

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Appropriate Regulatory Treatment for	)	CS Docket No. 02-52
Broadband Access to the Internet Over	)	
Cable Facilities	)	

**COMMENTS OF THE NATIONAL CABLE &  
TELECOMMUNICATIONS ASSOCIATION**

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The National Cable & Telecommunications Association (“NCTA”) hereby submits its comments on the Notice of Proposed Rulemaking in the above-captioned proceeding.

NCTA is the principal trade association representing the cable television industry in the United States. Its members include cable operators serving more than 90% of the nation’s cable television subscribers. Cable operators are rapidly introducing high-speed access to the Internet over cable facilities (“cable modem service”) – the subject of this proceeding – and currently provide such service to more than eight million customers throughout the nation. NCTA’s members also include companies operating more than 200 cable program networks, as well as providers of other services and equipment to the cable industry.

**INTRODUCTION AND SUMMARY**

On March 14, 2002, the Commission adopted a Declaratory Ruling that cable modem service is neither a “cable service” nor a “telecommunications service,” but is an interstate “information service,” as those terms are defined by Section 3 of the Communications Act of 1934, as amended, 47 U.S.C. § 153. The Commission also concluded that cable modem service includes “no separate

telecommunications service offering to subscribers or ISPs.”<sup>1</sup> In this rulemaking proceeding, the Commission seeks to determine the regulatory implications of its rulings. Specifically, what is the scope of the Commission’s authority to regulate – and to preempt state and local regulation of – this interstate information service? And, to the extent that it has such authority, how and to what extent should the Commission exercise it?

Because, as the Commission has held, cable modem service is an interstate information service but not a cable service or a telecommunications service, the Commission’s “ancillary jurisdiction” to regulate it is narrowly constrained. Any regulation must be necessary to further a statutory policy or regulatory mandate, and it may not be inconsistent with any provision of the Communications Act. It is hard to see how a requirement that cable operators allow multiple Internet service providers (“ISPs”) to access their systems would meet either prong of this test.

Forced access is not necessary to achieve, nor would it promote, any statutory task of the Commission. Moreover, it is flatly at odds with the statutory “policy of the United States . . . to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.”<sup>2</sup> Also, because a forced access requirement is likely to have the effects of stifling deployment of broadband facilities and diminishing the efficiency and increasing the cost of providing cable modem service to consumers, it

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<sup>1</sup> Declaratory Ruling and Notice of Proposed Rulemaking, GN Docket No. 00-185 and CS Docket No. 02-52, ¶33, released March 15, 2002 (“Notice”).

<sup>2</sup> 47 U.S.C. § 230(b).

would be directly inconsistent with the Commission's statutory mandate to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."<sup>3</sup>

Even if the Commission had jurisdiction to impose some sort of multiple access obligation on cable operators, it would be contrary to the public interest to do so. As explained by economist Bruce M. Owen in a paper accompanying these comments, the substantial costs of such regulation would outweigh any conceivable benefits. Wholly apart from the costs of enforcing a multiple access requirement, to the extent that such a requirement forced cable operators to offer cable modem service in a different and less efficient manner than they would otherwise choose, such service would be more costly to provide. Where facilities have not yet been deployed, these costs would deter investment and deployment. Where they have been deployed, the costs of regulation would inevitably affect the price and quality of service for consumers. In either case, the effect would be to suppress the ability of consumers to purchase this exciting new service.

While the costs of a multiple access requirement would be substantial, there would be virtually no countervailing benefits. Multiple access regulation is not necessary to remedy any market failure. Cable operators, who currently face vibrant facilities-based competition in the provision of high-speed Internet access service, are in no way "essential facilities." There is no evidence or reason to expect that cable operators, who are increasingly offering subscribers a choice of multiple ISPs, have any incentive or ability to exercise market power to exclude more efficient ISPs from the marketplace or to monopolize that marketplace. Nor is there any reason to believe that the forced carriage of multiple ISPs will do anything to promote the availability of additional facilities-based competitors.

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<sup>3</sup> Pub. L. No. 104-104, Title VII, § 706, Feb. 8, 1996, 110 Stat. 153, reproduced in the notes under 47 U.S.C. § 157 ("Section 706").

This cost-benefit analysis remains the same regardless of whether or not local exchange carriers and other non-cable providers of high-speed Internet access service are, for one reason or another, subjected to some form of mandatory multiple ISP access. There are many reasons why DSL and cable modem service are subject to different regulatory regimes, based on differences in their history, their technologies, and other factors. But, as Owen's paper explains, "regulatory parity" would be a poor reason to regulate cable modem service, regardless of the reasons for the current regulatory disparity. Consumer welfare would be diminished by such regulation, which would do nothing but raise the cost and lower the quality of cable modem service.

For all these reasons, it would similarly be contrary to the policies of the Communications Act and the public interest for state and local governments to impose access regulations or other substantive requirements on the provision of cable modem service. The Commission should confirm that a patchwork quilt of state and local rules and requirements would interfere with the rapid and efficient nationwide development of cable modem service and that such regulation is, therefore, preempted.

The Commission should also clarify that state and local governments have no authority to require franchised cable operators to obtain a separate franchise or pay additional fees in order to provide cable modem service. The provision of such service imposes no additional burden on, and requires no additional regulatory management of, municipal rights-of-way. Any fees imposed specifically on cable modem service are "franchise fees," and franchise fees generally may not be assessed on cable modem revenues. While fees imposed on all providers of information services may not be deemed "franchise fees," such fees are generally prohibited by the Internet Tax Freedom Act, which prohibits all fees and taxes on Internet services except franchise fees. In any event, even if separate franchises and fees were not otherwise barred, their imposition would severely frustrate the

nationwide development and deployment of cable modem service, so that preemption by the Commission would be warranted.

**I. THE COMMISSION’S ANCILLARY JURISDICTION TO REGULATE CABLE MODEM SERVICE IS NARROWLY CONSTRAINED AND DOES NOT EXTEND TO REQUIRING MULTIPLE ISP ACCESS.**

If the Commission had found cable modem service to be a telecommunications service or a cable service, its regulatory authority and responsibilities would have been established by the provisions of Title II or Title VI of the Act, respectively. But the Commission held that cable modem service is neither a telecommunications service nor a cable service but is an “interstate information service.” The Commission has no specific statutory mandate to regulate information services, and therefore it asks whether and to what extent it has any authority to regulate such services.

The Supreme Court made clear in United States v. Southwestern Cable, 392 U.S. 157, 173 (1968), that Title I of the Act gives the Commission general regulatory jurisdiction over “all interstate . . . communication by wire or radio.” But this general jurisdiction does not give the Commission unfettered authority to regulate all “communication by wire or radio” in any manner that it chooses. To the contrary, Title I – specifically, Section 4(i) – limits the Commission’s authority to “mak[ing] such rules and regulations and issu[ing] such orders, not inconsistent with this Act, as may be necessary in the execution of its functions.”<sup>4</sup>

Where, as in the case of information services, the Commission has no specific statutory responsibilities, its only jurisdiction under Title I is “ancillary jurisdiction” – that which, according to Southwestern Cable, is “reasonably ancillary to the effective performance of the Commission’s various

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<sup>4</sup> Id., § 154(i) (emphasis added).



responsibilities.”<sup>5</sup> Any regulation must be necessary to achieve one of its enumerated mandates. And it must not be inconsistent with any policy or provision of the Act.

Whether or not the Commission has such ancillary jurisdiction to regulate cable modem service cannot, therefore, be addressed and answered in the abstract without knowing what particular form of regulation is at issue. The principal form of regulation raised by the Commission is the imposition of a “multiple ISP requirement on cable operators.”<sup>6</sup> It is hard to see how imposing such a requirement would advance any of the Commission’s statutory responsibilities – the sine qua non of ancillary jurisdiction. To the contrary, such regulation of Internet services would be directly contrary to Federal policy, as expressly set forth in the Act.

**A. The Communications Act Mandates That Internet Services *Not* Be Regulated.**

At the outset, before even considering whether imposing a multiple ISP requirement on cable operators might be necessary to fulfill any statutory responsibilities of the Commission, the first question to ask is whether such a requirement would be inconsistent with any provisions of the Act. The answer is that it would.

In 1996, Congress added Section 230 of the Act, which explicitly established, as a matter of Federal policy, that the Commission *not* regulate Internet services. Congress mandated, in 1996, that “[i]t is the policy of the United States . . . to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State

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<sup>5</sup> United States v. Southwestern Cable Co., 392 U.S. 157, 178 (1968).

<sup>6</sup> Notice, ¶ 72.

regulation.”<sup>7</sup> While this policy mandate obviously does not override any statutory provision specifically authorizing or requiring regulation of Internet and interactive services, it weighs heavily against the exercise of ancillary jurisdiction to impose such regulation in the absence of such an express mandate. Unless, as the Supreme Court found to be the case in Southwestern Cable, the Commission’s exercise of regulatory authority “is imperative if it is to perform with appropriate effectiveness its other responsibilities,”<sup>8</sup> the Commission’s assertion of ancillary jurisdiction is, and should be, barred by the statutory policy against regulating Internet services.<sup>9</sup>

**B. Requiring Multiple ISP Access Is Neither Necessary nor Helpful To Fulfill Any Statutory Responsibility of the Commission.**

Recognizing that any ancillary jurisdiction must be tied to some specific statutory responsibility, the Commission seeks to identify “any explicit statutory provisions, including expressions of congressional goals, that would be furthered by the Commission’s exercise of ancillary jurisdiction over cable modem service.”<sup>10</sup> The Commission suggests some provisions upon which it might rely. But none of them provide a jurisdictional basis for imposing a multiple ISP access requirement on cable operators.

**1. Section 1.**

The Commission cites as a possible basis of ancillary jurisdiction Section 1 of the Act, which sets forth, as one of the Act’s broad, general purposes, “mak[ing] available, so far as possible, to all the

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<sup>7</sup> 47 U.S.C. § 230(b)(2) (emphasis added).

<sup>8</sup> 392 U.S. at 173 (emphasis added).

<sup>9</sup> See, e.g., L. Kennedy and L. Zallaps, “If It Ain’t Broke. . . The FCC and Internet Regulation,” 7 *CommLaw Conspectus* 17, 25 n.73 (1999). (“Although Congress did not expressly mandate that the Commission lacks ancillary jurisdiction over information services, section 154(i) still requires any ancillary jurisdiction of the Commission to be consistent with the Act. Congress did expressly mandate that Internet services would remain unfettered by federal and State regulation, and to regulate these services would be inconsistent with the Act.”)

people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.”<sup>11</sup> But Section 1 would be a thin reed upon which to rest ancillary jurisdiction, even if the proposed regulation arguably advanced those broad general purposes, and even if there were no countervailing specific statutory policy against regulating Internet services.

In none of the Supreme Court cases acknowledging the Commission’s ancillary jurisdiction over cable did the Court rely on Section 1 as a sufficient independent basis for regulation. Those cases, decided prior to the enactment of Title VI, all considered whether the Commission’s exercise of jurisdiction to regulate cable television systems was ancillary to its specific statutory responsibilities with respect to broadcasting, as set forth in Title III of the Act.

The Supreme Court never suggested that, merely because cable television involved “communication by wire,” the Commission had ancillary jurisdiction pursuant to Section 1 – and independent of its Title III responsibilities – to regulate cable for the sole purpose of promoting the “rapid, efficient, Nation-wide” availability of cable service “with adequate facilities at reasonable charges.” To the contrary, in United States v. Midwest Video Corp., (“Midwest Video I”),<sup>12</sup> the Court upheld the Commission’s jurisdiction to adopt a regulation requiring cable systems to provide locally originated programming only because it found that the regulation “preserves and enhances the integrity of broadcast signals” and therefore is “reasonably ancillary to the effective performance of the

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<sup>10</sup> Notice, ¶ 79.

<sup>11</sup> 47 U.S.C. § 151.

<sup>12</sup> 406 U.S. 649 (1972)

Commission's various responsibilities for the regulation of television broadcasting."<sup>13</sup> Subsequently, in FCC v. Midwest Video Corp., ("Midwest Video II"),<sup>14</sup> the Court confirmed that the Commission's ancillary jurisdiction over cable television, as established by Southwestern Cable and Midwest Video I, was "delimited by its statutory responsibilities over television broadcasting."<sup>15</sup>

Although the Supreme Court has never addressed the extent to which the Commission's ancillary jurisdiction might be based on specific statutory responsibilities under Title II as well as under Title III, lower courts have upheld the Commission's authority to regulate "enhanced services," "information services," and other non-Title II services when necessary to fulfill specific Title II responsibilities.<sup>16</sup> But the courts have also confirmed that ancillary jurisdiction must be grounded somewhere in the substantive titles of the Act and cannot be based solely on the broad language of Title I.

As the D.C. Circuit has noted, "While [Section 1] does set forth worthy aims toward which the Commission should strive, it has not heretofore been read as a general grant of power to take any action necessary and proper to those ends."<sup>17</sup> Accordingly, the court subsequently confirmed that "[t]he Commission's general jurisdiction over interstate communication and persons engaged in such communication . . . 'is restricted to that reasonably ancillary to the effective performance of [its] various

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<sup>13</sup> Id. at 670 (plurality opinion) (emphasis added). Indeed, in providing the necessary fifth vote for the Court's decision, Chief Justice Burger made clear that the Commission's jurisdiction rested solely on cable's effect on the relationship of cable to broadcasting and that the origination rules "strain[ed] the outer limits of even the open-ended and pervasive jurisdiction that has evolved by decisions of the Commission and the courts." Id. at 676 (Burger, C.J., concurring).

<sup>14</sup> 440 U.S. 689 (1979)

<sup>15</sup> FCC v. Midwest Video Corp., 440 U.S. 689, 698 (1979) ("Midwest Video II").

<sup>16</sup> See, e.g., CCIA v. FCC, 693 F.2d 198, 213 (D.C. Cir. 1982); GTE Serv. Corp. v. FCC, 474 F.2d 724, 731 (2d Cir. 1973).

<sup>17</sup> National Ass'n of Regulatory Utility Com'rs v. FCC, 533 F.2d 601, 613 n.77 (D.C. Cir.1976) (emphasis added).

responsibilities’ under titles II and III of the Act.”<sup>18</sup> Similarly, the Ninth Circuit has confirmed that “Title I is not an independent source of regulatory authority; rather, it confers on the FCC only such power as is ancillary to the Commission’s specific statutory responsibilities.”<sup>19</sup>

Even if the Commission could generally assert ancillary jurisdiction based solely on the broad policies of Section 1, such jurisdiction would not extend to imposing a multiple ISP requirement on providers of cable modem service – because, for reasons more fully discussed below, such a requirement would not actually promote those policies. As we will show, forced multiple ISP access would not be helpful, much less necessary or imperative, in making cable modem service available nationwide “with adequate facilities at reasonable prices.” Moreover, Congress itself determined, in Section 230, that a “vibrant and competitive free market . . . presently exists” for Internet services and that regulation of such services would not promote Federal communications policy.

But, in any event, the Commission need not reach these questions. Whatever statutory bases may exist for asserting ancillary jurisdiction over cable modem service as an interstate information service, the Commission cannot rely on Section 1 alone as a source of such jurisdiction.

## **2. Section 230(b).**

The Commission also cites Section 230(b) as a potential basis of ancillary jurisdiction over cable modem service.<sup>20</sup> But for reasons already discussed, Section 230(b) is, if anything, an insurmountable barrier to the assertion of such jurisdiction to regulate cable modem service. Section 230(b) establishes a Federal policy of leaving Internet services “unfettered by Federal or State

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<sup>18</sup> Southwestern Bell Telephone Co. v. FCC, 19 F.3d 1475, 1479 (D.C. Cir. 1994) (quoting Southwestern Cable, *supra*) (emphasis added).

<sup>19</sup> People of State of California v. FCC, 905 F.2d 1217, 1240 n.35 (9<sup>th</sup> Cir. 1990) (emphasis added).

<sup>20</sup> Notice, ¶ 79.

regulation.” It is hard to imagine how regulating cable modem service by imposing a multiple ISP requirement could be deemed ancillary to this deregulatory policy mandate.

### 3. Title VI.

The Commission asks whether it might base a claim of ancillary jurisdiction over cable modem service on its regulatory responsibilities under Title VI – specifically “the Title VI goal of assuring ‘that cable communications provide and are encouraged to provide the widest possible diversity of information sources and services to the public.’”<sup>21</sup> But none of the provisions of Title VI give the Commission any specific regulatory authority to promote the provision of services other than “cable services.” And there is no reason to believe that the language cited by the Commission was meant to refer to services other than “cable services.”

Indeed, Congress specifically made clear in the Cable Communications Policy Act of 1984, which added Title VI to the Communications Act, that Title VI was not meant to affect in any way the Commission’s jurisdiction to regulate non-cable services. To the contrary, Section 3(b) of the 1984 Act provides that

[t]he provisions of this Act and amendments made by this Act shall not be construed to affect any jurisdiction the Federal Communications Commission may have under the Communications Act of 1934 with respect to any communication by wire or radio (other than cable service, as defined in section 602(5) of such Act) which is provided through a cable system, or persons or facilities engaged in such communications.<sup>22</sup>

Thus, according to the legislative history, the 1984 Act was intended to “preserve[] the regulatory and jurisdictional status quo with respect to non-cable communications services.”<sup>23</sup> The

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<sup>21</sup> Id.

