(a) provides: *"The Commission... shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans... by utilising... measures that promote*

competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment."

Similarly, Section 706(b) directs the FCC to *"take immediate action... [to] remov[e] barriers to infrastructure investment"* and *"promot[e] competition in the telecommunications market"* if it finds that *"advanced telecommunications capability is [not] being deployed to all Americans in a reasonable and timely fashion"*. The statute makes clear that 'advanced telecoms capability' includes broadband service.

VERIZON VS FCC

While the majority of broadband providers accepted the FCC's Open Internet Order, Verizon – the fourth largest US broadband provider, with approximately nine million broadband subscribers – launched an aggressive judicial challenge. Verizon made three basic arguments. First, the FCC lacks statutory authority to regulate broadband providers' carriage of internet traffic. Second, even if the FCC has statutory authority, it did not adequately justify the rules that it adopted. And, third, the anti-blocking and anti-discrimination rules contravene the express statutory prohibition on the FCC imposing common carrier regulation on entities that are not providing a "telecommunications service". The DC Circuit firmly rejected the first two arguments, but accepted the third.

STATUTORY AUTHORITY. The court concluded that Section 706 of the Telecommunications Act, "furnishes the Commission with the requisite affirmative authority to adopt" net neutrality rules. The court's decision represents a significant change in the law. In 1998, the FCC concluded that Section 706 was not an "independent grant of authority" to adopt regulatory methods that went beyond those expressly provided for in the Communications Act. Based on that decision, the DC Circuit subsequently struck down an FCC order, grounded on Section 706, governing Comcast's internet traffic management practices. However, in the Verizon case, the court found that the FCC had expressly repudiated its prior position and had provided a reasonable explanation as to why Section 706 gives it the power to adopt regulations governing broadband providers' management of internet traffic.

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The court's decision appears to provide the FCC with very broad authority to use Section 706 to regulate the internet. Indeed, the court was able to identify only two "limiting principles" within Section 706. First, the FCC's exercise of its authority under this provision must be within the agency's "subject matter" jurisdiction. The court concluded that regulation of the internet "falls comfortably within the Commission's jurisdiction over 'all interstate and foreign communications by wire or radio'". Second, any regulation that the FCC adopts pursuant to Section 706 "must be designed to achieve [the statutory] purpose: to 'encourage the deployment... of advanced telecommunications capability to all Americans". This, of course, is really no limit at all. Rather, it is a remarkably broad grant of authority for the FCC to impose any regulation on broadband providers – other than one expressly prohibited elsewhere in the Communications Act – that the FCC can plausibly contend will promote broadband deployment.

JUSTIFICATION. The court also found that the FCC had adequately explained why adopting the Open Internet Rules would achieve the statutory purpose of encouraging broadband deployment. While the connection between internet openness and broadband deployment is a bit attenuated, the court concluded that the FCC had "more than adequately supported and explained its conclusion" that a "virtuous cycle" exists in which "internet openness fosters edge provider innovation" and "edge provider innovation leads to an expansion and improvement of broadband infrastructure". The court further found that the FCC had adequately supported its determination that broadband providers have both the ability and incentive to block or discriminate against edge providers, thereby impeding this "virtuous cycle". The court appears to have been especially persuaded by evidence that most end users cannot easily switch to another broadband provider if their current provider blocks or degrades access to specific edge providers. Finally, the court observed that the FCC had found that "the threat that broadband providers would... restrict edge provider traffic is not... 'merely theoretical'". Rather, the court noted, the FCC had "pointed to four prior instances in which they had done just that".[1]

The court also rejected Verizon's claim that the Open Internet Rules were "arbitrary and capricious" because they would have "the opposite of their intended effect" by deterring – rather than promoting – broadband investment. Verizon's argument has considerable force. At a minimum, the notion that restricting broadband providers' ability to generate additional revenue by imposing charges on edge providers will increase their incentive to deploy infrastructure is counter-intuitive. However, the court deferred to the FCC's predictive judgment, which was buttressed by evidence that similar restrictions had not discouraged broadband investment.