<sup>22</sup> Pub. L. No. 98-549, § 3, Oct. 30, 1984, 98 Stat. 2779, reproduced in the notes under 47 U.S.C. § 521.

<sup>23</sup> H.R. Rep. No. 98-934, 98<sup>th</sup> Cong., 2d Sess. 29 (1984) (emphasis added).

Commission cannot derive ancillary jurisdiction to regulate non-cable services provided over cable systems from a statutory provision specifically intended to have no jurisdictional effect on such services.

#### 4. Section 706.

Finally, the Commission asks whether Section 706 of the Telecommunications Act of 1996 might provide some basis for ancillary jurisdiction over cable modem service. Section 706 directs the Commission

to encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.<sup>24</sup>

Its purpose, according to the legislative history, is “to accelerate deployment of an advanced capability that will enable subscribers in all parts of the United States to send and receive information in all its forms – voice, data, graphics, and video – over a high-speed switched, interactive, broadband, transmission capability.”<sup>25</sup>

Reliance on Section 706 as a basis for regulating Internet services that are otherwise outside the scope of the regulatory provisions of the Act would turn Section 706 on its head. First of all, that provision is primarily a deregulatory provision, intended by Congress to facilitate investment in and deployment of broadband facilities through the removal of unnecessary regulatory impediments.<sup>26</sup>

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<sup>24</sup> Pub. L. No. 104-104, Title VII, § 706, Feb. 8, 1996, 110 Stat. 153, reproduced in the notes at 47 U.S.C. § 157.

<sup>25</sup> S. Rep. No. 104-23, 104<sup>th</sup> Cong., 1<sup>st</sup> Sess. 51 (1995).

<sup>26</sup> See, e.g., Statement of Senator Conrad Burns, Communications Subcommittee of the Commerce, Science and Transportation Committee Hearing on Section 706 and Related Broadband Issues, April 22, 1998 (“I authored Section 706, which directs the FCC and the State Public Utility Commissions to promote the deployment of advanced telecommunications capabilities through deregulatory measures” (emphasis added)).

Second, the Commission has repeatedly found that the best way to foster the goals of Section 706 is, in fact, by allowing the competitive marketplace to function with minimal regulation. Thus, in its third annual Section 706 Report, the Commission reaffirmed its determination that “‘competition, not regulation, holds the key to stimulating further deployment.’ . . . . We believe that a minimal regulatory framework will promote competition and thus encourage investment in advanced telecommunications capability.’<sup>27</sup>

Regulating cable modem service – and, in particular, requiring multiple ISP access – is not only not imperative but is wholly unnecessary to further the goals of Section 706. As the Commission has found,

advanced telecommunications is being deployed to all Americans in a reasonable and timely manner. We are encouraged that the advanced services market continues to grow, and that the availability of and subscribership to advanced telecommunications has increased significantly. We also conclude that although investment trends have slowed recently, investment in infrastructure for advanced telecommunications remains strong. We are also encouraged by technological and industry trends, which indicate that alternative and developing technologies will continue to be made available to consumers.<sup>28</sup>

As we show in Section II, below, a multiple ISP requirement will have precisely the sorts of adverse effects on consumers that Section 706 was intended to prevent while doing nothing to promote the availability of advanced telecommunications capabilities.

In short, Section 706 provides no basis for ancillary jurisdiction to regulate cable modem service. To the contrary, because such regulation would be inconsistent with its goals and mandates,

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<sup>27</sup> Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, Third Report, CC Docket 98-146, ¶ 133 (emphasis added) (quoting Second Report).

<sup>28</sup> Id., ¶ 1.



Section 706 is, like Section 230, a mandate not to regulate – and instead is a basis for preempting state and local regulation.

## **II. THE COSTS OF A MULTIPLE ISP REQUIREMENT WOULD BE PROHIBITIVE, AND THE BENEFITS WOULD BE ILLUSORY.**

Even if the Commission could somehow find a source of ancillary jurisdiction and a Constitutional justification<sup>29</sup> to impose a multiple ISP requirement on facilities-based providers of cable modem service, the harm that such a requirement would inflict on consumers would far outweigh any benefits.<sup>30</sup>

Replacing marketplace forces with regulation would impose costs and inefficiencies on cable operators that would deter investment and hinder deployment of cable modem service. These costs and inefficiencies would, in turn, make cable modem service more costly and/or less attractive to consumers, which would have the effect of artificially suppressing subscribership even where facilities are deployed and service is available. Moreover, regulation would impose substantial costs on the Commission.

Meanwhile, how such regulation could conceivably promote the deployment of facilities is hard to imagine. Already, as the Commission has found, deployment of facilities to provide high-speed Internet access is proceeding at a rapid pace. Requiring multiple ISP access would do nothing to

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<sup>29</sup> See Comcast Cablevision of Broward County, Inc. v. Broward County, 124 F. Supp. 2d 685 (S.D. Fla. 2000). See also Comments in GEN Docket No. 00-185 of NCTA at 38-39; Comcast Corporation at 26; Cox Communications at 47-51, and Reply Comments of NCTA at 3; Charter Communications at 34.

<sup>30</sup> For this reason, if, as the result of judicial proceedings, the Commission were to be required to treat cable modem service as a telecommunications service in certain jurisdictions, the Commission should exercise its authority under Section 10 of the Act, 47 U.S.C. § 160, to forbear from applying each provision of Title II or common carrier regulation. The Commission's tentative conclusion that the public interest would best be served by a uniform national policy with respect to this interstate service is correct, as is its belief that it would be inappropriate and counterproductive to regulate such a service while it is "still in its early stages." Notice, ¶ 95. The problems with regulation, as we show in this and the following section, go beyond the need for uniformity and the undesirability of regulating a nascent service. There are, as we show in this section and the next, serious and wholly foreseeable costs associated with imposing Title II-type regulation on cable modem service – and virtually no foreseeable benefits.

promote facilities-based competition. But facilities-based competition is, in any event, flourishing, so that there is every reason to believe that consumers nationwide will have a choice of providers.

Moreover, whatever reasons consumers may have for demanding a choice of providers, access to diverse content on the Internet is not one of them. Every provider of cable modem service offers its subscribers access to all content on the Internet. In any event, the facilities-based competition that has taken hold will ensure that if consumers do demand a choice of multiple ISP providers, the marketplace will provide such choice more efficiently than regulation. Cable operators are already offering or planning to offer a choice of ISPs on terms that are dictated by marketplace negotiations, technological considerations and consumer demand.

**A. A Mandatory Multiple ISP Access Requirement Would Impose Significant Costs on Consumers and on the Commission.**

Even if a multiple ISP access requirement were likely to produce significant benefits (which, as we will show, is not the case), any such benefits would have to be balanced against the substantial – and thoroughly predictable – harm to consumers that would such regulation would cause. In his attached paper, Bruce Owen of Economists Incorporated and Stanford University describes the multiple ways in which access regulation would impose significant costs and inefficiencies in the provision of cable modem service and the adverse effects that this would have on consumers. This should be familiar ground for the Commission, which has itself from the outset recognized that regulation of cable modem service would be a poor, costly and intractable substitute for marketplace forces and, to the extent permitted by law, should be avoided.

## 1. Access Regulation Is Sure To Impose More Than a “Light Touch.”

Three years ago, the Cable Services Bureau undertook a comprehensive review of the development of cable modem service and other broadband Internet services and concluded that the Commission’s policy of “vigilant restraint” was working to foster the rapid competitive deployment of such services.<sup>31</sup> In its report, the Bureau concluded that

[t]he notion of applying prophylactic “open access” measures – whether they be in the form of Title II, Title VI, or more simple unbundling regulations -- before fuller development of the broadband industry would be unsound public policy that could have the unintended effect of impeding the rapid development of this industry. The market is the only force, at this stage, that is sufficiently dynamic and informed to create a competitive broadband marketplace.<sup>32</sup>

The Bureau noted that a multiple access requirement, even if intended to be something less than Title II common carrier regulation, would inevitably result in a “very complex and burdensome” regulatory regime:

The Commission’s experience from implementation and enforcement of the Title II “non-discriminatory” interconnection and access requirements teaches us that a complex regulatory and tariffing scheme would likely accompany broadband access requirements. For instance, the seemingly simple dictate in section 251(c)(2) of the Communications Act, which requires ILECs to provide network interconnection and access by telecommunications carriers at any “technically feasible point” on “rates terms and conditions that are just, reasonable, and non-discriminatory,” has been the subject of complex and lengthy rulemakings and litigation.<sup>33</sup>

More recently, Chairman Powell has similarly warned that using regulation rather than the marketplace to ensure access to broadband facilities almost always results in a more complex and intrusive regulatory structure and process than its proponents predict or suggest:

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<sup>31</sup> “Broadband Today,” Staff Report of Cable Services Bureau, Oct. 1999.

<sup>32</sup> *Id.* at 44.

<sup>33</sup> *Id.* at 44-45.

When someone advocates regulatory regimes for broadband that look like, smell like, feel like common carriage, scream at them! They will almost always suggest it is just a “light touch.” Demand to see the size of the hand that is going to lay its finger on the market. Insist on knowing where it all stops. Require they explain who gets to make the key decisions – if it is enlightened regulators, rather than consumers and producers, walk out of the meeting.<sup>34</sup>

Owen confirms that regulating to ensure multiple access to facilities generally evolves into considerably more than a “light touch.” As he explains, “If ISP access is desirable from a consumer welfare perspective and yet would not otherwise be available . . . it must be that cable systems have very substantial market power in the relevant market, that alternatives are not available, that operators refuse to grant access, and that access would force cable operators to lower retail prices.”<sup>35</sup> As discussed above, Owen shows that none of those conditions applies. But if they did, “any regulation less intrusive than current DSL-type regulation would likely be ineffective.”<sup>36</sup> If the government rather than the marketplace is to dictate access, regulators will, as Chairman Powell suggested, inevitably either have to dictate the rates, terms and conditions of such access or decide whether the rates, terms and conditions imposed by the cable operator are reasonable.

As described in Part III, below, efforts to replicate reasonable marketplace rates, terms and conditions through regulation led to an extremely complex and burdensome regulatory regime for telephone common carriers. Moreover, despite all its complexity, this regime inevitably created perverse incentives to over-invest in facilities and to use regulated ratepayer revenues to cross-subsidize unregulated services provided over shared facilities. This is why, during the last 25 years, legislators and

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<sup>34</sup> Remarks of Chairman Powell, National Summit on Broadband Deployment, Oct. 25, 2001, p.18.

<sup>35</sup> Owen, ¶ 12 (emphasis added).

<sup>36</sup> Id.

regulators have moved consistently away from such regulatory efforts and now focus instead on fostering facilities-based competition.<sup>37</sup>

The Commission's efforts to regulate rates for cable television service – which were specifically not meant to involve full-fledged common-carrier type regulation – provide further evidence that there is no simple way to replicate marketplace forces through regulation. The Commission's "benchmark" approach to regulation required constant revision and adjustment, including 13 orders on reconsideration.

Moreover, the Commission's efforts to establish a "cost-of-service" alternative to its benchmark approach proved even more intractable, as that task required the Commission to establish a cost-of-service model based on a uniform system of accounts, which identifies different plant elements, details how those elements are treated, and to the extent they are commonly used for regulated and unregulated activity, how to apportion them.<sup>38</sup> In addition to establishing tangible and intangible elements of the rate base, a COS system requires rules for treatment of start-up losses, depreciation, expenses, and taxes, as well as determining a rate of return on the rate base. Any government mandated pricing scheme that

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<sup>37</sup> As the Supreme Court recently explained, "The enduring feature of ratesetting from Smyth v. Ames to the institution of price caps was the idea that calculating a rate base and then allowing a fair rate of return on it was a sensible way to identify a range of rates that would be just and reasonable to investors and ratepayers. Equally enduring throughout the period was dissatisfaction with the successive rate-based variants." Verizon Communications, Inc. v. FCC, 122 S. Ct. 1646, 1660 (2002) (emphasis added).

<sup>38</sup> Initially, the FCC allowed operators to make individual cost showings under a cost-of-service approach that would be judged on a case by case basis. See Report & Order & Further Notice of Proposed Rulemaking, MM Docket No. 92-266, 8 FCC Rcd 5794 (1993). The FCC then issued a Notice of Proposed Rulemaking to gain comment on specific regulatory requirements to govern cost-of-service showings, resulting in a decision detailing principles to guide disposition of cost-of-service filings. See Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, Notice of Proposed Rulemaking, MM Docket No. 93-215, FCC 93-353, 74 R.R. 2d 1247 (1993). Even these rules were "presumptive" only, rebuttable by the circumstances of individual cases. In the Second Report and Order and First Order on Reconsideration of these rules, which was also accompanied by a Further Notice of Proposed Rulemaking, the FCC adopted most of its interim rules although matters relating to prior year losses were changed. MM Docket No. 92-215, CS 94-28, 2 C.R. 193 (1996).

did not include this protection would be suspect as a taking under the Fifth Amendment.<sup>39</sup> Ultimately, the FCC backed out of developing a uniform system of accounts for cost-of-service showings, concluding that it would be unduly and unnecessarily burdensome.<sup>40</sup>

In sum, regulation of access inevitably requires government involvement in determining the price, terms and conditions of access. As the Commission and other regulators have found, there is no simple, inexpensive way to make such determinations. In weighing the costs and benefits of a multiple ISP access requirement, the burden and complexity of designing and enforcing any such requirement weigh heavily on the cost side of the balance.

## **2. Implementing Requirements for ISP Access Will Have Technological, Operational and Financial Effects on Cable Operators, Which Will Affect the Cost and Quality of Cable Modem Service.**

The record in the Commission's Inquiry amply demonstrated that cable operators will incur significant costs in implementing any mandatory multiple ISP requirements – and these costs will ultimately increase the cost or lower the quality of service to consumers. As the Commission found, “the multiple-ISP environment requires a re-thinking of many technical, operational, and financial issues, including implementation of routing techniques to accommodate multiple ISPs, Quality of Service, and the compensation, billing, and customer service arrangements between the cable operators and the ISPs.”<sup>41</sup>

This is because cable networks were not originally engineered to provide multiple ISPs with physical interconnection with the cable modem platform. It's not impossible to re-engineer the facilities

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<sup>39</sup> See, e.g., Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

<sup>40</sup> 2 C.R. 193, ¶131.

<sup>41</sup> Declaratory Ruling, ¶ 29. See also *id.*, ¶ 15.

to offer subscribers a choice of ISPs, and, as discussed above, several cable operators are currently doing so. But forcing operators to provide access to all, or a particular number of, ISPs in a particular way raises serious and costly implementation problems which, by adversely affecting the cost and quality of service, will be harmful to consumers.

**Establishing a Connection to the Internet.** To launch a high-speed data service, a cable operator must first have an operational two-way cable plant. The operator must install in the headend network devices, including what is referred to as a Cable Modem Termination System (“CMTS”). The CMTS manages information flowing from the network to the individual consumers and vice versa. Each CMTS serves about 500 or more homes.

At the CMTS, data from the homes are passed to routers, which connect to a metropolitan area fiber network, which is connected to a national backbone. The backbone network carries the data packets between the metropolitan regions and is where data are interconnected with other ISP networks.

Cable operators usually allocate one dedicated downstream channel and varying amounts of upstream spectrum for connection with the Internet. As discussed below, the amount of available bandwidth connecting homes to the CMTS is shared by all ISPs and subscribers accessing the cable plant. Modern HFC cable plant designs attempt to have sufficient downstream spectrum to support anticipated future needs.

**Accommodating Multiple ISPs.** Because all ISPs will share the available bandwidth, when multiple ISPs are present, there must be a method by which data are routed between customers and their chosen ISPs. For example, some industry participants today are considering “policy-based” routing using the source address (also sometimes called “source based routing”). Under source based

routing, the CMTS reads the “from address” (rather than the “to address”) on any message coming from a consumer. Each consumer, as identified by the “from address,” is then paired in a table with an ISP, and the router sends the packet to the corresponding ISP, which forwards the message or data to its ultimate destination. This method of routing provides the technical basis for multiple ISPs to share the same bandwidth.

Even with source-based routing, however, there is a limit to the number of ISPs that can be accommodated by a single cable operator. Tests of the “policy routers” used for this purpose confirm that using the source address to match each incoming packet with the appropriate ISP introduces levels of delay and degradation into the routing process.<sup>42/</sup>

**Connection Locations.** Provision of multiple ISPs requires a determination of where the ISPs will connect to the cable facility. Several physical connection locations are possible, including: (1) the headend; (2) the regional data center; and (3) the national Internet backbone. Each location has advantages and disadvantages -- discussed below -- that are best weighed by the particular parties who have detailed knowledge of network architecture, physical plant capacity, and ISP needs.

Connecting at the headend can be accomplished by permitting ISPs to connect to the cable operator’s CMTS. This option is likely to permit better performance of caching and traffic management systems, resulting in lower network architecture restructuring costs, and may be more scalable.

However, there are drawbacks to connecting at the headend. First, the greater number of connection locations will increase operational problems as various ISPs seek physical access to facilities for installation, maintenance, and other functions. Many headends are unmanned and some even have

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<sup>42/</sup> See “Third Party Internet Access, Point of Interconnect Acceptance Test Phase 2 Results (abridged version),” Videotron Ltee, revision 1.0 (April 3, 2000).



restricted access times due to local zoning. Second, the number of ISPs that can effectively connect at these local sites, which typically have little spare floor space, may be more limited than at alternative connection locations.

Connecting at the regional or national level presents different concerns. Adding the aggregate ISP traffic loads at the regional or national level would require increasing regional network capacity, increasing the cost of overall network service. After all, each ISP's traffic must eventually arrive at the headend somehow. Moreover, caching and traffic management functions are more difficult to accomplish at higher levels. Aggregating the caching function at the regional or network level forces the deployment of more expensive technologies, increases demands on the regional network system, and raises the potential for network congestion.

**Bandwidth Management.** Cable systems have a "shared" network architecture. Because bandwidth and CMTS resources are shared, what each ISP does affects every other ISP on the system. If one ISP launches a streaming service (long packets of data, music or video), it might block all of the other ISPs from using the bandwidth set aside for Internet access. If an ISP tries to offer an IP telephony service, another ISP could send enough packets to severely degrade the telephony quality. If one ISP's customers are using a disproportionate amount of bandwidth, the other ISPs' customers will have to share the remaining bandwidth, resulting in slower service. Within the protocol known as the DOCSIS 1.0 standard<sup>43</sup> there is currently no technical way to limit the amount of bandwidth that any individual ISP can utilize. Rather, it is up to the cable operator to manage that bandwidth by creating incentives for ISPs to limit their bandwidth use in reasonable ways.

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<sup>43</sup> The Data Over Cable Service Interface Specification (DOCSIS) defines interface requirements for cable modems involved in high-speed data distribution over cable television system networks.

The protocol DOCSIS 1.1, which is being deployed, has characteristics that are meant to alleviate this limitation, although it will only gradually become available and it, too, will have limitations. One possible means of managing bandwidth is by measuring and charging for each individual data packet (and its priority) as well as the speed of that data on a cable pipe, enabling customers to choose their data speeds. The protocol DOCSIS 1.1, currently in deployment, enables the cable operator to set cable modems to operate at different speeds. A subscriber that wants more speed will be able to receive it. DOCSIS 1.1 also permits large packets to be broken up into cells, each of which can be sent at different times and then reassembled at the receiving end CMTS or cable modem. This will prevent one large packet from occupying all available bandwidth at a given time and thus permit bandwidth to be shared more evenly and effectively among competing customers and ISPs.

DOCSIS 1.1 also allows the cable operator to set priorities, so that different ISPs can obtain brief bursts of “guaranteed” delivery, or obtain service at different speeds at different times, further enabling the cable operator to manage bandwidth use efficiently. For example, a system could be programmed so that requests for voice over IP service, which is more sensitive to delay and interference, can be prioritized and assigned higher speeds. Customers simultaneously using voice over IP and surfing the Internet (which is not as latency-sensitive) could receive service at two different speeds and levels of priority.

Although DOCSIS 1.1 offers significant advantages over DOCSIS 1.0, its introduction does not resolve all outstanding technical issues immediately. First, not all users immediately upgrade to DOCSIS 1.1.<sup>44</sup> Some, for example, have already purchased a DOCSIS 1.0 modem at retail and will

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<sup>44</sup> In fact, some older DOCSIS 1.0 modems cannot be upgraded to DOCSIS 1.1. Newer DOCSIS 1.0 modems allow for upgrades.

be reluctant to switch out their equipment. The upgrade to DOCSIS 1.1 will also be extremely expensive. The transition will therefore be gradual, and many cable operators will continue using DOCSIS 1.0, which has no bandwidth management capability. Second, even DOCSIS 1.1 would not enable a cable operator to accommodate every ISP. Efficient cable bandwidth management is possible only if there are a reasonable number of ISPs using the network. Third, DOCSIS 1.1's prioritizing capabilities will raise new bandwidth management issues. In particular, difficult questions of which ISPs will have priority and how and when that priority is assigned will need to be resolved.

**Traffic Management.** Providing multiple ISPs on a cable system also raises new and possibly difficult engineering issues, including capacity management and traffic engineering difficulties. The cable plant (in particular, the number of customers per node) has been physically designed in accordance with the cable operator's business plans and traffic assumptions. If an ISP implements a business plan that significantly alters that forecast -- by, for example, offering video streaming -- the traffic could well exceed the amount the system is designed to handle. This problem is exacerbated by the fact that each ISP will be signing up customers and launching services in a manner that will be kept secret from the other ISPs, and likely from the cable operator as well.

By interfering with the ability of cable operators to forecast usage accurately, multiple ISP service can have a detrimental effect on the cable plant's capabilities. All customers could experience slower connect times.

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To the extent that marketplace forces -- and, in particular, consumer demand -- impel cable operators to offer subscribers multiple ISPs, the increased costs will be justified by the associated increased customer satisfaction. But where these costs of implementation are incurred only because of

a regulatory requirement, the result is increased prices without increasing the value of the service to consumers. Consumers will, in other words, be made worse off. Moreover, increased prices will only suppress significant increases in the penetration rate of cable modem service – i.e., the percentage of households that purchase cable modem service where it is available.

### **3. Access Regulation Would Deter Investment and Impede Deployment of Facilities and Services.**

The costs and uncertainty of accommodating multiple ISPs in a manner dictated by the government rather than the marketplace would almost certainly have significant adverse effects on investment in and deployment of cable modem capabilities. The Cable Services Bureau foresaw these adverse effects three years ago:

Mandated access also could reduce the financial incentives and the build-out capital for cable companies to make the large investments necessary to upgrade their systems. . . . While we are not persuaded necessarily that cable operators would halt their nationwide broadband deployment in the face of a mandated access requirement, there is a significant and credible risk that rapid deployment of these services to all Americans would be greatly compromised.<sup>45</sup>

The Commission chose to avoid these stifling effects by continuing its policy of “vigilant restraint.” And, in the absence of regulation, investment in and deployment of broadband facilities and services have flourished. But, as Owen explains, the risk has not abated. First, “it is the systems and subscribers that have not yet been updated to broadband that, as a logical matter, promise the lowest returns on investment. These are precisely the subscribers most likely to face delayed or denied access to broadband services if access regulations lower the expected profitability of upgrade investments.”<sup>46</sup>

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<sup>45</sup> “Broadband Today,” supra, at 45. For a full discussion of why regulation would have adversely affected investment incentives, see B. Owen and G. Rosston, “Cable Modems, Access and Investment Incentives” (1998) (submitted by NCTA in CC Docket 98-146, Dec. 10, 1998).

<sup>46</sup> Owen, ¶40.

But even where, as in most of the nation, cable operators have already upgraded their facilities to provide cable modem service, regulation that diminishes and discourages investment will stunt the development of cable modem service and the evolution of high-speed Internet services. As Owen explains, “upgrading a cable system to permit broadband Internet access services is not a once-and-for-all investment. Not only must plant be continuously updated as technology advances, but growing use of broadband service will require continuous investment in smaller nodes in order to maintain quality of service standards.”<sup>47</sup>

Moreover, to maximize the attractiveness of cable modem service to subscribers, “cable operators will have to invest in demand-enhancing complementary features, such as content that takes advantage of broadband capabilities.”<sup>48</sup> Nobody can today predict the range of services and features that will ultimately be available using high-speed access to the Internet. All that is certain is that today’s exciting capabilities will someday seem primitive. And, as Owen points out, that someday – and each step along the way – is likely to be delayed by access requirements that reduce operators’ incentives to invest in new demand-enhancing features.<sup>49</sup>

#### **4. Regulation Has Unintended Side Effects and Is Intractable.**

In addition to these tangible and wholly predictable adverse consequences, Owen also points out that replacing market forces with regulatory constraints almost always produces unintended side

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<sup>47</sup> Id.

<sup>48</sup> Id.

<sup>49</sup> Id.

effects and behavior that counter the intended benefits of such regulation. Regulated entities alter their conduct in order to minimize their own costs, further distorting the efficient marketplace allocation of resources. “It is,” according to Owen, “difficult or impossible to predict in advance what the effects of these incentives would be, but there is no reason to think that the costs of the resulting distortions would be small.”<sup>50</sup>

Moreover, as Owen points out, even economic regulation that may initially be deemed necessary to correct a market failure usually takes on a life of its own and remains in place long after it stops doing consumers any good. This is especially true of regulation that protects, boosts or jump-starts certain competitors:

As conditions change, the regulation may no longer generate net benefits for consumers – in other words, consumers may subsequently be better off in a market that has no regulatory constraint. It may nevertheless be difficult to repeal the regulation because to do so would destroy rents enjoyed by those economic interests originally protected (or created) by the regulation.<sup>51</sup>

Like all the costs identified in this section, this is one that needs to be considered even when there is a reasonable prospect that regulatory intervention may have some beneficial short-term corrective effects. In the present case, the benefits of intervention, even in the short-term, are tenuous at best. Mandatory multiple ISP access would, in these circumstances, result in net harm to consumers.

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<sup>50</sup> Id., ¶ 39.

<sup>51</sup> Id., ¶ 44.

**B. Current Marketplace Conditions Indicate That There Is Little To Be Gained From Regulating Cable Modem Service.**

**1. There Is No Evidence or Reason To Believe That Cable Operators Will Restrict Access to Content.**

In the past, some proponents of mandatory multiple ISP access have suggested that such mandatory access is somehow necessary to ensure that consumers have access to the fullest array of content available on the Internet. In response to these suggestions, the Commission asks whether “the threat that subscriber access to Internet content or services could be blocked or impaired, as compared to content or services provided by the cable operator or its affiliate, [is] sufficient to justify regulatory intervention at this time.”<sup>52</sup>

But the Commission is skeptical that any content, whether provided by ISPs or by the millions of websites on the Internet, is or will be unavailable to cable modem subscribers. It notes that it is “unaware of any allegation that a cable operator has denied ‘click through’ access to other ISPs,” and that “although it is technically feasible for a cable operator to deny access to unaffiliated content, or to relegate unaffiliated content to the ‘slow lane’ of its residential high-speed Internet access service, we are unaware of a single allegation that a cable operator has done so.”<sup>53</sup>

The Commission’s skepticism is justified. Restriction of access to content is a red herring in this proceeding. Cable modem customers demand full access to the Internet and to the Internet-based services of ISPs, and, as a result, that is what cable operators uniformly provide. There once was a time – before the flowering of the World Wide Web – when dial-up subscribers to online services such as America Online, Prodigy and CompuServe, had access only to the proprietary content offered by the

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<sup>52</sup> Notice, ¶ 87.

<sup>53</sup> Id.

services to which they subscribed. But the Web changed all that. Consumers demanded access to the burgeoning array of content on the Internet, and the competing online service providers had no choice but to meet that demand by becoming Internet Service Providers with full web-browsing functionality.

No widely available facilities-based ISP can compete by limiting access to the Internet – and no provider of cable modem service tries to do so. Even if it faced no facilities-based competition, a cable operator that restricted access to content would severely constrict demand for its cable modem service. But cable operators do face vigorous facilities-based competition, and this would constrain their ability to block or discriminate against content providers even if they had any incentive to do so.

## **2. Mandatory Multiple ISP Access Will Not Enhance Facilities-Based Competition.**

As Owen points out, “mere resale can never create competition in the market for the product being resold.”<sup>54</sup> Therefore, “in communication policy the principal reason to insist on unbundling and resale of a communication service has been to facilitate a transition to facilities-based competition in that service.”<sup>55</sup> If consumers are to benefit from a mandatory multiple ISP access requirement, it must be because such a requirement would promote the development of facilities-based competition in the provision of high-speed Internet access or other local transmission services.

But a mandatory multiple ISP access requirement will not enhance facilities-based competition. First, the marketplace is already ensuring that consumers will have a choice of facilities-based providers

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<sup>54</sup> Owen, ¶ 15

<sup>55</sup> *Id.*, ¶ 16. As Owen points out, “To the extent that resale is accompanied by substantial value added, resale may permit competition in the provision of the value added services, which might otherwise be impossible. Thus, an access or resale requirement may be beneficial to consumers when the resold good or service is both ‘essential’ and a relatively small part of the final product, as with long distance telephone services and their access to local facilities.” *Id.*, ¶ 15. But neither of those conditions is present in this case. *Id.* Similarly, while “a resale requirement may be a practical device to prevent price discrimination or cross-subsidy, where that is a relevant policy goal,” *id.*, those are not relevant policy goals in the case of mandatory ISP access.



of high-speed Internet access – as well as virtually all the other services that cable operators provide over their facilities. Second, there is no prospect that ISPs seeking access to cable facilities will use this access as a stepping stone to the provision of service over their own facilities.

There seems to be little doubt that advanced telecommunications facilities are being deployed at a rapid rate – and on a competitive basis – nationwide. That’s certainly what the Commission found in its third annual Section 706 report.<sup>56</sup> The Commission cited estimates of availability of residential cable modem and DSL service, showing that at the end of 2001, cable modem service was available to 77.5 million households, while DSL was available to 51.5 million.<sup>57</sup> Although cable operators got a head start in deploying high-speed Internet service (since telephone companies elected not to begin deploying and offering DSL service at affordable rates to residential customers until cable operators established cable modem service as a viable, competitive offering), the Commission has found that “overall deployment of DSL is catching up.”<sup>58</sup> Indeed, according to the Commission, “analysts differ . . . as to which technology will ultimately take the lead.”<sup>59</sup>

DSL’s substantial and rapidly growing share of subscribers should be sufficient to dispel any notion that cable operators could exercise market power in the provision of cable modem service. But in addition, as Owen shows, “[t]here is empirical evidence (beyond the mere existence of competitors with substantial market shares) that cable operators do not have the requisite degree of market power in

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<sup>56</sup> See Third Report, CC Docket 98-146, supra.

<sup>57</sup> Id., ¶¶ 65, 70.

<sup>58</sup> Id., ¶ 68.

supplying broadband services.’<sup>60</sup> In particular, two recent studies confirm that demand for cable modem service among those who want Internet access is price-elastic. Also, there is significant cross-elasticity of demand with respect to DSL service.<sup>61</sup>

Moreover, while cable modem and DSL service are the leading, and increasingly ubiquitous, facilities-based providers of high-speed Internet service, they are not the only ones. Wireless and satellite services are also developing as additional competitive options for consumers.<sup>62</sup>

This means not only that cable faces facilities-based competitors but also that consumers are already experiencing the benefits associated with choice and competition. To the extent that DSL and other providers of Internet access already provide vibrant competition, there is no need for imposing a regulatory regime to jump-start additional facilities-based competitors. As discussed below, access regulation imposes significant costs and marketplace distortions that have generally been deemed necessary only to remedy the market failures that are sometimes associated with “essential facilities.”

In any event, there is no reason to believe that a mandatory access requirement would jump-start additional facilities-based competitors, much less enhance facilities-based competition. Offering service to subscribers directly, using a cable operator’s facilities under a forced-access regime, may give ISPs a marketing advantage and business opportunity. But there is no evidence that any ISP beneficiaries of a mandatory multiple ISP requirement intend ever to compete over their own facilities.

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<sup>59</sup> Id.

<sup>60</sup> Owen, ¶ 28.

<sup>61</sup> Id. (citing P. Rappoport, D. Kride, L. Taylor & K. Duffy-Demo, Residential Demand for Access to the Internet, University of Arizona Working Paper (2001); R. Crandall, J.G. Sidak & H. Singer, “The Empirical Case Against Asymmetric Regulation of Broadband Internet Access” (2002).

### **3. Cable Operators Are Increasingly Offering Consumers a Choice of ISPs.**

While access to multiple ISPs is not necessary to ensure that consumers have access to the full array of content on the Internet, nor will it provide consumers with the tangible benefits of facilities-based competition, it may be argued that offering a choice of ISPs will somehow enhance the value of cable modem service to consumers. If that turns out to be the case, regulation will not be necessary to induce cable operators to offer that choice, any more than it is required to ensure that they offer their video subscribers a choice of competing cable program networks. And, in fact, several cable operators are currently testing marketplace demand (and technological feasibility) by making multiple ISPs available to their subscribers.

For example:

- After completing technical and operational trials on its Columbus, Ohio system, Time Warner Cable began commercial rollout of its multiple ISP initiative in September 2001 on a division-by-division basis. At the beginning of 2002, Time Warner was providing consumers in each of its 20 largest divisions with a choice of three national ISP services: America Online; Road Runner; and EarthLink. These 20 divisions account for approximately 70 percent of Time Warner's subscribers, passing over 14.7 million homes. Time Warner has also entered into agreements with more than ten other national and regional ISPs, which will enable it to offer additional choices to customers in each division.<sup>63</sup>
- AT&T Broadband and EarthLink reached an agreement in March 2002 that allows EarthLink to offer high speed cable Internet service via AT&T Broadband's network. EarthLink High Speed Internet service initially will be offered in greater Boston and in the Seattle market with additional launches anticipated in 2003.<sup>64</sup> AT&T Broadband also signed an agreement in April 2002 with a second ISP

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<sup>62</sup> See Notice, ¶ 9 n.23.