COMMON CARRIER REGULATION. While the court found that "section 706 grants the Commission authority to promote broadband deployment by regulating how broadband providers treat edge providers", and that the agency had reasonably concluded that its Open Internet Rules would promote broadband deployment, the court nonetheless struck down the anti-discrimination and the anti-blocking rules on the grounds that they impermissibly imposed common carrier regulation on information service providers.

The court's decision reflects a long-standing feature of US telecoms law. Since 1980, the FCC has distinguished between services that involve the 'pure' transmission of information (originally known as basic services) and those that use telecoms to provide customers with the ability to access, generate, or transform information (originally known as enhanced services). The Telecommunications Act codified this distinction, but used the terms 'telecommunications' and 'information' services.[2] The Act further mandates that a "telecommunications carrier" may only "be treated as a common carrier... to the extent that it is engaged in providing telecommunications services". Thus, to the extent that a carrier is providing an information service, the FCC cannot impose common carrier regulation on it.

For more than a decade, the FCC has classified broadband access to the internet as an information service. Therefore, the court was required to determine whether the FCC's adoption of the anti-discrimination and anti-blocking rules constituted the imposition of common carrier regulation on broadband providers. The court recognised that the FCC may impose some restrictions on the terms and conditions on which a carrier provides service without being deemed to have imposed common carrier regulation. However, the court went on to state that "if a carrier is forced to offer service indiscriminately and on general terms," rather than being allowed to engage in "individualised bargaining and discrimination in terms", then "that carrier is being relegated to common carrier status". Applying this standard, the court found that the anti-discrimination and anti-blocking rules constitute the impermissible imposition of common carrier regulation on broadband providers.

ANTI-DISCRIMINATION RULES. The court had little difficulty concluding that the anti-discrimination rules impose common carrier regulation. The court noted that the prohibition "mirrors, almost precisely" the core common carrier requirement contained in Title II of the Communications Act, which prohibits a common carrier from engaging in any "unjust or unreasonable discrimination". Indeed, the prohibition on broadband provider discrimination actually goes well beyond the restriction typically imposed on common carriers. Regulated telephone companies, for example, are allowed to offer different grades of service, at different prices, so long as they provide each service to any requesting party on prices, terms and conditions that are "just and reasonable" and not unreasonably discriminatory. By contrast, as the court noted, the FCC would likely apply the anti-discrimination rule to bar broadband providers from adopting "paid priority" arrangements, in which an edge provider pays a higher fee in order to obtain preferential access to end users. As a result, broadband providers would be required to provide a single grade of service to all edge providers "at a price of $0".

ANTI-BLOCKING RULES. The court also ruled that the anti-blocking rules impermissibly impose common carrier regulation. These rules, the court observed, require broadband providers to offer "effectively usable" service to all edge providers at no charge. Because they deprive carriers of the ability to decide which edge providers' traffic to carry, and – in conjunction with the prohibition of paid priority arrangements – effectively set a "uniform price of zero", these rules preclude broadband

providers from engaging in individualised negotiations and discriminating among edge providers.

DISCLOSURE RULES. By contrast, the court found that the disclosure rules, which merely require broadband providers to disclose their network management practices, "do not constitute per se common carrier obligations". The court therefore allowed these regulations to remain in effect, while vacating the anti-discrimination and the anti-blocking rules.

Senior judge Laurence Silberman issued a partial dissent in which he opined that, while Section 706 is a grant of substantive authority, it does not provide a basis for the anti-discrimination and anti-blocking rules because the FCC had failed to identify a specific "barrier to investment" in broadband facilities, or any impediments to competition, that the rules would remove. Judge Silberman further opined that, because the agency did not conduct an analysis to determine whether broadband providers have market power in defined product and geographic markets, the agency had failed to demonstrate that broadband providers have the ability to act in a manner that would serve as a barrier to investment or impede competition.

POSSIBLE FCC RESPONSES

While the major broadband providers have publicly stated that they do not intend to change their existing practices, the court's decision leaves broadband providers free to take actions that would fundamentally alter the current open nature of the internet. For example, a broadband provider could block an edge provider that offers a competing service (such as VoIP or video programming) from using the broadband provider's network to deliver the service to end-users; require an edge provider to pay a significant charge to have its traffic delivered to end users; or relegate some edge providers to an internet 'slow lane'.