<sup>63</sup> See Letter from Steven Teplitz, Vice President and Associate General Counsel, AOL Time Warner to Royce Sherlock, Deputy Chief, Policy and Rules Division, Cable Services Bureau, GN Docket No. 00-185, Jan. 22, 2002.

<sup>64</sup> AT&T press release, "AT&T Broadband and Earthlink Forge ISP Choice Agreement," Tuesday, March 12, 2002.

provider, NET1Plus (New England).<sup>65</sup> AT&T Broadband plans to pursue discussions with other ISPs to offer consumers additional choice. The company conducted a successful six-month trial of multiple ISPs last year and had invested \$20 million in developing technology to facilitate this trial even before it began.

- Comcast announced in February 2002 that it has reached an agreement to offer high speed Internet service over Comcast's cable systems to enable United Online, which owns the NetZero and Juno Internet services, to offer broadband access. United Online Internet service is now available to Comcast customers in Nashville, TN, and Indianapolis, IN. Comcast will continue to provide Internet service through its own ISP, Comcast High-Speed Internet. The United Online agreement is not exclusive and does not preclude Comcast from making other ISPs available to its customers in the future. In addition, Comcast has an agreement with MSN, whereby that ISP may obtain the same terms and conditions as other ISPs carried on Comcast's network.<sup>66</sup>
- Cox Communications launched its technical trial of EarthLink and America Online Internet services in El Dorado, AR, on November 6, 2001,<sup>67</sup> and hopes to begin offering multiple ISP choice by the first quarter of next year.
- Insight Communications announced in April 2001 an agreement to install routers that will enable multiple ISP offerings over its broadband network. In January 2002, Insight announced terms of its transition process from the @Home network to its @InsightBB network. @InsightBB service is available to customers in Illinois, Indiana, and Kentucky. High speed service is offered to Insight customers in Ohio via Road Runner. Insight's new broadband Internet service is the first step toward the company's ultimate goal of offering multiple high speed Internet service providers on its network.<sup>68</sup>

These multiple ISP trials and commercial deployments by cable operators do not guarantee that consumers who choose cable modem service for their high-speed access to the Internet will, in all instances, have a choice of any and all ISPs. What they do indicate, however, is that if, for whatever

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<sup>65</sup> "AT&T Broadband Inks ISP Deal," Multichannel News, April 23, 2002.

<sup>66</sup> Comcast press release, "Comcast and United Online to Offer NetZero and Juno High-Speed Internet Service," Tuesday, February 26, 2002.

<sup>67</sup> Cox press release, "Cox, AOL and Earthlink Launch High-Speed Service Trial," November 6, 2001.

<sup>68</sup> Insight press release, "Insight Communications Deploys RiverDelta Networks Broadband Services Routers for Residential and Business Services," April 30, 2001.

reasons, there is consumer demand for such a choice (due to service, price, or home-page differences), the marketplace is likely to provide it. Even in the absence of competition from facilities-based service providers, cable operators would likely provide a choice of ISPs if doing so would enhance consumer demand for their service. In the competitive marketplace that already exists for high-speed broadband services from DSL and others, they would have no alternative but to do so.

### **III. “REGULATORY PARITY” IS NOT A SOUND REASON TO REGULATE CABLE MODEM SERVICE.**

The Notice invites comment on the extent to which concerns about “regulatory parity” across broadband platforms should affect the Commission’s decision on possible multiple ISP requirements.<sup>69</sup> The short answer is that they should not.

The Communications Act does not compel such a “one-size-fits-all” approach. Indeed, the Act and the Commission’s implementing regulations plainly differentiate among industries and within industries. This is as it should be, since the principal purpose of economic regulation is to compensate where possible for market power and other sources of market failure. These determinations involve matters of degree.

It is not uncommon for firms that deliver similar services to be treated differently under the Communications Act and the Commission’s rules. For example, cable, DBS, and broadcast are subject to differing regulatory regimes, even though each industry provides similar video programming services. Cable companies must comply with numerous local franchising requirements, pay billions of dollars in annual franchise fees, and often must provide free service to local governments and schools.<sup>70</sup>

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<sup>69</sup> See Notice ¶ 85.

<sup>70</sup> See generally 47 U.S.C. §§ 541-47. See also Implementation of Section 25 of the Cable Television Consumer Protection and Competition Act of 1992: Direct Broadcast Satellite Public Interest Obligations, 13 FCC Rcd 23254,

Neither DBS operators nor broadcasters face such obligations. Similarly, cable operators (and to a lesser degree, DBS providers) are subject to must-carry, public access, leased access, and other regulations that require them to share their networks.<sup>71</sup> Broadcasters have no sharing requirements.

Congress and the Commission have even accorded different regulatory treatment to providers within the same industry sector. For 20 years, for instance, the Commission had different rules for “dominant” and “non-dominant” common carriers. Likewise, since 1996, ILECs and CLECs have faced significantly different regulatory requirements under the Communications Act and Commission policy.<sup>72</sup>

Moreover, where Congress has determined that regulatory parity should govern, it has declared so explicitly and selectively.<sup>73</sup> In other cases, the Act proceeds in precisely the opposite direction. For instance, ILECs are given a choice of three distinct regulatory schemes for the distribution of local video programming: a common carrier regime, an open video systems regime,<sup>74</sup> and a cable system regime. Thus, the proposition that “regulatory parity” is a public policy good unto itself is unsupported by the way Congress has dealt with this question elsewhere; to the contrary, the fundamental approach of the Communications Act is to tailor discrete regimes to specific contexts.

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¶¶ 56-61 (1998) (noting that “DBS and cable are separate and distinct services, warranting separate and distinct [public interest] obligations”).

<sup>71</sup> See 47 U.S.C. §§ 531-32, 534-36 (cable carriage obligations). See also *id.* § 338 (DBS must-carry rules).

<sup>72</sup> See *id.* §§ 160, 161, 251, 271. See also In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, 84 FCC 2d 445 (1980) (“Competitive Common Carrier Order”) (eliminating certain Title II regulations with respect to competitive carriers).

<sup>73</sup> See 47 U.S.C. § 332 (creating regulatory parity among commercial mobile service providers, but maintaining distinct regulatory regimes for common carriers and private mobile providers).

<sup>74</sup> See *id.* § 573.

**A. There Are Many Reasons Why Cable Systems and Telephone Networks Are Subject To Different Regulatory Regimes.**

The very different regulatory regimes imposed on the cable and telephone industries reflect differences in their history, the manner in which they offer their services, and their technology.

The common carrier regulations imposed on the ILECs in Title II of the Communications Act are designed to address market power and are rooted in common law principles that date back hundreds of years.<sup>75</sup> At common law, a common carrier had a duty to provide service upon reasonable request when the service was considered essential and when the carrier had persistent and substantial market power.<sup>76</sup> The duty ensured that any person in need of such service would have access to it. Prior to enactment of the Communications Act, state courts had imposed such obligations on phone companies in recognition of their importance to the public's health and safety.<sup>77</sup> In turn, Congress codified this common law duty to serve in Section 201(a) of the Communications Act in light of the monopoly status enjoyed by the Bell Companies and the perceived necessity of phone service to consumers.<sup>78</sup>

In order effectively to ensure compliance with a duty to deal, ILEC regulation extensively addresses the terms and conditions of the required services. The rate rules imposed on the ILECs

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<sup>75</sup> See National Ass'n of Regulatory Utility Commissioners v. FCC, 525 F.2d 630, 641 (D.C. Cir. 1976) ("NARUCI") (describing history of common law treatment of common carriers).

<sup>76</sup> See Munn v. Illinois, 94 U.S. 113, 125-130 (1876).

<sup>77</sup> See, e.g., Hockett v. State, 5 N.E. 178 (Ind. 1886); State ex rel Webster v. Nebraska Telephone Co., 22 N.W. 237, 238 (Neb. 1885).

<sup>78</sup> See Competitive Common Carrier Order at 485 ("Section 201(a) is based on Section 1(4) of the Interstate Commerce Act, which in turn is a codification of common law."). See also id. at 459 (noting that at the time the Communications Act was enacted, the Bell companies had a monopoly on local, long distance, and international phone traffic).

pursuant to Title II derive in the U.S. from a tradition of public utilities regulation from the 19<sup>th</sup> century.<sup>79</sup>

“At the dawn of modern utility regulation, in order to offset monopoly power and ensure affordable, stable public access to a utility’s goods or services, legislatures enacted rate schedules to fix the prices a utility could charge.”<sup>80</sup> Over the ensuing decades, such regulation evolved into cost-based rate-of-return schemes<sup>81</sup> (and, ultimately, price caps) embodied in Title II of the Communications Act.<sup>82</sup>

This history raises a critical point. The combination of cost-based rate regulation and local market dominance has been recognized to produce what one analyst called a “poisonous synergy” that makes suspect the ILECs’ extension into new services, especially those unregulated or less regulated than their core traditional telephone service.<sup>83</sup> Among other things, ILECs have had a rational incentive to overstate the costs of regulated service and understate the cost of unregulated service – an incentive not wholly eliminated by price caps. The resulting harms fall to both telephone consumers and to would-be competitors. Telephone ratepayers pay higher rates than are reasonable; competitors in the unregulated (or less regulated) market face prices that are below true costs. In an effort to deal with this problem, the Commission, and each state public utility commission, developed an extensive set of rate

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<sup>79</sup> See, e.g., Munn v. Illinois, 94 U.S. 113 (1876) (upholding state regulation of grain elevator operators); Smyth v. Ames, 169 U.S. 466 (1898) (considering reasonableness of railroad rate regulation).

<sup>80</sup> Verizon v. FCC, Nos. 00-511, 00-555, 00-587, 00-590, and 00-602, slip op. at 4 (S. Ct. May 13, 2002). Cf. NCTA v. Gulf Power, Nos. 00-832 and 00-843, slip op. at 1 (S. Ct. Jan. 16, 2002) (“Since the inception of cable television, cable companies have sought the means to run a wire into the home of each subscriber. They have found it convenient, and often essential to lease space for their cables on telephone and electric utility poles. Utilities, in turn, have found it convenient to charge monopoly rents.”).

<sup>81</sup> See Verizon v. FCC at 12

<sup>82</sup> See 47 U.S.C. § 201(b) (providing for public control of rates by requiring just and reasonable charges); id. § 202(a) (making unreasonable price or service discrimination unlawful); id. § 205 (providing the Commission with authority to prescribe carrier rates and practices); id. § 214 (providing the Commission with authority to approve investments).

<sup>83</sup> See Peter W. Huber, The Geodesic Network: 1987 Report on Competition in the Telephone Industry, at 1.9 (1987) (prepared for the U.S. Department of Justice, Antitrust Division).



rules to prevent the misallocation of costs, particularly from non-competitive services, such as local exchange service, to competitive services, such as broadband.<sup>84</sup>

Congress and the Commission have taken a very different approach with respect to cable operators. Unlike the core service and facilities provided by telephone companies, neither cable television services nor cable facilities were ever viewed as essential monopoly services and facilities that warranted common carrier regulation. Indeed, Section 621 of the Communications Act specifically provides that no cable system shall be “subject to regulation as a common carrier or utility by reason of providing any cable service.”<sup>85</sup> And with the prospect of vibrant and ever-growing competition from DBS and other multichannel video programming distributors, Congress repealed regulation of most cable rates as part of the 1996 Telecommunications Act.<sup>86</sup> With no legacy of common carrier regulation of cable service and cable facilities – and in light of the fact that cable modem service faces facilities-based competition from local telephone companies – it is not surprising that Congress and the Commission have repeatedly rejected proposals to impose common-carrier type regulations on cable operators in their provision of cable modem service.<sup>87</sup>

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<sup>84</sup> See, e.g., 47 C.F.R. pts. 32 (uniform system of accounts for telecommunications companies), 36 (jurisdictional separations procedures; standards procedures for separating telecommunications property costs, revenues, expenses, taxes and reserves for telecommunications companies), 64 (allocation of jurisdictional and nonjurisdictional costs), and 61 and 69 (distribution of regulated costs). The Commission also introduced price cap regulation as a means of minimizing these inefficient incentives, but it is well recognized that price caps cannot truly eliminate the incentive of the ILECs to cross-subsidize across services. See *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 178 (D.C. Cir. 1993).

<sup>85</sup> 47 U.S.C. § 541(c).

<sup>86</sup> See *id.* § 543(c)(4). Legislation permitting rate regulation of cable programming services in any event lasted for only four years.

<sup>87</sup> See, e.g., [Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act](#), 14 FCC Rcd 2398 (1999) (“[First 706 Report](#)”); [Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act](#), 15 FCC Rcd

In addition to these different regulatory legacies, the significant physical differences in telephone and cable network architecture also argue against a “one-size-fits-all” regulatory approach in the area of broadband services. Indeed, the Commission has noted that the “architectures of the telephone and cable networks are fundamentally different,” in that the “telephone network functions as a national and international system that requires a high degree of stability, coordination, and planning.”<sup>88</sup> Telephone services are provided over networks in which transmission wires and facilities are dedicated to each individual telephone subscriber and are designed to provide service to any person or entity, including firms providing online services. This uniform nation-wide network is the result of decades of federal and state common carrier regulatory policies, from universal service to access charges, designed to promote affordable and available dial-up service. The facilities used by ILECs to provide broadband services are nearly all common to those used to provide traditional voice services, making cost misallocation all the more probable and all the more likely to escape detection.<sup>89</sup>

In contrast, there is no uniform national cable network. Rather, reflecting the predominantly local regulation of cable (under Federal standards and oversight), there are approximately 10,000 different cable systems, with many different architectures, technologies, and equipment configurations. And, unlike telephone subscribers, who have dedicated capacity, cable subscribers “share the capacity

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20913 (2000) (“Second 706 Report”); Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act, 17 FCC Rcd 2844 (2002) (“Third 706 Report”).

<sup>88</sup> Implementation of Section 304 of the Telecommunications Act of 1996: Commercial Availability of Navigation Devices, 13 FCC Rcd 14775, ¶ 122 (1998) (“Navigation Devices Order”).

<sup>89</sup> The degree to which ILECs must unbundle their networks for DSL competitors remains uncertain. See USTA v. FCC, No. 01-1012 (D.C. Cir. May 24, 2002).

of the coaxial cable infrastructure potentially making it more vulnerable to interference or other forms of degradation caused by the actions of individual subscribers' equipment.’<sup>90</sup>

The Commission has relied on these fundamental network differences in establishing different rules for telephone and cable customer equipment.<sup>91</sup> In particular, the Commission noted in its 1998 order establishing rules for cable customer equipment that it was attempting to “accommodate these differences from the telephone model.”<sup>92</sup> The Commission elaborated on this point:

The parallel to the telephone has its limitations. When customer ownership of telephone CPE became available, the telephone network was effectively a national monopoly. Well developed technical standards existed throughout an almost ubiquitous network. CPE compatible with the telephone network was part of this environment. In contrast, cable networks do not reflect universal attributes, and have substantially different designs. . . . Additionally, as Section 629 [*i.e.*, the navigation devices statute] recognizes, preventing interference to other network users and maintaining the integrity of the system signal is of greater concern for video delivery systems than for telephone systems.<sup>93</sup>

The differing regulatory legacies of cable and the ILECs have also influenced their approach to deployment of broadband services. The cable industry has invested more than \$60 billion in private-risk capital since 1996 to upgrade their infrastructures to provide advanced broadband services, such as cable modem service, and the service is now available to more than 70 million U.S. households.<sup>94</sup> And this investment was on top of the billions of dollars in private-risk capital used to construct cable's infrastructure in the first place.

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<sup>90</sup> Navigation Devices Order, ¶ 122.

<sup>91</sup> Compare 47 C.F.R. § 76.1200 et seq. (navigation devices rules) with id., Part 68 (customer equipment rules for telephone network).

<sup>92</sup> Navigation Devices Order, ¶ 12.

<sup>93</sup> Id.

<sup>94</sup> See Consumer Demand For Cable's Broadband Services Continues To Grow, NCTA Press Release (Mar. 11, 2002), at <http://www.ncta.com/press/press.cfm?PRid=238&showArticles=ok>.

In contrast, the basic infrastructure used by ILECs to provide high-speed services was deployed under a regulatory regime that shielded them from competition and funded their investments with captive ratepayer charges. The ILECs also faced no research and development risk with regard to the use of DSL technology -- which was developed by Bell Labs in the 1980s. Even so, as the Commission has noted, the ILECs did not offer DSL until just recently “for concern that it would negatively impact their other lines of business,” such as T1 and second-line phone services,<sup>95</sup> and “the expansion of DSL in the past two years by [the ILECs] is primarily a reaction to other companies’ entry into broadband.”<sup>96</sup>

In sum, notions of regulatory parity ignore fundamental differences among participants in the broadband marketplace, and take no account of the legacy regulations that have developed over the last half century to deal with the specific marketplace characteristics of such participants. Congress and the Commission established common carrier regulation – and a government-supervised duty to deal on just and reasonable terms and conditions – for the Bell companies in response to the monopoly power they have historically exercised in the telephone market, but have created very different rules for cable, DBS, and other communications providers based on the unique circumstances of those industries.

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<sup>95</sup> See Broadband Today, Cable Services Bureau, Rept. No. CS 99-14, at 27 & n.73 (Oct. 1999) (“The deployment of DSL could have an adverse impact on the telephone companies’ T1 business.”); Robertson Stephens, DSL Market: Demand Doesn’t Seem To Be An Issue, But Carrier Deployment Execution Does (Jan. 3, 2001) (“Residential second lines are a financial bonanza for local phone companies. Most homes are already wired for additional connections, which makes turning on new service as simple and cheap as typing a few keystrokes. Incremental profit margins often exceed 70%.”).

<sup>96</sup> Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and America Online, Inc., Transferors, to AOL Time Warner Inc., Transferee, 16 FCC Rcd 6547, ¶ 113 (2001); Broadband Today at 29 (“The deployment of cable modem service . . . spurred the ILECs to offer DSL or risk losing potential subscribers to cable.”).

**B. Regulating Cable Modem Service for the Sake of Regulatory Parity Would Make Consumers Worse Off.**

Wholly apart from whether the regulations that govern telephone company provision of Internet access should remain in place, continuing regulation of DSL service is not itself a public policy justification for imposing similar regulation on cable modem service. As Bruce Owen shows in his attached paper, subjecting cable modem service to the same regulation as DSL service (with all the costs, described above, that would accompany such regulation) would not promote competition in a way that benefits consumers. To the contrary, it would only make consumers worse off.

Today, notwithstanding any current regulatory disparity, “it appears also to be the case that DSL service and cable modem service are substitutes and that they compete in the same market.”<sup>97</sup> As discussed above, empirical evidence described by Owen “leads to the conclusion that DSL provides effective competition to cable modem service.”<sup>98</sup> Moreover, DSL’s deployment is rapidly catching up with cable’s, and its penetration rate where it is available is similar to cable’s.

Imposing regulation uniquely on DSL service – whether or not such regulation serves some uniquely applicable purpose, such as promoting facilities-based telephone competition – could, as Owen points out, have the unintended side effect of “mak[ing] DSL temporarily a less effective competitor to cable.”<sup>99</sup> But while imposing similar regulation on cable might benefit telephone companies, its effect would be to raise the price or lower the quality of service to consumers of both services:

Whatever aspects of DSL regulation (by assumption) increase telephone company DSL costs or reduce DSL quality or lower DSL investment incentives would surely produce the same results when applied to cable systems. The effect simply would be to increase

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<sup>97</sup> Owen, ¶ 50.

<sup>98</sup> Id., ¶ 51 (emphasis added).

<sup>99</sup> Id., ¶ 49.

the costs (or reduce the quality) of both services, moving consumers away from, not toward, a better outcome. Other things equal, equilibrium cable modem prices will increase if the cost of providing service increases, and that in turn will further increase the profit-maximizing price of substitute services such as DSL.<sup>100</sup>

In what is already a competitive environment, regulatory parity is in no way necessary to ensure that consumers will have a choice among competitive, substitutable facilities-based providers.

Regulatory parity, if it means subjecting cable modem service to additional regulatory burdens, will only raise the cost or lower the quality of high-speed access from all providers, slowing down the affordable availability and the demand for this service. This is precisely the opposite of what would best serve consumers and the public interest.

#### **IV. STATE AND LOCAL GOVERNMENTS HAVE MINIMAL AUTHORITY TO REGULATE CABLE MODEM SERVICE.**

In attempting to clarify the regulatory implications of its classification of cable modem service as an interstate information service, the Commission asks not only about its own authority and appropriate role but also that of state and local governments. The Communications Act specifically preserves state and local authority to perform certain regulatory functions with respect to telecommunications services under Title II and with respect to cable services under Title VI. But it carves out no such role with respect to interstate information services that are neither telecommunications services nor cable services.

To the contrary, regulation by state and local governments of the manner in which cable modem service is provided would be inconsistent with federal law and policy, and it is therefore preempted.

Moreover, federal law prevents state and local governments from targeting cable modem service with fees, whether as part of the franchise fee assessed in a cable franchise agreement or elsewhere. And, while local governments may have a legitimate interest in managing the use of public rights-of-way, this

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<sup>100</sup> Id., ¶ 52 (emphasis added).

interest does not justify imposing a franchise upon or otherwise regulating the provision of cable modem service. Such regulation would impede the provision of cable modem service. Moreover, it is unwarranted insofar as the provision of cable modem service imposes no incremental burden on rights-of-way beyond what has already been authorized for the provision of cable service.

**A. State and Local Governments Have No Authority To Impose Mandatory Access or Other Requirements Regulating the Manner in Which Cable Modem Service Is Provided.**

If, as shown above, the costs to consumers of imposing a multiple ISP requirement on facilities-based cable modem service providers overwhelmingly outweigh the benefits, it would be no less harmful to the public interest for state and local governments to impose such regulation as for the Commission to do so. Indeed, it would be even more harmful to impose a hodgepodge of varying state and local requirements on this interstate service. And because this would be contrary to, and would frustrate, the policies of the Act, the Commission must make clear that such regulation is impermissible. Its conclusion that cable modem service is an information service, interstate in nature, mandates this directive.

As discussed above, Congress has determined that, as a matter of federal policy, the Internet and other interactive services should be allowed to develop “unfettered by Federal or State regulation.”<sup>101</sup> Even if this provision were not deemed to preempt all regulation of Internet services, it squarely preempts regulation that burdens and impedes the development, deployment and provision of such services. Since, for all the reasons discussed above, multiple ISP requirements would impose significant impediments and costs on the provision of cable modem service, such requirements would fall within the ambit of preempted activity.

Moreover, Congress has specifically directed, in Section 706 of the Telecommunications Act of 1996, that the Commission “encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans.”<sup>102</sup> Again, the cost-benefit analysis in the previous section demonstrates that multiple ISP requirements would have the opposite effect. Where state and local requirements would so clearly be inconsistent with federal policy, they are inappropriate and impermissible – and the Commission should make clear that they are preempted.

Furthermore, wholly apart from Congress’s explicit intention that deployment of Internet services be “encouraged” and “unfettered by . . . regulation,” there is clear Commission and judicial precedent for preemption of state and local regulation of interstate information services.<sup>103</sup> As the D.C. Circuit made clear in affirming the Commission’s preemption, in Computer II, of state regulation of enhanced services and customer premises equipment, the Commission may preempt regulation of an interstate service with an affirmative policy of deregulation as well as by occupying the field with comprehensive regulation:

We agree with the Second Circuit: “Federal regulation need not be heavy-handed in order to preempt state regulation.” Some parties argue forcefully that the states, like the Commission, have a responsibility to protect the interests of consumers and that the best way to do this is to continue to tariff CPE. We cannot engage in debate about whether a policy of price control through tariffing or a policy of free competition best serves the public interest in this area. All we are empowered to do is determine whether the Commission had the statutory authority to adopt the policy it did and whether that policy is arbitrary or capricious or an abuse of discretion. We believe that Congress has empowered the Commission to adopt policies to deal with new developments in the

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<sup>101</sup> 47 U.S.C. § 230. See Section I, supra.

<sup>102</sup> Section 706 of the Telecommunications Act of 1996, supra.

<sup>103</sup> See, e.g., Amendment of Section 64.702 of the Commission’s Rules and Regulations (Second Computer Inquiry), 88 FCC 2d 512, 523-24, 541-42 (1981) (“Computer II”) aff’d, Computer and Communications Industry Ass’n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 983 (1983), in which the Commission exercised its exclusive jurisdiction over “interstate communication by wire or radio” to preempt any efforts by states to apply common carrier or utility regulation to firms that provide interstate information services.



communications industry and that the policy favoring regulation by marketplace forces embodied in Computer II is neither arbitrary, capricious, nor an abuse of discretion. With this holding our review of the wisdom of state preemption is at an end.<sup>104</sup>

Thus, if the Commission determines, as it should, that multiple ISP requirements and other regulation of cable modem service would impede the development of this interstate service, it should not only refrain from such regulation itself but also confirm that such regulation by state and local governments is preempted.

Finally, Title VI of the Act makes clear that local cable franchising authorities may not impose a multiple ISP access requirement or otherwise regulate the provision of cable modem service, even if it is classified as an information service rather than a cable service. Section 624(a) provides that “[a]ny franchising authority may not regulate the services, facilities, and equipment provided by a cable operator except to the extent consistent with this title.”<sup>105</sup> Title VI was meant by Congress to “define and limit the authority that a franchising authority may exercise through the franchise process.”<sup>106</sup> And nothing in Title VI authorizes franchising authorities to regulate cable modem service to the extent that it is an information service but not a cable service. To the contrary, Section 624(b)(1) specifies that a franchising authority “may not . . . establish requirements for video programming or other information services.”<sup>107</sup>

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<sup>104</sup> Computer and Communications Industry Association v. FCC, 693 F.2d 198, 217 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983) (quoting New York State Comm’n on Cable Television v. FCC, 669 F.2d 58 (2d Cir. 1982)). See also California v. FCC, 39 F.3d 919, 931 (9<sup>th</sup> Cir. 1994), in which the Ninth Circuit confirmed the Commission’s authority to preempt state regulation of enhanced services even where, unlike the case of cable modem service, there is an intrastate component of the services, where “state regulation would negate valid FCC regulatory goals.”

<sup>105</sup> 47 U.S.C. § 544(a).

<sup>106</sup> H.R. Rep. 98-934, 98<sup>th</sup> Cong., 2d Sess. 19 (1984) (emphasis added).

<sup>107</sup> Id., § 544(b)(1) (emphasis added).

Moreover, Section 621(b)(3)(D) provides that “a franchising authority may not require a cable operator to provide any telecommunications service or facilities. . . .”<sup>108</sup> As the Fourth Circuit held in MediaOne Group, Inc. v. County of Henrico, 257 F.3d 356 (4<sup>th</sup> Cir. 2001), this provision specifically precludes a requirement that cable operators make their facilities available to multiple ISPs. Even though cable modem service is not a “telecommunications service,” as defined by the Act, a facility used to provide cable modem service “is a telecommunications facility because it is a pipeline for telecommunications, that is, for ‘the transmission ... of information of the user's choosing, without change in the form or content.’”<sup>109</sup> And, therefore, as the Fourth Circuit noted, forcing a cable operator “to offer [its] platform to unaffiliated ISPs for use as a transmission pipeline for their services” would be directly “in violation of Section 621(b)(3)(D).”<sup>110</sup>

**B. State and Local Governments May Not Require Cable Operators To Obtain a Separate Franchise To Provide Cable Modem Service.**

While there is no basis, as shown above, for the imposition by state and local governments of ISP access requirements or other substantive conditions on the provision of cable modem service, the Commission and the cable industry have recognized that state and local governments may have legitimate interests in managing the use of public rights-of-way. Even so, as the Commission has tentatively concluded, these interests are in no way implicated by the provision of cable modem service by cable operators.

Section 621 of the Act requires all cable operators to obtain a franchise from a local franchising authority, and that franchise is deemed to “authorize the construction over public rights-of-way, and

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<sup>108</sup> Id., § 542(b)(3)(D) (emphasis added).

<sup>109</sup> 257 F.3d at 363 (emphasis added), quoting 47 U.S.C. § 153(43), which defines “telecommunications.”

through easements, which is within the area to be served by the cable system and which have been dedicated for compatible uses. . . .”<sup>111</sup> Cable operators make use of no additional rights-of-way in providing cable modem service. The provision of cable modem service also imposes no additional burden on the use of the rights-of-way. Therefore, the Commission is right to conclude that “[o]nce a cable operator has obtained a franchise for such a system, our information service classification should not affect the right of cable operators to access rights-of-way as necessary to provide cable modem service or to use their previously franchised systems to provide cable modem service.”<sup>112</sup>

In any event, to the extent that cable modem service requires upgrading or replacing equipment in the rights-of-way that are already authorized and used to provide cable service, it imposes no new burdens than conventional cable service already does. Section 621 makes clear that cable operators remain responsible for matters of safety, appearance, costs of construction and clean-up and other burdens on the rights-of-way, just as when they use the rights-of-way for the provision of cable service.<sup>113</sup> If Section 621 affirmatively authorizes a franchised cable operator to use public rights-of-way and easements to construct and operate a cable system, it follows that cities may not – pursuant to Title VI or any other authority – require cable operators to obtain separate permission to use the same rights-of-way and easements for the provision of cable modem service over the same system.

Managing the rights-of-way entails little other than granting permission to use the rights-of-way and ensuring that such use not adversely affect the safety and appearance of the rights-of-way – all of which is covered by existing cable franchises. As the Commission and the courts have found, imposing

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<sup>110</sup> Id.

<sup>111</sup> 47 U.S.C. § 541(a)(2).

<sup>112</sup> Notice, ¶ 102.

any franchise requirements or conditions beyond this limited rights-of way management on prospective providers of communications services impedes and frustrates the deployment and provision of such services.

The Commission has specifically addressed a similar set of concerns in the context of construing and applying Section 253 of the Act. That provision bars any state or local regulation or requirement that “may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service,” while specifically preserving state and local authority to “manage the public rights-of-way.”<sup>114</sup> In TCI Cablevision of Oakland County, Inc., 12 FCC Rcd 21396 (1997), reconsideration denied, 13 FCC Rcd 16400 (1998), the Commission determined that any local requirements that went beyond the “statutorily protected interests in managing the public rights-of-way” might prohibit or have the effect of prohibiting the provision of service and therefore was forbidden.<sup>115</sup> Several courts have reached the same conclusion.<sup>116</sup>

Moreover, the Commission made clear that “the types of activities that fall within the sphere of appropriate rights-of-way management”<sup>117</sup> are extremely limited. Those activities include “coordination of construction schedules, determination of insurance, bonding and indemnity requirements,

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<sup>113</sup> See 47 U.S.C. § 541(a)(2).

<sup>114</sup> 47 U.S.C. § 253.

<sup>115</sup> 12 FCC Rcd at 21441.

<sup>116</sup> See, e.g., Bell Atlantic-Maryland v. Prince George’s County, 49 F.Supp.2d 805, 814 (D. Md. 1999); Bellsouth Telecommunications v. City of Coral Springs, 42 F.Supp.2d 1304, 1307 (S.D. Fla. 1999). See generally “The Concrete Barrier at the End of the Information Superhighway: Why Lack of Local Rights-of-Way Access Is Killing Competitive Local Exchange Carriers,” 54 Fed. Comm. L. J. 461 (2002).

<sup>117</sup> 12 FCC Rcd at 21439.

establishment and enforcement of building codes, and keeping track of the various systems using the rights-of-way to prevent interference between them.”<sup>118</sup>

All these functions are covered by existing cable franchises. Imposing the additional costs and burdens of obtaining a duplicative franchise is completely unnecessary to the legitimate management of rights-of-way and would only impede the deployment and affordable availability of cable modem service. And imposing new franchise requirements that go beyond the limited rights-of-way management activities identified by the Commission would, as described in the previous section, even more severely frustrate the federal policy of promoting such deployment and availability. The Commission should, therefore, confirm that state and local governments may not require cable operators to obtain a separate franchise – whether under Title VI or any other authority – to provide cable modem service.

**C. No Fees May Be Assessed on the Provision of Cable Modem Service.**

As the Commission recognizes, its determination that cable modem service is not a “cable service” directly affects the extent to which state and local governments may assess fees on cable operators based on the provision of such service. First, the Commission is right that “revenue from cable modem service would not be included in the calculation of gross revenues from which the franchise fee ceiling is determined.”<sup>119</sup> Section 622(b), as amended by the Telecommunications Act of 1996, now expressly limits the amount of franchise fees that a cable operator may pay to “five percent of such cable operator’s gross revenues derived in such period from the operation of the cable system

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<sup>118</sup> Id. at 21441.

<sup>119</sup> Notice, ¶ 105.

to provide cable services.”<sup>120</sup> If cable modem service is not a cable service, the revenues that it generates cannot be taken into account in calculating how much the cable operator may be charged in franchise fees.

Second, the Commission is also right in its tentative conclusion “that Title VI does not provide an independent basis of authority for assessing franchise fees on cable modem service.”<sup>121</sup> Indeed, Congress specifically intended that no franchise fees be collected on cable modem revenues. Thus, the language added to Section 622 in 1996, according to the legislative history, was meant to clarify that “franchising authorities may collect franchise fees under section 622 . . . solely on the basis of revenues derived by a cable operator from the provision of cable service”<sup>122</sup>

Moreover, Section 622’s limitation on franchise fees is a broad, not narrow, one. It applies not only to fees assessed in cable franchise agreements but to all fees assessed by any governmental entity that single out and apply specifically to cable operators. The term “franchise fee” is defined to include “any tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely because of their status as such.”<sup>123</sup>

What this means is that states and local governments have no authority in Title VI or anywhere else to impose a fee specifically on cable operators based on the provision of cable modem service. For purposes of this statutory limitation, it makes no difference how cities characterize their assessments or how they intend to use the fees they collect. Nothing in Section 622 limits fees to the actual administrative costs of regulation, as did the Commission’s rules in effect prior to the enactment of Title

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<sup>120</sup> 47 U.S.C § 542(b) (emphasis added to indicate the language added by the Telecommunications Act of 1996).

<sup>121</sup> Notice, ¶ 105.

<sup>122</sup> H.R. Rep. No. 104-204, Part 1, 104<sup>th</sup> Cong., 1<sup>st</sup> Sess. 93 (1995) (emphasis added).

VI.<sup>124</sup> (Nor can it be seriously argued that the two billion dollars paid by cable operators as franchise fees covers only such administrative costs.)