There are at least six possible ways in which the FCC may respond to the DC Circuit's decision.

APPEAL. The FCC could ask the Supreme Court to reverse the DC Circuit's decision. While the Supreme Court is not legally obligated to hear the case, given the importance of the issue the Court would be likely to do so. However, the FCC might not want to go this route for several reasons. First, trying to get the Supreme Court to reverse the DC Circuit's finding that the Open Internet Order imposes common carrier regulation on broadband providers would be an uphill battle. Second, the Court might well go further and rule that the agency has limited or no authority to regulate the internet. And, third, because the Court would be unlikely to rule before mid-2015, appealing would create an extended period of regulatory uncertainty, during which it would be difficult for the agency to take any action in this area.

WAIT-AND-SEE. The FCC could accept the decision and see how the major broadband providers respond. Perhaps, as they have initially indicated, they will not make any changes to their existing network management practices. However, it is hard to understand why Verizon would invest significant resources to overturn the FCC's Open Internet Rules if it did not intend to take some action that would not have been allowed under those rules. Of course, Verizon or one of the other broadband providers might offer new services for which there is consumer demand, such as ultra-high-speed video streaming. Or broadband providers could take actions – such as blocking access of an edge provider that offers a competing service – that would strengthen the case for legislative or regulatory action to preserve the openness of the internet.

NET NEUTRALITY LITE. Another possibility is that the FCC will try to use the DC Circuit's conclusion that Section 706 provides authority for the agency to regulate the relationship between broadband providers and edge providers as a basis on which to develop more narrowly crafted net neutrality rules. The court upheld the FCC's disclosure rules. Therefore, the agency clearly could take actions to ensure that broadband providers disclose to end users any instance in which they blocked access or provided access on discriminatory terms. The FCC could go further, and actively publicise instances in which a broadband provider took such actions.

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The FCC also might try to adopt new anti-blocking rules. The court went out of its way to suggest that, in the absence of an anti-discrimination requirement, the agency might be able to adopt a rule that requires broadband providers to offer a minimum level of access – presumably at no charge – to all edge providers, so long as it allowed broadband providers to negotiate 'priority access' agreements with other edge providers, on whatever terms the two parties agreed. Such a rule, the court suggested, might "leave sufficient 'room for individualised bargaining and discrimination in terms' so as not to run afoul of the statutory prohibitions on common carrier treatment". Such a rule, of course, would leave smaller edge providers that could not afford to pay for prioritised access, or competing edge providers that would not be allowed to do so, at a significant disadvantage, while likely sparking another round of litigation.[3]

The FCC also could seek to impose net neutrality requirements on a case-by-case basis as a condition of any mergers that the agency approves. The FCC previously used this approach when it approved the merger of Comcast and NBC Universal.

RECLASSIFICATION. The DC Circuit's decision makes clear that, so long as the FCC classifies access to the internet over a broadband network as an information service, the agency cannot impose common carrier regulation. However, if the FCC were able to reclassify broadband internet access as a telecoms service, no legal impediment would appear to exist to using Section 706 to impose anti-discrimination and anti-blocking rules on broadband providers. The FCC will doubtless give serious consideration to going down this road.

There is precedent for this approach. In 1998, the FCC ruled that telephone companies that provided broadband internet access using DSL technology were actually offering two services: broadband transmission and internet access. The former, the agency ruled, was a telecoms service, while the later was an information service. The agency further ruled that if local facilities-based telephone companies chose to offer a DSL-based internet access service, they were obligated to unbundle the DSL transmission service and offer it to competing information service providers on a non-discriminatory basis. Four years later, however, the FCC changed course, ruling that cable system operators that offered a broadband internet access services were providing a "single integrated information service" and were not obligated to unbundle the transmission component and provide it

on a non-discriminatory basis. The agency subsequently extended this approach to broadband internet access services provided over wireline telephone networks, mobile networks, and other transmission media.

If the FCC wants to re-impose the Open Internet Rules on broadband providers, it would need to find a sound basis on which to conclude that, contrary to its prior determination, broadband providers are providing two separate services: internet connectivity (which is a telecoms service) and internet applications (which are information services). Any effort to do so, however, would be likely to provoke a firestorm of industry opposition, which would divert attention from the many other goals that the FCC's new chairman, Tom Wheeler, wants to achieve during his time in office.