But if Section 622 is not limited to recovering costs, it does impose a limit. It limits fees to five percent of gross revenues from the provision of cable service, regardless of the cities' costs of regulating cable operators, and regardless of the supposed rental value of the public rights-of-way. Section 622 permits a certain payment but no more than the limit; otherwise there would be no bound to the fee collection, since the fee is no longer tethered to administrative costs. Whether characterized as a regulatory fee or as "rent" (a term never used or suggested by the statute), assessment of fees specifically on cable modem revenues is impermissible.

The term "franchise fee" does not include a "tax, fee or assessment of general applicability," so long as it is not "unduly discriminatory against cable operators or subscribers."<sup>125</sup> But even though Title VI does not prohibit the assessment of such nondiscriminatory fees on cable modem service, they may be separately prohibited by the Internet Tax Freedom Act.<sup>126</sup> That law bars the imposition of any new taxes on Internet access. The prohibition does not apply to cable franchise fees assessed pursuant to Section 622 revenues from cable services. But fees of general applicability are not cable franchise fees – and therefore fees that are assessed generally on cable modem service and other Internet access services would be covered by the prohibition.<sup>127</sup>

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<sup>123</sup> 47 U.S.C. § 542(g)(1).

<sup>124</sup> See H.R. Rep. No. 98-934, 98<sup>th</sup> Cong., 2d Sess. 64 (1984).

<sup>125</sup> Id., § 542(g)(2)(A).

<sup>126</sup> Pub.L. No. 105-277, § 1100 et seq., 112 Stat. 2681 (1998) (reproduced at note to 47 U.S.C. § 151).

<sup>127</sup> The Internet Tax Freedom Act was enacted "to avoid stifling the potential for an innovative form of technology to provide information, goods, and services quickly and cheaply throughout the world." H.R. Rep. 105-808(I), 105<sup>th</sup> Cong., 2d Sess. 7 (1998). Just as state and local taxes that single out Internet services can unduly stifle the

**D. The Commission Should Rule That Franchise Fees Previously Paid on Cable Modem Revenues Were Permissible and Not Subject To Refund.**

Until the Commission determined that cable modem service was an interstate information service and not a cable service, many cable operators and franchising authorities treated revenues from cable modem service as subject to franchise fee assessments. The payment and collection of such fees was not in defiance of the provisions of Section 622, nor can it reasonably be said that operators and franchising authorities should have known that cable modem service was not a cable service. To the contrary, the Commission conducted a lengthy inquiry to determine the proper classification of cable modem service precisely because of the uncertainty surrounding that question.

Nevertheless, as the Commission notes, some subscribers “have raised the issue of whether franchise fees were lawfully collected from them and whether the fees collected should be refunded.”<sup>128</sup> Indeed, there is class action litigation pending on this issue,<sup>129</sup> which stems from the Ninth Circuit’s prior determination, in the absence of a Commission ruling, that cable modem service was not a cable service. The Commission’s ruling could encourage more such litigation. If local franchising authorities or cable operators or both are ultimately required to refund fees collected and paid in good faith over long

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development of those services, the imposition by utilities of a higher pole attachment rate on cable operators that provide cable modem service would deter and suppress the growth of such service. Under the Commission’s pole attachment regulations, the maximum pole attachment rate for cable operators that offer cable modem service along with cable service is the same as for operators that offer only cable service. See Implementation of Section 703(e) of the Telecommunications Act of 1996, Amendment of the Commission’s Rules and Policies Governing Pole Attachments, CS Docket No. 97-51, Report and Order, 13 FCC Rcd 6777, 6794-96 (1998), *aff’d*, NCTA v. Gulf Power Co., 122 S.Ct. 782 (2002). But the Commission’s regulations do not apply “where such matters are regulated by a State,” 47 U.S.C. § 224(c)(1), and states that choose to regulate could be urged by utilities to allow them to charge significantly higher rates to cable operators that offer cable modem service. Such higher rates would frustrate the federal policy objectives embodied not only in the Internet Tax Freedom Act but also in Section 230 of the Communications Act and Section 706 of the Telecommunications Act of 1996, and the Commission should urge states not to allow them.

<sup>128</sup> Notice, ¶ 106.

<sup>129</sup> See Bova v. Cox Communications, Inc., Civil Action No. 7:01 CV 00090 (W.D. Va.).



periods of time –or even to litigate class-action lawsuits – this would have a serious impact on municipal treasuries and on cable resources.

Although the Commission generally leaves local disputes over franchise fee issues to the courts, it decided, shortly after enactment of the 1984 Cable Act, that it would “resolve franchise fee questions that bear directly on a national policy concerning communications and that call upon our expertise.”<sup>130</sup> The refund issue here clearly is one that warrants Commission intervention. The costs and disruption that is threatened by litigation over previously collected fees far outweigh any legitimate entitlements of or benefits to consumers. The Commission should rule that, prior to its declaratory ruling, cable modem service legitimately was treated by many cable operators and franchising authorities as a cable service for purposes of the assessment of franchise fees, and that no refunds of fees collected during that period are to be required.

**V. ALL ONLINE SERVICES, INCLUDING CABLE MODEM SERVICE, SHOULD BE SUBJECT TO THE SAME PRIVACY REGIME.**

Finally, the Commission asks whether, even though cable modem service is not a cable service, it is nevertheless subject to the cable privacy provisions of Section 631 – and, if so, how this will affect the provision of cable modem service. The Commission suggests that Section 631 does apply to cable modem service because its provisions apply to the provision by cable operators of “cable service or other service to a subscriber.”<sup>131</sup> “Other service” is defined to include “any wire or radio communications service provided using any of the facilities of a cable operator that are used in the

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<sup>130</sup> Notice, ¶ 107, citing Amendment of Parts 1, 63 and 76 of the Commission’s Rules to Implement the Provisions of the Cable Communications Policy Act of 1984, MM Docket No. 84-1296, Memorandum Opinion and Order, 104 FCC 2d 386, 393 ¶¶ 18-19 (1986), aff’d on this point sub nom ACLU v. FCC, 823 F.2d 1554, 1573-75 (D.C. Cir. 1987).

<sup>131</sup> 47 U.S.C. § 551(a)(1) (emphasis added).

provision of cable service.” This, as the Commission suggests, would appear to encompass cable modem service.

As a general matter, the provisions of Section 631 embody reasonable and effective protections of cable subscribers’ privacy, both as applied to cable service and to cable modem service. But the prospect of new privacy legislation that applies to Internet services could subject cable modem service to a whole new regulatory regime – in addition to Section 631. A dual regime of potentially conflicting regulatory obligations would, with respect to cable modem service, undermine the legitimate privacy concerns that underlie both Section 631 and comprehensive Internet privacy legislation.

The best solution to this problem would be to leave Section 631 intact for cable service and other services not covered by Internet privacy legislation, but to remove cable modem service from the purview of Section 631.<sup>132</sup> This would place Internet-based cable services under the same privacy regime as other online and Internet services. It would harmonize consumer privacy rights without regard to whether consumers receive their Internet services over telephone lines, cable, or any other platform. Consumers would be best served by consistent privacy protections across the ever-increasing array of online services.

## CONCLUSION

The Commission’s determination that cable modem service is an interstate information service provides a sound basis for allowing marketplace forces to propel the continued investment in and deployment of affordable broadband Internet access service throughout the nation. The Communications Act neither requires nor authorizes the Commission to impose a mandatory multiple

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<sup>132</sup> The current version of Internet privacy legislation proposed by Sen. Hollings adopts this approach. See S. 2201, 107<sup>th</sup> Cong., 2d Sess (2002). See also Cong. Rec. at S.2950 (daily ed., Apr. 18, 2002).

ISP access requirement on cable modem service. Such a requirement would impose substantial costs and burdens on the Commission, on cable operators, and – most importantly – on consumers without providing any countervailing benefits.

Moreover, state and local governments have no basis – in Title VI of the Act or anywhere else – for imposing access requirements or otherwise regulating the provision of this interstate service. Cable operators have already been granted the right to use public rights-of-way within their cable franchise areas. No additional franchise or permission is necessary – nor may any such permission be required – for the provision of cable modem service over the same rights-of-way. Moreover, the Act precludes state and local governments from imposing fees attributable to the provision of services that, like cable modem service, are not a “cable service.”

This is as it should be. There is, as Congress has recognized, a vibrantly competitive marketplace for Internet services – including broadband Internet access. The public interest is best served, as Congress also recognized, when that competitive marketplace is allowed to develop “unfettered by Federal or state regulation.” The Commission should, in this proceeding, make clear that this is precisely what follows from its determination that cable modem service is neither a cable service nor a telecommunications service but an interstate information service.

Respectfully submitted,

**/s/ Daniel L. Brenner**

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June 17, 2002

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BEFORE THE  
**FEDERAL COMMUNICATIONS COMMISSION**  
WASHINGTON, DC 20554

In the Matter of

Appropriate Regulatory  
Treatment for Broad-  
band Access to the  
Internet Over Cable Fa-  
cilities

CS Docket No. 02-52

**Forced Access to Broadband Cable**

**Bruce M. Owen**

**Submitted on behalf of NCTA**

**June 17, 2002**

## **Abstract**

Most cable television systems in the United States have invested heavily in capital improvements that permit them to offer high-speed digital Internet access (“cable modem”) services to subscribers. This service is widely available, and about 25 percent of households with Internet access have subscribed, either to the cable service or to competing Internet access services offered by local phone companies. Increasing the rate of adoption is a national priority.

The Federal Communications Commission (FCC) is presently considering whether to force cable operators to offer unbundled bandwidth and other related services to independent Internet Service Providers (ISPs). Such regulation would parallel the regulations already applied to the Internet access services offered by phone companies (which are also under review). This paper examines the costs and benefits for consumers of adopting a forced access policy for cable modem services.

The possible benefits of a forced access policy are that, if certain necessary conditions are met, it might encourage facilities-based competition in the provision of local transmission services, expand competition in the provision of value-added services associated with local broadband Internet access, or reduce opportunities for price discrimination. Among the necessary conditions for these benefits is the presence of established, otherwise intractable monopoly power on the part of cable operators. But in fact, cable operators already face facilities-based competition, not only in the provision of cable modem services, but even in their core market, video delivery. Thus, there could be no benefit for consumers from forced access. While the possibility exists that the necessary conditions for benefits might exist in the future, such speculation is not an adequate basis for regulation today in light of the costs imposed by regulation.

The costs of broadband access regulation fall into several categories: (1) direct costs of implementing access requirements; (2) distortions in resource allocation attributable to the creation of economic incentives to minimize the impact of regulatory constraints; (3) reductions in the willingness of regulated providers to make risky investments; (4) unintended side-effects with an adverse impact on groups whose interests are not adequately

represented in the policymaking process; (5) creation of rents that can be sustained only by the continuation of regulation, even after it has ceased to be beneficial to consumers. There are numerous examples in the FCC's experience of such costs appearing, often quite unexpectedly.

The likelihood of significant costs for consumers, taken together with the absence of benefits to consumers, suggests strongly that forced access regulation should not, on the merits, be applied to broadband cable services. Two other possible arguments in favor of such regulation have been put forward. One is that forced access regulation might be prudent in light of cable's current status as the leading provider of broadband residential services. Another is that such regulation might be warranted by the need to maintain "regulatory parity" between cable operators and the phone companies with which they compete. Neither argument supports forced access regulation as a policy beneficial to consumers.

If the FCC adopts a policy of forced access to broadband cable systems, the most likely result will be higher prices and slower adoption of broadband services by consumers. This would frustrate the national policy of promoting consumer acceptance of broadband as well as cause economic injury to consumers.

The author is president of Economists Incorporated and visiting professor of economics at Stanford in Washington. He is the author of *The Internet Challenge to Television* (Harvard University Press, 1999) and co-author of *Video Economics* (Harvard University Press 1993).

## Introduction

1. This paper examines, from an economic policy perspective, several of the key issues raised by the Commission in its Declaratory Ruling and Notice of Proposed Rulemaking, “Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities,” released March 15, 2002 (hereinafter, *Notice*). It concludes that an FCC requirement that cable operators provide access to independent Internet Service Providers (ISPs) is unwise because it would be more likely to reduce consumer welfare than to increase it. This conclusion is not affected by the existence of regulatory restrictions on the behavior of competing providers of broadband service, such as local telephone companies.<sup>1</sup>
2. Part I of this paper outlines the background, underlying assumptions and framework of my analysis. Part II contains the main body of the analysis. Part III provides a brief conclusion.

## I. Background

3. The vast majority of consumers who connect their home computers to the Internet still do so over ordinary telephone lines using analog modems. However, digital “broadband” or “high speed” Internet connections are now a widely available alternative to analog modem connections.<sup>2</sup> Although digital connections are more expensive than analog connections, often costing two to four times as much, the higher speeds and other useful features of digital connections are sufficiently attractive that some

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<sup>1</sup> I have written previously on this and related subjects. See, e.g., Bruce M. Owen, “Broadband Mysteries,” in Robert W. Crandall, ed., *Should We Regulate High-Speed Access...?* Brookings Institution, (forthcoming 2002); Bruce M. Owen and Gregory L. Rosston, “Cable Modems, Access and Investment Incentives,” report prepared for the National Cable Television Association (December 1998).

<sup>2</sup> Terrestrial wired high speed digital service is available to about 80 percent of all U.S. households. I use the terms “broadband,” “high speed,” and “digital” herein synonymously, and in contrast to “analog,” always in the context of “last mile” communication.



home computer users (around 11 percent of all households, or just over 25 percent of those with Internet connections) have switched to digital Internet connections.<sup>3</sup>

4. Virtually all residential analog Internet connections are provided on facilities owned by local telephone companies (“incumbent local exchange carriers” or ILECs). Broadband Internet connections from residences to Internet backbones are provided chiefly by local wireline telephone companies and local cable operators. Cable offerings are often referred to as “cable modem” services. Telephone company offerings are often called “digital subscriber line” (DSL) services. High speed digital connections are also offered by wireless providers such as CMRS and satellite operators, but these media do not yet have significant market shares.<sup>4</sup>
5. Both industry and government have promoted increased consumer use of local high speed digital Internet access service. A number of interests other than telephone and cable companies stand to benefit from an increase in consumer use of broadband Internet access, among them the computer hardware and software industries and manufacturers of networking equipment.
6. The federal government has granted various concessions to promote broadband deployment, including favorable regulatory and tax treatment, and subsidies for certain customers, such as schools. I take as given for present purposes that it is a policy goal of the federal government to expand the consumption of broadband services.<sup>5</sup> This re-

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<sup>3</sup> Based on First Quarter 2002 data, there are over 12 million broadband Internet users, of which 8.1 million have cable modems and 4.1 have DSL connections (source: NCTA). For earlier data, see *Notice* ¶ 9 et seq.

<sup>4</sup> Fixed wireless and mobile technologies such as 2.5G, 3G, LMDS, WLAN, IEEE 802.11a and b (WiFi), Bluetooth and the rest presently are not aimed at fixed residential broadband access needs, but may become available for that use as competition increases and prices drop. Indeed, the New York Times recently reported on a proposal to use WiFi for local broadband distribution. John Markoff, “2 Tinkerers Say They’ve Found a Cheap Way to Broadband,” *New York Times on the Web*, June 10, 2002, <http://www.nytimes.com/2002/06/10/technology/10WIRE.html>. For a survey of technologies and business strategies, see Dave Molta, *Mobile and Wireless Technology: The Survivor’s Guide to 2002*, TechWeb, December 17, 2001, <http://www.networkcomputing.com/1226/1226f44.html>.

<sup>5</sup> *Notice* ¶¶ 4, 73.

enforces the usual economic policy goal of maximizing output for the benefit of consumers.

7. As broadband service is now very widely available to American consumers, the focus of policy concern has shifted to the rate at which consumers are adopting the new services. While the rate of growth of new subscribers for these services has been significant, overall penetration remains at an early stage.
8. Demand for broadband Internet service can be increased in two ways: more attractive features and lower prices. Internet content providers, aggregators and portals (some of which are also vertically integrated Internet service providers or ISPs) are at work on new products that take advantage of broadband capabilities, but this is not an area easily affected by regulatory policy. In contrast, regulators can help make prices more affordable by promoting competition and by avoiding regulation that increases the cost of providing service.<sup>6</sup>
9. Cable operators and telephone companies now provide the bulk of broadband capacity, and compete for customers.<sup>7</sup> Both cable operators and telephone companies provide broadband Internet access services on the same facilities used to provide other services—chiefly video entertainment and voice messaging, respectively. Cable operator video delivery was formerly subject to rate regulation, and basic service rates still are, but today the cable industry faces competitive discipline from satellite providers of video entertainment services and other sources.

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<sup>6</sup> A recent cross-country OECD study documents the adverse effects of regulation on the development of high tech growth sectors. Stefano Scarpetta, Philip Hemmings, Thierry Tressel, Jaejoon Woo, *The Role of Policy and Institutions For Productivity and Firm Dynamics: Evidence From Micro and Industry Data*, (RePEc:oed:oeccdec:329, 2002).