The FCC also would need to tackle a broad array of complex technical and legal questions. In particular, the agency would need to determine exactly what features and functions would be considered to be part of the broadband providers' regulated internet connectivity service. In addition, it would have to decide the extent to which it would apply the large number of common carrier requirements contained in Title II of the Communications Act, and the extent to which it should use its statutory authority to 'forebear' from applying certain requirements.[4]

Reclassification could also have international implications. In its bilateral trade negotiations, and its participation in multilateral organisations such as the ITU, the US has long opposed the application of traditional telecoms regulation to the internet. Indeed, US concerns that governments might impose 'legacy regulation' on the internet led the US (and many of its allies) to oppose the attempt, during the World Conference on International Telecommunications in Doha, to extend the ITU's jurisdiction to include the internet. FCC reclassification of broadband internet access as a telecoms service subject to common carrier regulation would significantly undercut the US's global position.

VOLUNTARY COMMITMENTS. A different approach – and one that might have particular appeal to chairman Wheeler – would be for the FCC to try to foster the adoption of a voluntary industry code of conduct. This could include some principles on which there is broad agreement, such as disclosure requirements for a prohibition on blocking access to lawful content, while providing industry with some flexibility to try new business models. For example, broadband providers could be allowed to offer tiers of service, provided they offered a free basic tier that would meet the needs of most edge providers, and that they allowed any edge provider that wanted to purchase a higher-speed access service to do so on terms that are not unreasonably discriminatory. Of course, this approach would require significant compromises by parties that have often taken absolutist positions regarding net neutrality.

PROMOTE COMPETITION. Finally, the FCC could seek to promote competition in the internet access market. For example, the agency could continue to classify broadband internet access service as an information service, but – as it initially did with DSL-based internet access service – require facilities-based broadband internet access providers to offer the underlying connectivity services on a non-discriminatory basis, thereby fostering service-based competition. The FCC also could seek to increase facilities-based competition in the broadband internet market, especially competition by wireless providers.

Finally, the FCC could take actions to make it easier for consumers to switch from one broadband provider to another. If successful, this approach would create what information service providers historically wanted: a vibrantly competitive internet access market in which limited (or no) FCC regulation is necessary.

INTERNATIONAL IMPLICATIONS

Governments and regulators around the world are grappling with the question of how best to regulate the internet. For example, the European Union is currently considering the Connected Continent legislative package, which would promote net neutrality by prohibiting the blocking or throttling (intentional slowing) of internet traffic, while allowing broadband providers to offer different qualities of service to edge providers.

The DC Circuit's findings regarding the benefits of an open internet, and the ability and incentive of broadband providers to restrict access, are applicable in almost all countries. At the same time, the court struck down the FCC's rules based on a unique aspect of US law: the prohibition against imposing common carrier regulation on information services providers. Consequently, the court's decision could actually encourage some countries to adopt net neutrality rules.

Of course, in other countries the court's decision could have the opposite effect. Eliminating the prohibition on blocking access to internet sites could embolden governments to increase restriction on internet access, while making it harder for the US to effectively press for greater internet openness.

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REFERENCES

Core sources: Verizon vs Federal Communications Commission, No. 11-1355 (DC Cir. Jan. 14, 2014). Preserving the Open Internet, Report and Order, 25 FCC Rcd, 17905, 2010. ('Open Internet Order').

1 This includes Comcast's blocking of a peer-to-peer filing sharing services which, ironically, had been the subject of the prior DC Circuit decision holding that the agency had failed to demonstrate that it had statutory authority to regulate broadband providers' internet traffic management practices. **2** 'Telecommunications' is defined 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 and received". By contrast, 'information services' are defined as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilising, or making available information via telecommunications..." **3** Silberman, SJ dissenting – contending that the minimum access service would be subject to common carrier regulation because the FCC would require that it be offered "at a regulated price of zero". **4** The FCC considered these issues prior to adopting the Open Internet Order, but ultimately chose not to try to reclassify internet access as a telecommunications service. See Framework for Broadband Internet Service, Notice of Inquiry, 25 FCC Rcd 7866 7893, 2010.