<sup>7</sup> There is not yet complete overlap in the areas where the two competitors offer service, chiefly because DSL service currently is available to fewer households than have access to cable modem service. This difference in coverage, which will diminish over time, explains a large part of the current difference in the relative “market” shares of cable modem and DSL services. For marketing and other reasons, it appears to be impractical for either of the competitors to discriminate in price against those customers who do not yet have a choice of provider. This leverages the benefits of competition from areas where there is, to areas where there is not yet, a direct overlap.

10. ILECs are subject both to rate regulation and to unbundling requirements that reflect the industry's long regulatory and antitrust history as owners of monopoly "essential facilities," and the federal government's objective of promoting facilities-based entry in local telephone markets.<sup>8</sup>
11. The central economic issue in this proceeding is whether to require cable operators to provide "access" to independent Internet service providers. While such access might take any number of forms,<sup>9</sup> my analysis assumes that the Commission would apply essentially the same access regulations to cable operators that are currently imposed on local telephone companies. I refer to this as the "DSL regulatory model." These regulations require ILECs to offer "unbundled elements" of their local networks, including bandwidth on local loops, to resellers at wholesale prices reflecting "forward-looking incremental cost." In addition, consumer prices are subject to regulation. I assume that analogous regulations would be fashioned for cable companies in the event the Commission opted to force access to broadband cable systems.<sup>10</sup>
12. The assumption that forced access to cable modem services, if it occurred, would resemble current DSL regulation is not arbitrary. As with DSL, a mere access requirement for cable systems is likely to be meaningless in the absence of unbundling and maximum wholesale price regulation once the Commission comes face to face with

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<sup>8</sup> Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696 (1999), at 3745-50, ¶¶ 101-16; 47 C.F.R. § 51.317(b)(3).

<sup>9</sup> Notice ¶ 74.

<sup>10</sup> Some but not all elements of such a regime are spelled out in the AOL-Time Warner/FTC settlement. See *FCC AOL Time Warner Merger Order*, 16 FCC Rcd at 6588-92 ¶¶ 93-100 (prohibiting discrimination against unaffiliated ISPs, their first screens, their content, and the quality of service afforded to them); *America Online, Inc., and Time Warner, Inc.*, Federal Trade Commission, Docket No. C-3989, File No. 001 0105, Decision and Order §§ II, III (Dec. 14, 2000) (requiring access for a small number of unaffiliated ISPs and prohibiting interference with the content of unaffiliated ISPs). My view, for reasons explained in the text, is that in the face of complaints about access decisions the AOL consent order is but the first step on a slippery slope to full DSL-type regulation. The issue discussed in this paper is not very interesting if the proposed regulations did not require cable operators to do something they would prefer not to do. I am assuming for purposes of my analysis that forced access would be a binding constraint on cable operator behavior. As I point out below, however, the Commission does not seem to have found any evidence that cable operators are systematically denying broadband access to anyone, implying strongly that there is no need for forced access.

the need to adjudicate access complaints. If ISP access is desirable from a consumer welfare perspective and yet would not otherwise be available, I argue below that it must be because cable systems have very substantial market power in the relevant market, that alternatives are not available, that operators refuse to grant access, and that access would force cable operators to lower retail prices. In those circumstances any regulation less intrusive than current DSL-type regulation would be unlikely, even if the Commission began with a simple access requirement, because increasingly intrusive and detailed regulation would flow inevitably from the need to resolve access disputes, just as it did in telephony.

13. I further assume that DSL and like services offered by telephone companies will continue to be regulated more or less in the manner I have described. In a companion proceeding, the Commission is examining whether to reaffirm its policies in this area.<sup>11</sup> If one makes the contrary assumption (that DSL will be deregulated), clearly there exists little likelihood of cable modem regulation because any substantive policy rationale for DSL deregulation (e.g., a finding that the relevant market is sufficiently competitive) would also militate against regulation of cable modem services. Also, the ILEC “regulatory parity” argument for cable regulation disappears (actually, works in cable’s favor) if DSL service is deregulated. This leaves the option of regulating cable modem services as the interesting case to analyze.
14. I express no view on the merits of DSL deregulation but I note that because of differences in the circumstances and history of telephone and cable providers, my conclusion that cable modem service should not be regulated is not necessarily applicable to DSL service. One significant economic difference in the circumstances of the two industries, for example, is that the major services co-produced on the same facilities as Internet access are, in the case of cable, faced with substantial facilities-based competition while in the case of local telephone service they are not.

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<sup>11</sup> Appropriate Framework for Broadband Access to the Internet over Wireline Facilities CC Docket No. 02-33.

15. Mere resale can never create competition in the market for the product being resold.<sup>12</sup> When the courts mandated access or “resale” to monopoly bridges across the Missouri at St. Louis, for example, no one thought the purpose was to promote competition in local bridge service.<sup>13</sup> Instead, the purpose was to encourage competition in long haul rail service, to which the Missouri crossings were an essential input or component. To the extent that resale is accompanied by substantial value added, resale may permit competition in the provision of the value added services, which might otherwise be impossible. Thus, an access or resale requirement may be beneficial to consumers when the resold good or service is both “essential” (as described below) and a relatively small part of the final product, as with long distance telephone services and their access to local facilities.<sup>14</sup> ISP access to broadband cable services does not fit this model because there has been no showing by anyone that ISP access to cable modem services is essential to competition in any broader value-added market. Indeed, whatever the services might be that require such access lack even names.
16. In communication policy, the principal reason to insist on unbundling and resale of a communication service has been to facilitate a transition to facilities-based competition in that service. The notion is that an entrant planning to construct competitive facilities can do so in a more orderly and less expensive way if it can quickly begin offering service to all potential customers in a marketing area, using its competitor’s facilities, where necessary, to supplement its own. The current regulation of DSL can best be understood in the context of efforts to encourage facilities-based competition in local telephone service, which, as noted, is produced on the same facilities as DSL.

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<sup>12</sup> Justice Breyer has made this point in the analogous context of resale of local telephone facilities: “A totally unbundled world—a world in which competitors share every part of an incumbent’s existing system, including, say, billing, advertising, sales staff, and work force (and in which regulators set all unbundling charges)—is a world in which competitors would have little, if anything, to compete about.” *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721 (1999) at 754 (Breyer, J., concurring in part and dissenting in part).

<sup>13</sup> *United States v. Terminal RR Ass’n*, 224 U.S. 383 (1912). For a revisionist history of the Terminal Railroad situation see David Reiffen and Andrew N. Kleit, “Terminal Railroad Revisited: Foreclosure of an Essential Facility or Simple Horizontal Monopoly?” 33 *J. of Law and Economics* 419 (1990).

<sup>14</sup> In addition, in some regulatory circumstances a resale requirement may be a practical device to prevent price discrimination or cross-subsidy, where that is a relevant policy goal.

17. I assume that the ultimate purpose of regulation is to benefit consumers. Therefore, proposed access regulations at the wholesale provider stage must be evaluated in the context of their effects on consumers. The only valid economic test of whether forced access to cable modem service should be mandated is the likely effect of such a policy on economic, and especially consumer, welfare. This principle is well-established nowadays in antitrust.<sup>15</sup> The Congress seems to have embraced a closely-related goal for communications policy. The preamble to the 1996 Telecommunications Act states that its purpose is to:<sup>16</sup>

“promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.”

18. As the Commission suggests (*Notice* ¶88), I organize my discussion in the spirit of cost/benefit analysis. However, I do not follow the suggestion that the relevant comparison is between the benefits of an access requirement for consumers and the costs of an access requirement for cable operators. Ultimately, all the costs and benefits are felt by consumers, and it is the present and future costs and benefits of regulation for consumers that should guide policymaking.

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<sup>15</sup> See the expression of this view in, for example, *NCAA v. Board of Regents*, 468 U.S. 85, 107 (1984) and *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979). Professor, now Justice, Stephen G. Breyer discusses applications of this idea to regulated industries in “Antitrust, Deregulation, and the Newly Liberated Marketplace,” 75 *California Law Rev.* 1005 (1987).

<sup>16</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, preamble, 110 Stat. 56, 56.

## II. Discussion

### *A. Should cable modem services be regulated on the merits?*

19. Neither market competition nor regulation is ever perfect. Although this country has long had a presumption in favor of market solutions, very imperfect markets present policymakers with a choice between poor market outcomes and regulatory intervention. This choice can be approached from a cost-benefit perspective. As a matter of logic, regulatory intervention may be justified when it effectively reduces the adverse welfare consequences of a market failure without introducing more than countervailing welfare losses.
20. In the present matter, presumably, the possible market failure is some species of distortion attributable to the exercise of market power by cable operators. Consumer welfare benefits might flow from the reduction or elimination of such a distortion. I begin with that potential benefit, postponing until later the discussion of regulatory costs.

### Benefits of Regulation

21. In assessing market power, its consequences and remedies, the Commission can learn from the 113-year experience of competition policy enforcement, which has long confronted nearly identical issues. The analogy between the forced access issue and the so-called “essential facilities doctrine” is unavoidable.<sup>17</sup> One need not conclude that the Commission is bound to follow antitrust precepts in order to accept the proposi-

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<sup>17</sup> It is noteworthy that the Supreme Court in the Iowa Utilities case acknowledged the analogy between the essential facilities doctrine in antitrust and the Commission’s access policies in telephone service. *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721 (1999) at 734-36. Professor Hovenkamp sees this analogy as inescapable: “The principal purpose of the 1996 Telecommunications Act is to deregulate, and deregulation can be accomplished only by minimizing the occasions for regulatory supervision. Competition requires that inputs economically capable of being supplied competitively—that is, by numerous independent sources—be supplied in that manner. Forced sharing of such inputs acts as a disincentive to producing them competitively in the first place and exacerbates and prolongs agency supervision.” Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* 787’c, at 247 (Supp. 1999). See also Jerry A. Hausman and J. Gregory Sidak, “A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunications Networks,” 109 *Yale Law Jour.* 417 (1999).

tion that the Commission can find the experience of competition policy instructive. Indeed, just a few weeks ago, the D.C. Circuit suggested that the essential facilities doctrine “may ... offer useful concepts for agency guidance” to the Commission in the analogous context of access to local telephone facilities.<sup>18</sup>

22. The essential facilities doctrine is relevant because it deals with the circumstances in which forced access is a useful remedy for a situation where the vertically-integrated owner of a bottleneck facility uses its monopoly of that facility to exclude competitors from an upstream or downstream market.<sup>19</sup> The remedy (forced access, or equivalently, forced unbundling and resale) is precisely the one that the Commission is considering in this proceeding. The interesting question, then, becomes whether the underlying problem for which the remedy is proposed meets the standards that courts and commentators have set as justifying the remedy on the basis of costs and benefits to consumers. While the Commission may not, as a legal matter, be required to accept these standards, in rejecting them it should be able to explain why its own analysis of the costs and benefits leads to a different conclusion.
23. Forced access (unbundling and resale) is regarded as an extraordinary remedy in monopoly cases because it requires on-going supervision of technical production decisions and regulation of prices, because it risks raising production costs and hence retail prices, and because it may have adverse spillover effects on the investment decisions of parties and nonparties alike. As Justice Breyer (*supra*, n.12) observes, “Even the simplest kind of compelled sharing, say, requiring a railroad to share

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<sup>18</sup> *United States Telecom Association v. FCC*, D.C. Circuit, decided May 24, 2002, slip opinion at note 4.

<sup>19</sup> Bruce M. Owen, “Determining Optimal Access to Regulated Essential Facilities,” 58 *Antitrust Law Journal* 887 (1989). The doctrine is discussed recently in, for example, Abbot B. Lipsky and J. Gregory Sidak, 51 *Stanford Law Review* 1187 (1999). I must note that there is much greater uniformity of opinion about the proper scope and application of the doctrine among scholars than there is in the case law. See Philip Areeda, “Essential Facilities: An Epithet in Need of Limiting Principles,” 58 *Antitrust Law Journal* 841 (1990). The essential facilities doctrine was applied to local exchange access by the Seventh Circuit in *MCI Communications Corp. v. American Telephone & Telegraph Co.* 708 F.2d 1081 (7th Cir. 1983). That decision required “(1) control of the essential facility by a monopolist; (2) a competitor’s inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility” for the doctrine to apply. (*Id.* at 1132-33).



bridges, tunnels, or track, means that someone must oversee the terms and conditions of that sharing. Moreover, a sharing requirement may diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of value-creating investment, research, or labor.”

24. A market power problem justifying such a drastic remedy as forced access must be truly a bottleneck—an entrenched, long term, otherwise intractable monopoly, and accompanied by ample evidence that the power has been abused with adverse effects on consumer welfare. Further, the situation must be one in which access can have a positive effect on consumer welfare, such as facilitating a transition to facilities-based competition or facilitating competition in products or services of which the monopolized component is a relatively small part. The standard for market power in essential facilities cases is the highest one that exists in competition policy.
25. Do cable operators have “bottleneck” market power in providing local broadband cable modem service? If so, is there evidence that the market power is used to exclude more efficient competitors or to raise consumer prices in either upstream or downstream markets? These questions must be answered affirmatively if forced access is to make economic sense. These questions should seem odd, because they both have obvious answers. Because there are significant competitive alternatives, cable operators by definition do not possess a “bottleneck” monopoly over anything. And, far from foreclosing competition in upstream or downstream markets, no one has even identified the products, services or markets from which foreclosure could take place, or identified either a refusal of access or an economic incentive to refuse access.
26. In any event, the Commission has already, as a practical matter, answered both of the preceding questions in the negative. Cable operators face facilities-based competition in the provision of broadband cable modem services from telephone companies and others.<sup>20</sup> Additional facilities-based entrants using various RF technologies are likely

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<sup>20</sup> Notice ¶ 9.

in the next few years.<sup>21</sup> Consumers also have choices other than cable modem or other high-speed services that some still greatly prefer and others find to be good substitutes for broadband at current prices, standard 56k analog “dial-up” service probably chief among them. The local broadband Internet access service industry has existed only for a few years, and is still in a fluid state both as to technology and as to market structure. “[T]he cable modem service business is still nascent, and the shape of broadband deployment is not yet clear.” (*Notice* ¶ 83.) These are *not* the characteristics of a monopolized market, much less an essential facility market.

27. The Commission has found no evidence that any broadband cable subscriber has been excluded from using the services of any Internet content provider or any ISP. Because subscribers are connected to the Internet, they can “click through” to any content provider. (“We are not aware of any cable operator that prevents subscribers from reaching the content of their choice.” *Notice* at n. 45. “[W]e are unaware of any allegation that a cable operator has denied “click through” access to other ISPs.” *Id.* at ¶ 87). They can subscribe to the services of content aggregators, such as AOL, often at lower prices reflecting their “BYO” Internet access.<sup>22</sup> Subscribers using either of the major browsers can choose their own home pages, and need not use one supplied by the cable operator.
28. There is empirical evidence (beyond the mere existence of competitors with substantial market shares) that cable operators do not have the requisite degree of market power in supplying broadband services. Rappoport, et al. report an econometric demand study that found that the demand (by subscribers for high-speed Internet access service) facing broadband cable operators was own-price elastic and cross-price elas-

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<sup>21</sup> See n. 4 and <http://standards.ieee.org/announcements/80216app.html>, <http://www.ieee802.org/16/pub/background.html>.

<sup>22</sup> AOL current charges \$23.90 per month for a standard dial-up subscription in which it supplies the Internet connection. In contrast, AOL subscribers who “bring their own” Internet access via a cable modem, DSL connection or corporate LAN are charged only \$ per month.

tic with DSL services.<sup>23</sup> A more recent study commissioned by SBC Communications, Inc. updated the Rappoport study, confirming elastic demand for cable modem service and significant cross-elasticity with DSL service.<sup>24</sup> In any event, the fact that there are two full-fledged broadband competitors at present, with more on the horizon, should be sufficient by itself to remove broadband cable service from the essential facilities category and thus from the forced access remedy.

29. Given current competition in providing broadband Internet access services, the question of forced access does not even get to first base in an analysis of potential costs and benefits under essential facilities analysis because there is no essential facility. Specifically, Internet content providers, aggregators, and ISPs have alternative ways to reach consumers, and consumers have alternatives to cable modems. These alternatives will likely increase in number.<sup>25</sup> Cable operators could not and do not exclude competitors in upstream or downstream markets.
30. If there is no present economic policy case for forced access requirements, might such regulations be a prudent precaution against future problems? Any new industry as it matures may begin to display increased concentration, heightened entry barriers and a slowing of technological change. Incumbent firms may gain market power or even monopolies. But such an outcome is by no means inevitable, and it makes no sense to apply essential facilities regulation prophylactically because to do so would penalize—and therefore discourage—efforts to achieve early success in young and dynamic industries.<sup>26</sup>

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<sup>23</sup> Paul Rappoport, Don Kridel, Lester Taylor & Kevin Duffy-Demo, “Residential Demand for Access to the Internet,” University of Arizona Working Paper, Spring 2001, at Table 10; *see also* Paul Rappoport, Don Kridel & Lester Taylor, “An Econometric Study of the Demand for Access to the Internet,” in *The Future of the Telecommunications Industry: Forecasting and Demand Analysis*, Loomis & Taylor eds., Kluwer Academic Publishers (1999).

<sup>24</sup> Robert W. Crandall, J. Gregory Sidak, and Hal J. Singer, “The Empirical Case Against Asymmetric Regulation of Broadband Internet Access,” (SSRN 2002).

<sup>25</sup> See n. 4, *supra*.

<sup>26</sup> See the OECD study cited at note 6, *supra*.

31. One of the puzzles in the debate about forced access to broadband cable facilities is what such access would accomplish for ISPs that simple IP interconnection (directly or via the Internet) would not provide. One possible answer appears to be a direct or personal relationship with customers that is *exclusive*, i.e., one that excludes the cable operator. But this cannot be taken seriously in the abstract as a *necessary* condition for business success, as required by essential facilities analysis. Plenty of consumer services companies have relationships with their customers that are intermediated by third parties (postal and package delivery companies, telephone and mass media, and independent dealers and retailers of all varieties) without apparent adverse effects.
32. The concept of ISP access through transparent unbundling and resale of local transmission service could never make sense (even if the essential facility conditions were met) if the only result were a resale market in the essential service itself. To justify an access requirement, the ISP demanding access must be in the process of constructing competing facilities (so far as I know none are) or planning to use the local transmission component as a vehicle for the sale of much more important complementary services, such as high bandwidth Internet content, aggregation or portal features, or some other as yet unnamed, undefined product. Even if such a product had been defined, one must ask whether the cable operator has denied such access, and if so for any reason related to market power (as opposed to technology or cost issues), or has any incentive to do so in spite of resulting losses in economic efficiency.
33. So far as I am aware, no cable operator has ventured into the non-local-transmission aspects of ISP service except as a means to jump start subscriber demand for their transmission services. The fact is that the earliest efforts to offer content and aggregation services that took advantage of broadband speeds were organized, not by independent ISPs, but by firms owned by cable operators.<sup>27</sup> These efforts took place in the face of the failure of independent suppliers of such services to come forward, and certainly have not resulted in any market power or dominance, as witnessed by the bank-

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<sup>27</sup> Notice, ¶ 21.

ruptcy of @Home, once the leading cable-owned provider. In other words, cable operators' so-far-not-very-successful efforts to offer upstream services tailored to the special features of broadband are better understood as attempts to remedy the failure of independent ISPs and content providers to provide such service than as an attempt to monopolize or foreclose any market.

34. One can imagine hypothetical situations in which a provider offering services not offered today might benefit from physical interconnection with and transparent resale of the capacity of "last mile" distributors, rather than mere IP backbone interconnection. But there is no reason to *assume* that if such a situation arose, the ISP and the cable operator could not reach a mutually advantageous agreement beneficial to subscribers. It is not reasonable for the Commission to impose access regulation in advance of such a situation becoming reality. The regulations could only have costs, and no benefits, until or unless the relevant situation arises. Further, since the relevant circumstances are speculative and outside the Commission's current experience, the particulars of the access requirements would likely be inappropriate to the actual need if it did arise.
35. The benefit (if any) of regulation of cable modem service is the potential consumer welfare gains from reducing the distortions caused by monopoly power. My conclusion from the preceding analysis is that there is no case for DSL-type regulation (i.e., essential facility regulation) of broadband cable services. There simply are no benefits for the public from the adoption of such regulation, because there is no conceptual or empirical evidence of any monopoly power or any distortion. Not a single one of the necessary conditions for essential facility treatment of broadband cable is met, implying that the weight of experience from more than a century of weighing costs and benefits of forced access militates strongly against such intervention. Whether the necessary conditions for essential facility regulation will exist in the future is an entirely speculative question; certainly there is no case for the imposition of regulation now.

### Costs of Regulation

36. I turn now to the potential costs of imposing access regulation on broadband cable services. The costs of broadband access regulation fall into several categories: (1) direct costs of implementing access requirements; (2) distortions in resource allocation attributable to the creation of economic incentives to minimize the impact of regulatory constraints; (3) reductions in the willingness of regulated providers to make risky investments; (4) unintended side-effects with an adverse impact on groups whose interests are not adequately represented in the policymaking process; (5) creation of rents that can be sustained only by the continuation of regulation, even after it has ceased to be beneficial to consumers.
37. The most obvious potential costs of forced access are the direct costs of implementing access requirements. These costs arise from the need to reconfigure facilities and operating procedures to meet the access conditions established by regulation.<sup>28</sup> These costs are borne ultimately by consumers, in higher prices, whether or not cable operators are compensated by ISPs.
38. A regulation that takes the form of a binding constraint on economic behavior invites adjustment by the entity being regulated, with the aim of easing or eliminating the effects of the constraint. Just as it is a rare tax rule that cannot, to some extent, be avoided, its impact reduced through adjustments in one's fiscal arrangements, the same is true of economic regulation. Perhaps the most famous and best-studied example is rate-of-return regulation. In the days when the Commission attempted to prevent telephone companies from charging monopoly prices by constraining their rate of return on capital, one of the costs may have been a serious distortion in the choice of technology, favoring excessively capital-intensive methods.<sup>29</sup> Another cost of rate-of-return regulation was that it gave telephone companies the incentive and opportunity to engage in permanent predatory pricing as a means to exclude competi-

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<sup>28</sup> For example, see *Notice* at ¶¶ 15, 29.

<sup>29</sup> For a discussion of this "Averch-Johnson effect," see, e.g., Edward Zajac, "A Geometric Treatment of Averch-Johnson's Behavior of the Firm Model," 60 *American Economic Review* 117-125 (1970).

tors.<sup>30</sup> Neither of these costs was recognized until rate-of-return regulation had been in place for the best part of a century. Once the problem was finally recognized, the Commission moved to replace rate-of-return regulation with price cap regulation.

39. Without suggesting any attempt at evasion,<sup>31</sup> a broadband access constraint on cable systems would give operators incentives to minimize its impact. It is difficult or impossible to predict in advance what the effects of these incentives would be, but there is no reason to think that the costs of the resulting distortions would be small.
40. In a paper submitted to the Commission in 1998, Greg Rosston and I explained how forced access requirements could adversely affect investment incentives, leading to reduction in the willingness of regulated providers to make risky investments.<sup>32</sup> Today, in 2002, very substantial broadband cable investment (in the form of updated cable plant) has already taken place. The point that Rosston and I made remains relevant, however, because it is the systems and subscribers that have not yet been updated to broadband that, as a logical matter, promise the lowest returns on investment. These are precisely the subscribers most likely to face delayed or denied access to broadband services if access regulations lower the expected profitability of upgrade investments. Further, upgrading a cable system to permit broadband Internet access services is not a once-and-for-all investment. Not only must the plant be continuously updated as technology advances, but growing use of broadband service will require continuous investment in smaller nodes in order to maintain quality of service standards. Finally, offering broadband Internet access requires cable operators to do more than invest in physical plant. To stimulate consumer demand for cable modem service, cable operators will have to invest in demand-enhancing complementary features, such as content that takes advantage of broadband capabilities. Operators'

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<sup>30</sup> Roger G. Noll and Bruce M. Owen, "United States v. AT&T: The Economic Issues," in John Kwoka and Lawrence White, eds., *The Antitrust Revolution*, Scott Foresman, (1988); 2nd ed. (1994).

<sup>31</sup> I adopt here the "evasion/avoidance" distinction so well-known in tax law enforcement. Avoidance, unlike evasion, is a lawful and rational response to the incentives created by public policy.

<sup>32</sup> Owen and Rosston, n. 1, *supra*.

incentives to invest in such demand-enhancing features is likely to be reduced by forced access requirements because of the spillover and free rider effects that Rosston and I described.

41. Unintended side-effects with an adverse impact on groups whose interests are not adequately represented in the policymaking process abound in regulated industries. The Congress and the courts have quite deliberately established policymaking machinery that provides substantial voice to economic interest groups. As in this very proceeding, regulators rely heavily on the participation of such groups to acquire information. The effectiveness of these groups varies widely. As Mancur Olson has explained, groups with diffuse interests that face high costs of organizing and free rider problems are likely to be less effective than groups that lack these disabilities.<sup>33</sup> Consumers comprise the classic interest group whose interests are less effectively represented in this process. Where an industry group would provide analysis and information that would help avoid regulations with unintended adverse effects, consumers lack such voice.
42. The Commission need look no further than its own experience with cable rate regulation for examples of unintended consequences and adverse effects on consumers, both well-documented by economic analysis.<sup>34</sup> The price regulation undertaken by the Commission under the 1992 cable act led to reductions in program offerings and a quagmire of increasingly detailed interventions and patches until repealed as part of the 1996 reforms.
43. Returning to the question of forced access to cable modem systems, the risk is that the Commission, in the absence of vigorous and effective participation by consumers, will adopt rules that inadvertently harm those interests. Of course, any Commission

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<sup>33</sup> Mancur Olson, *The Logic of Collective Action : Public Goods and the Theory of Groups*, rev. ed., Harvard University Press (1971).

<sup>34</sup> For independent analyses see Robert W. Crandall and Harold Furchtgott-Roth, *Cable TV: Regulation or Competition?* Brookings Institution (1996), Thomas W. Hazlett and Matthew L. Spitzer, *Public Policy Toward Cable Television*, American Enterprise Institute (1997), and Hudson Institute, *The Role of Competition and Regulation in Today's Cable TV Marketplace* (1998).



intervention carries this risk and its potential costs. Nevertheless, it is a risk that must be weighed against any potential benefits of regulation. Non-intervention is less risky in this respect because it is far more easily reversed.

44. The final potential cost of forced access to broadband cable is associated with the creation of rents that can be sustained only by the continuation of regulation, even after it has ceased to benefit consumers. The problem here is that a regulation can both create and destroy economic rents, and its effects on rents can change over time as circumstances change. As conditions change, the regulation may no longer generate net benefits for consumers—in other words, consumers may subsequently be better off in a market that has no regulatory constraint. It may nevertheless be difficult to repeal the regulation because to do so would destroy rents enjoyed by those economic interests originally protected (or created) by the regulation.<sup>35</sup> Both in practice and in principle, the administrative process exists to protect the status quo; it takes a considerable effort to overcome such an inertial force. As I pointed out above, consumer interests often lack the organization or resources to make such an effort. In the present case, the danger is that regulations designed to facilitate access by independent ISPs will later provide those same ISPs with a vested interest in and therefore a strong incentive to defend vigorously what may become a special treatment that protects them from competitive challenges.
45. Realism requires recognition of the fact that unintended effects are hard to predict and regulatory interventions are difficult to remove even when there is ample evidence that they harm consumers. Markets, in contrast, can change and adapt much more quickly to changed circumstances.<sup>36</sup> This is true whether or not particular interventions have immediate benefits that exceed costs. It is not a sufficient reason to counsel against any intervention. But it is sufficient reason for healthy skepticism of interven-

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<sup>35</sup> For an elaboration of this point, see Roger G. Noll and Bruce M. Owen, *The Political Economic of Deregulation*, American Enterprise Institute (1983), chapters 1-3.

<sup>36</sup> It is instructive to compare, for example, the rate at which digital technology permeated non-regulated sectors of the economy with the speed at which digital broadcasting has arrived.

tions that are not justified by very strong evidence of palpable and immediate consumer benefits.

46. In the case of forced access to cable modem facilities, none of the costs, not even the direct ones, can be adequately quantified until some specific proposal is advanced. But the near certainty of at least some costs should compel the Commission to identify tangible and immediate benefits in order to justify regulation. As I have argued above, such benefits are unlikely because, as Commission has found, nothing “bad” has in fact happened or seems likely to happen, and because effective facilities-based competitors already exist.

*B. Should access be regulated if cable is the “Leading Provider” of local broadband Internet access?*

47. The Commission, noting that cable at present has a larger number of broadband Internet subscribers nationwide than DSL, asks whether forced access is desirable in light of cable’s current status as the “leading provider” of broadband access to the Internet. (*Notice ¶¶ 78, 85*) There is nothing sinister about the label “leading provider.” Every market has a “leading provider.” Some “leading providers” have market shares that are modest and face extensive competition from existing and potential competitors. Some “leading providers” achieve their status blamelessly, by superior efficiency, foresight and industry. Thus, “cable operators’ current status as the leading providers of residential broadband services” has no relevance at all to the merits of forced access unless that status can be shown to translate into monopoly power in the relevant market for bottleneck services—so much and such intractable monopoly power as to make worthwhile the risks and costs of regulation, discussed above.

*C. Should cable modem service be regulated as a matter of parity?*

48. Telephone company DSL services are currently subject to the unbundling and wholesale price regulation regime that applies to local POTS. Telephone companies argue that this regulation should be withdrawn, but that if it is not withdrawn, similar regulation should be applied to cable modem services with which DSL competes. The apparent unfairness of regulating one competitor but not the other is called the

“regulatory parity” issue. (*Notice* ¶ 85) Unfair or not, however, the Commission must put the interest of consumers first. The pursuit of parity cannot be a legitimate policy goal if it entails a sacrifice of consumer welfare, as it almost certainly does. It is perfectly possible, at least as a logical matter, that a regulatory policy with the apparent or immediate effect of favoring one class of competitors over another may produce better results for consumers than a policy that meets the criteria (whatever they may be) for “regulatory parity.”

49. To begin the analysis, assume hypothetically that DSL regulation has the effect (despite facilitating desirable future facilities-based competition) of raising the costs of providing DSL service, or reducing quality of service, or decreasing telco investment incentives. Assume further that an unintended side effect of this is to make DSL temporarily a less effective competitor to cable.<sup>37</sup> Do these assumptions lead to the conclusion that regulatory “parity” would make consumers better off?
50. The logical implication of the preceding assumptions, from an economic perspective, is that the price of DSL service and therefore the price of its substitute, cable modem service, will in competition be higher than otherwise. Other things equal, higher DSL prices lead to higher equilibrium cable modem prices. Still, it appears also to be the case that DSL service and cable modem service are substitutes and that they compete in the same market. For example, the Commission has stated that “[t]he main competitor to cable in the market for residential high-speed Internet services is currently DSL.”<sup>38</sup>
51. The only empirical study of the issue of which I am aware led to the conclusion that DSL service provides effective competition to cable.<sup>39</sup> Still, DSL competition would be even more “effective”—DSL would have a higher market share, and both prices

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<sup>37</sup> As noted above, I express no opinion on the validity of these assumptions.

<sup>38</sup> Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time Warner Inc. and American Online, Inc., Transferors, to AOL Time Warner Inc., Transferee, CS Dkt. No. 00-30, 16 F.C.C. Rcd. 6547, ¶ 65 (2001).

<sup>39</sup> See Crandall et al., n. 23, *supra*.

might be lower or service improved—if DSL regulation were removed. Thus, if the factual assumptions above are correct, analysis leads to the conclusion that DSL regulation, at least in the short run, leads to a “second best” outcome. Could it be that regulation of broadband cable provides a possible remedy? Could imposition of such regulation move the market back toward a more efficient outcome?

52. The answer, clearly, is no. Whatever aspects of DSL regulation (by assumption) increase telephone company DSL costs or reduce DSL quality or lower DSL investment incentives would surely produce the same results when applied to cable systems. The effect simply would be to increase the costs (or reduce the quality) of both services, moving to consumers away from, not toward, a better outcome. Other things equal, equilibrium cable modem prices will increase if the cost of providing service increases, and that in turn will further increase the profit-maximizing price of substitute services such as DSL.
53. My principal point is that if two or more suppliers are supplying competing services, whatever their technologies or regulatory categories, there can be little or no justification for regulation of either. I recognize that having only two competitors does not necessarily lead to a perfectly competitive outcome. Still, the presence of some effective competition eliminates any presumption that regulatory intervention can produce consumer benefits. But if some reason exists to regulate one mode, despite the costs and risks of doing so,<sup>40</sup> that provides no reason to regulate both suppliers.
54. I take it that the principal rationale for regulation of DSL service has been the expectation that such regulation would promote facilities-based competition in wireline telephony. There is no need to resort to the DSL model to regulate cable in order to encourage facilities-based competition in cable services (whether video or Internet access). Cable already faces video competition from DBS, and is likely to face video competition from other media in the future. Cable already faces competition in digital

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<sup>40</sup> Again, I do not wish to imply a position on the merits of DSL regulation.

services from DSL and is likely to face competition from other technologies in the future. Thus, the DSL regulatory model is inapplicable to broadband cable services.

55. The parity issue also can be approached from a different perspective. Assume that the purpose of regulation is to benefit consumers. Imagine, in general, that the Commission finds a set of regulatory policies that seem likely to succeed in maximizing consumer welfare. But suppose that these particular policies—the ones that most benefit consumers—do not happen to display “regulatory parity.” It follows that any attempt by the Commission to achieve regulatory parity must be at the expense of consumers. Because parity is not part of the particular policy formulation that maximizes consumer welfare, any policy formulation of which parity is a part must produce less, perhaps much less, consumer welfare. It would be coincidental for welfare-optimizing policies to display regulatory parity. (Parity obviously is *not* one of standard marginal-social-cost-equals-marginal-social-benefit criteria for economic efficiency and welfare maximization.) Many would regard it as unseemly for the Commission to sacrifice consumer welfare in order to pursue a Platonic ideal of regulatory parity in the treatment of corporate interests.

### **Conclusion**

56. If the FCC adopts a policy of forced access to broadband cable systems the most likely result will be higher prices and therefore slower adoption of broadband services by consumers. This would frustrate the national policy of promoting broadband diffusion as well as causing economic injury to consumers.